

**INTERNAL REVENUE CODE SECTION 170(h):  
NATIONAL PERPETUITY STANDARDS  
FOR FEDERALLY SUBSIDIZED  
CONSERVATION EASEMENTS**

**PART 1: THE STANDARDS**

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*Editors' Synopsis: This Article is the first of two companion articles that (i) analyze the requirements in Internal Revenue Code section 170(h) that a deductible conservation easement be "granted in perpetuity" and its conservation purpose be "protected in perpetuity" and (ii) compare those requirements to state law provisions addressing the transfer, modification, or termination of conservation easements. This Article discusses the historical development of the federal charitable income tax deduction for conservation easement donations, the legislative history of section 170(h), and the Treasury Regulations interpreting that section. It explains that section 170(h) and the Treasury Regulations contain a complex web of requirements intended to ensure that a federal subsidy is provided only with respect to conservation easements that permanently protect unique or otherwise significant properties. Such requirements are also intended to ensure that, in the unlikely event changed conditions make continued use of the subject property for conservation or historic preservation purposes impossible or impractical and the easement is extinguished in a state court proceeding, the holder will receive proceeds and use those proceeds to replace the lost conservation or historic values on behalf of the public.*

*The companion article, which will be published in the Winter 2010 edition of this journal, surveys the over one hundred statutes extant in the fifty states and the District of Columbia that authorize the creation or acquisition of conservation easements. That article explains that such statutes contain widely divergent transfer, modification, and termination provisions that were not, for the most part, crafted with an eye toward complying with federal tax law perpetuity requirements. The author concludes that landowners wishing to take advantage of the federal tax incentives offered for conservation easement donations should be required to draft their easements and otherwise structure*

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*their donations to satisfy the perpetuity requirements imposed under federal tax law, and any additional conditions or restrictions on the transfer, modification, or termination of conservation easements imposed under state law should also apply, and should provide an added layer of protection of the public interest and investment in such gifts.*

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## I. INTRODUCTION

The public is investing considerable resources in conservation easements pursuant to the federal tax incentive program embodied in section 170(h) of the Internal Revenue Code (Code). To be eligible for a federal charitable income tax deduction under section 170(h), a conservation easement must be “granted in perpetuity” to a government entity or charitable organization exclusively for one or more of four qualifying conservation purposes, and the conservation purpose of the contribution must be “protected in perpetuity.” The easement must also satisfy numerous additional requirements set forth in section 170(h) and the Treasury Regulations interpreting that section (Treasury Regulations) intended to ensure that the conservation purpose of a contribution will, indeed, be protected in perpetuity.

To date, there has been little examination of the various perpetuity requirements in section 170(h) and the Treasury Regulations. That, however, is starting to change. The Internal Revenue Service (Service) is beginning to challenge claimed deductions for easement donations on perpetuity grounds, and state courts are increasingly faced with the task of interpreting conservation easements in cases involving their attempted modification or termination. This Article, which is the first of two companion articles, examines the perpetuity requirements in section 170(h) and the Treasury Regulations.

Part II.A of this Article begins with a brief history of the federal charitable income tax deduction available for conservation easement donations, which culminated with the enactment of section 170(h) and its protected in perpetuity requirement in 1980. Part II.B then discusses the legislative history of section 170(h), which indicates that Congress and the Treasury Department (Treasury) were concerned about abuses in the conservation easement donation context, and Congress intended to provide a federal subsidy for the donation of only those easements that would *permanently* protect the conservation or historic values of unique or otherwise significant properties. The legislative history also indicates that Congress intended to restrict the ability of government and nonprofit holders to sell, release, or otherwise transfer tax-deductible easements, except for transfers made to other qualified organizations that agree to continue to enforce the easements. In other words, Congress did not intend, through section 170(h), to subsidize the donation of conservation easements that would be fungible or liquid assets in the hands of their government or nonprofit holders. Part II.C then examines the perpetuity-related requirements in the Treasury Regulations, many of which were

drawn directly from the legislative history. Along the way, a number of cases in which the Tax Court has addressed or ignored the perpetuity issue are discussed.

Part III of this Article explains why “swaps” or “trades,” which involve the removal of land from an easement’s restrictions in exchange for the protection of some other land, constitute partial terminations that should be deemed to violate federal tax law requirements. Part IV, however, recommends that section 170(h) be interpreted to authorize deductions with respect to conservation easements that grant the holders the discretion to agree to amendments, provided the amendments either further, or are at least consistent with, the conservation purposes of such easements and mechanisms are in place to ensure that holders do not abuse such a grant of discretion.

This Article concludes that section 170(h) and the Treasury Regulations should be interpreted as establishing uniform national perpetuity standards for tax-deductible conservation easement donations—standards that may be supplemented, but not supplanted, by conservation easement transfer, modification, and termination policies and procedures that may be crafted by states, localities, or individual holders.

## II. FEDERAL TAX LAW REQUIREMENTS

### A. History of the Deduction for Conservation Easement Donations<sup>1</sup>

Congress first enacted explicit statutory authority for charitable income, gift, and estate tax deductions for conservation easement donations as part of the Tax Reform Act of 1976.<sup>2</sup> That Act added a provision to the Code authorizing a deduction for the donation of a conservation easement of not less than thirty years’ duration, provided the easement was donated to a governmental unit or qualifying charitable organization exclusively for conservation purposes.<sup>3</sup> In other words, the Act authorized deductions for the donation of both term and perpetual conservation easements, provided the term easements had a term of not less than thirty years. The Act also defined the term *conservation purposes* to mean (1) the preservation of land areas for public outdoor recreation, educa-

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<sup>1</sup> See generally Nancy A. McLaughlin, *Increasing the Tax Incentives for Conservation Easement Donations—A Responsible Approach*, 31 *ECOLOGY L.Q.* 1, 10-17 (2004) [hereinafter *Tax Incentives*] (providing a detailed discussion of this history).

<sup>2</sup> Pub. L. No. 94-455, 90 Stat. 1520.

<sup>3</sup> See § 280B, 90 Stat. at 1919.

tion, or scenic enjoyment, (2) the preservation of historically important land areas or structures, or (3) the protection of natural environmental systems.<sup>4</sup>

In 1977, a senator introduced legislation to extend the one-year expiration date of the 1976 deduction provision.<sup>5</sup> Although the Treasury Department had endorsed the enactment of the deduction provision in 1976, in 1977 it urged eliminating the deduction with respect to term easements.<sup>6</sup> The Treasury was apparently influenced by the views of land conservation organizations, particularly The Nature Conservancy, which believed that term easements were undesirable because they merely allowed development pressures to build up over thirty years, at which time the pressure to develop would be irresistible.<sup>7</sup> Those organizations also felt the availability of a deduction for the donation of term easements inhibited the giving of perpetual easements on the same property.<sup>8</sup>

The Treasury was successful in pressing its position, and the Tax Reduction and Simplification Act of 1977<sup>9</sup> limited charitable income, gift, and estate tax deductions to the donation of conservation easements granted in perpetuity to governmental units or qualifying charitable organizations exclusively for one or more of the three conservation purposes specified in the 1976 legislation.<sup>10</sup> Neither the 1976 nor the 1977 legislation specified the meaning of the requirement that an easement be donated exclusively for conservation purposes.

The 1977 deduction provision was scheduled to expire in 1981 because it represented a departure from the general principle that charitable gifts of partial interests are not deductible.<sup>11</sup> The purpose of the trial pe-

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<sup>4</sup> See *id.* (codified as amended at I.R.C. § 170(h)(4)).

<sup>5</sup> A Bill to Amend the Tax Reform Act of 1976 to Conform the Termination Date for Certain Tax Deductions for Transfers of Partial Interests in Property for Conservation Purposes with the Termination Dates of Related Provisions, S.685, 95th Cong. (1977).

<sup>6</sup> See Stephen J. Small, *The Tax Benefits of Donating Easements on Scenic and Historic Property*, 7 REAL EST. L.J. 304, 315–16 (1979).

<sup>7</sup> See *id.* at 316.

<sup>8</sup> See *id.*

<sup>9</sup> Pub. L. No. 95-30, 91 Stat. 126.

<sup>10</sup> See § 309, 91 Stat. at 154.

<sup>11</sup> See *Miscellaneous Tax Bills: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means*, 96th Cong. 3, 4 (1979) (statement of Hon. Daniel I. Halperin, Deputy Assistant Secretary for Tax Policy, Department of the Treasury) [hereinafter *Miscellaneous Tax Bills*]. Charitable gifts of partial interests in property generally are not deductible because of the potential for abuse and lack of

riod was to give Congress and the Treasury time to evaluate the operation of the provision, weigh the administrative problems and potential abuses against the benefits obtained, and consider whether to extend the provision and, if so, subject to what kind of modifications.<sup>12</sup>

As part of the Tax Treatment Extension Act of 1980,<sup>13</sup> Congress made the conservation easement deduction provision a permanent part of the Code. Although the Treasury had initially been favorably inclined toward the deduction, by 1980 it had become hostile to the deduction, believing that conservation easements were being aggressively overvalued, the deduction was available with respect to easements that provided little or no public benefit, and no sufficient mechanisms were in place to ensure that the easements would continue to be used for the purposes for which they were donated.<sup>14</sup> With regard to the last point, the Treasury's then Deputy Assistant Secretary for Tax Policy, Daniel Halperin, noted:

[I]t is not clear to us whether procedures exist to insure that a donated partial interest in property, such as a conservation easement contributed to a private charitable organization, will continue to be used for conservation purposes and for the benefit of the general public. Without mechanisms to insure the continued use of the donated interest for such purposes, it is not clear that the public interest is being properly served.<sup>15</sup>

In addition, while Congress was still supportive of the deduction for conservation easement donations in 1980, it too had become concerned about the potential for abuse.<sup>16</sup> Accordingly, in enacting section 170(h) in 1980, Congress imposed substantial new limitations on the deduction.

Pursuant to section 170(h), a landowner donating a conservation easement is eligible for a federal charitable income tax deduction provided the easement is (1) granted in perpetuity (2) to a qualified organization (defined as a governmental unit, a publicly-supported charity, or

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assured benefit to the public when a taxpayer retains use and enjoyment rights with respect to donated property.

<sup>12</sup> *See id.*

<sup>13</sup> Pub. L. No. 96-541, 94 Stat. 3204.

<sup>14</sup> *See Miscellaneous Tax Bills, supra* note 11 at 3-13.

<sup>15</sup> *Id.* at 12.

<sup>16</sup> *See S. REP. NO. 96-1007, at 9 (1980).*

satellite of such charity)<sup>17</sup> (3) exclusively for conservation purposes. Congress expanded the qualifying conservation purposes under section 170(h) to include the preservation of open space.<sup>18</sup> Congress also revised and restricted those purposes in an effort to ensure that the public benefit from a conservation easement donation would be sufficient to justify the federal subsidy in the form of a charitable income tax deduction.<sup>19</sup> Thus, the qualifying conservation purposes under section 170(h) are:

[1] the preservation of land areas for outdoor recreation by the general public or for the education of the general public[,] . . .

[2] the protection of a relatively natural fish, wildlife or plant habitat, or similar ecosystem[,] . . .

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

. . . .

[4] the preservation of an historically important land area or a certified historic structure.<sup>20</sup>

Congress also included a provision in section 170(h) specifying what it means to grant a conservation easement “exclusively for conservation purposes.”<sup>21</sup> The general rule, set forth in section 170(h)(5)(A), provides that “[a] contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.”<sup>22</sup> Section 170(h)(5)(B) as originally enacted then provided that this new “protected in perpetuity” requirement would not be met unless surface

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<sup>17</sup> In response to the Treasury’s concern that conservation easements donated to private foundations were less likely to be enforced and, presumably, less likely to provide benefits to the general public, private foundations were excluded from the definition of *qualified organization* under section 170(h). *See Tax Incentives, supra* note 1, at 51.

<sup>18</sup> *See S. REP. NO. 96-1007*, at 10 (1980). Deductions had previously been granted for the donation of open space easements based on language included in the Conference Report on the Tax Reform Act of 1969. *See id.* at 11.

<sup>19</sup> *See id.* at 10.

<sup>20</sup> *Id.* at 10-12; *see* I.R.C. § 170(h).

<sup>21</sup> I.R.C. § 170(h)(1)(c) (1980).

<sup>22</sup> I.R.C. § 170(h)(5)(A).

mining on the subject property was prohibited; Congress apparently considered surface mining *per se* incompatible with the protection of the conservation or historic values of property. Although Congress did not provide further guidance on the meaning of the new protected in perpetuity requirement in Section 170(h), it provided significant additional guidance regarding the meaning of such requirement in the legislative history.<sup>23</sup>

#### B. Legislative History of Section 170(h)

The Senate Finance Committee issued a report in connection with the enactment of section 170(h) (Senate Report).<sup>24</sup> The Senate Report sets forth the reasons for the changes made to the deduction provision in 1980. It also elaborates on the meaning of the new conservation purposes tests and the new protected in perpetuity requirement.

With regard to the reasons for the changes made to the deduction provision in 1980, the Senate Report explains:

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 [federal charitable] deductions for conservation easement [donations] should be directed at the preservation of unique or otherwise significant land areas or structures.<sup>25</sup>

The Senate Report then describes the four revised conservation purposes tests included in section 170(h) and provides examples of the types

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<sup>23</sup> Although Congress has made a few changes to section 170(h) since 1980, including to the surface mining prohibition in section 170(h)(5)(B) (discussed *infra* Part II.C.3.d), the general requirements that are the focus of this Article—that a conservation easement be granted in perpetuity and its conservation purpose be protected in perpetuity—have remained unchanged.

<sup>24</sup> See S. REP. NO. 96-1007 (1980). The House of Representatives Committee on Ways and Means also issued a report in connection with the enactment of section 170(h), but because both reports are substantially identical, this Article refers only to the Senate Finance Committee's report. See H.R. REP. NO. 96-1278, at 14-20 (1980).

<sup>25</sup> S. REP. NO. 96-1007, at 9 (1980).



of preservation that would qualify under each test.<sup>26</sup> The report explains, for example, that “the preservation of a water area for boating or fishing or a nature or hiking trail,” in each case for use by the public, would satisfy the “outdoor recreation by the general public” conservation purposes test;<sup>27</sup> the preservation of a natural area contributing “to the ecological viability of [an existing conservation area, such as] a local, state, or national park, nature preserve, wildlife refuge, [or] wilderness area” would satisfy the “habitat protection” conservation purpose test;<sup>28</sup> and the preservation of independently significant historic land areas, such as Civil War battlefields, would satisfy the “historic preservation” conservation purpose test.<sup>29</sup> The Senate Report also contains detailed provisions describing the new “open space” conservation purpose test, including a list of factors to be considered in determining whether preservation of land as open space will yield a significant public benefit as required under section 170(h).<sup>30</sup>

The Senate Report contains a multifaceted explanation of the new requirement in section 170(h) that the conservation purpose of the contribution of an easement be protected in perpetuity.<sup>31</sup> The report first provides that, to be deductible for federal tax purposes, the contribution of a conservation easement “must involve legally enforceable restrictions on the interest in the property retained by the donor that would prevent uses of [that] retained interest inconsistent with the conservation purposes” of the easement.<sup>32</sup> The report also provides that the protected in perpetuity requirement will not be “met if the contribution [of a conservation easement] would accomplish one of the enumerated conservation purposes, but would allow uses of the property that would be destructive of other significant conservation interests.”<sup>33</sup> As an example, the report notes that “the preservation of farmland would not qualify under the open space [conservation] purpose [test] if a natural ecosystem has been or, under the terms of the contribution, could be significantly injured or

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<sup>26</sup> See *id.* at 10.

<sup>27</sup> *Id.*

<sup>28</sup> *Id.* at 11.

<sup>29</sup> See *id.* at 12.

<sup>30</sup> *Id.*

<sup>31</sup> See *id.* at 13.

<sup>32</sup> *Id.* at 13.

<sup>33</sup> *Id.*

destroyed by the use of pesticides in the operation of the farm.”<sup>34</sup> On the other hand, the report notes that the protected in perpetuity “requirement is not intended to prohibit uses of the property, such as the selective cutting of timber or farming, if under the circumstances they are not destructive of significant conservation interests.”<sup>35</sup>

The Senate Report further explains that, by requiring the conservation purpose be protected in perpetuity, the Senate Finance Committee intended that “the perpetual restrictions must be enforceable by the donee organization (and successors in interest) against all other parties in interest (including successors in interest).”<sup>36</sup> The report notes that the committee contemplated that the conservation easements would generally be recorded, thus ensuring that they would be legally enforceable.<sup>37</sup>

The Senate Report states that the Senate Finance Committee did not intend that donees “must set aside funds for the enforcement” of easements.<sup>38</sup> The report also states, however, that the committee did intend to limit deductions “only to those cases where the conservation purposes will in practice be carried out.”<sup>39</sup> Thus, the committee contemplated that deductible contributions would be made to organizations that have the commitment and the resources to enforce the perpetual restrictions and protect the conservation purposes of the contributions.<sup>40</sup>

The committee also intended to limit deductible contributions to those that “require that the donee (or successor in interest) hold the conservation easement . . . exclusively for conservation purposes (i.e., that [the easement] not be transferable by the donee except to other qualified organizations that also will hold the perpetual restriction. . . exclusively for conservation purposes).”<sup>41</sup> Although not defined in the Senate Report, the term *transfer* generally encompasses any method of disposing or parting with an interest in property, including by gift, sale, exchange, or release.<sup>42</sup> Accordingly, giving the term *transfer* its ordinary meaning, the

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<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.* at 14.

<sup>37</sup> *See id.*

<sup>38</sup> *Id.* at 14.

<sup>39</sup> *Id.*

<sup>40</sup> *See id.*

<sup>41</sup> *Id.*

<sup>42</sup> *See* BLACK’S LAW DICTIONARY 1636 (9th ed. 2009); *see also* BALLENTINE’S LAW DICTIONARY 1292 (3d ed. 1969) (defining *transfer*, in relevant part, to mean “[e]very means and manner by which property can pass from the ownership and possession of one

committee intended to limit deductible contributions to those that require that the donee not donate, sell, exchange, release, or otherwise transfer the easement except for a transfer made to another qualified organization that will also hold the easement exclusively for conservation purposes. This interpretation of the term *transfer* is sensible given that a donee's gift, sale, exchange, release, or other transfer of a tax-deductible conservation easement could result in the easement's extinguishment,<sup>43</sup> which would be contrary to the Senate Report's directives that (i) the donee (and its successors) hold the easement exclusively for conservation purposes, (ii) the donee have the commitment and resources to enforce the perpetual restrictions, (iii) the restrictions in the easement be enforceable by the donee (and its successors) against all other parties in interest (including the donor's successors), and (iv) the easement prevent uses of the subject property that would be either destructive of significant conservation interests or inconsistent with the easement's conservation purposes. None of those directives would be satisfied if the donee of a tax-deductible conservation easement were free to, for example, sell the easement back to the donor or to a subsequent owner of the encumbered land and thereby extinguish the easement.

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person to the ownership and possession of another, either by act of the parties or by operation of law, or both").

<sup>43</sup> Easements can generally be extinguished through a variety of means. The owner of an easement could execute a release and thereby extinguish the easement. *See* RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 7.3 cmt. a (2000) (noting that a release effectively transfers the servitude benefits to the owner of the burdened property, who can thereafter engage in previously prohibited uses of the property). The owner of an easement could transfer the easement to the owner of the burdened property by gift, sale, or exchange, and that owner, once in possession of the easement, could release and thereby extinguish the easement. *See id.* § 7.3. Alternatively, following such a transfer the easement might be extinguished pursuant to the doctrine of merger. *See id.* § 7.5 ("A servitude is terminated [by merger] when all the benefits and burdens come into a single ownership"). The owner of an easement could agree with the owner of the burdened property to extinguish the easement, although "a release is often used to consummate such a transaction." *Id.* § 7.1, cmt. a & b. The owner of an easement could also abandon its rights under the easement, thereby extinguishing the easement. *See id.* § 7.4. Government and nonprofit holders of tax-deductible conservation easements should not, however, have any such rights, both because of the provisions that should be included in a conservation easement deed to satisfy the requirements in section 170(h) and the Treasury Regulations, and because of a holder's fiduciary obligation under state law to administer the easement, which is a charitable asset, in accordance with its stated terms and charitable conservation purpose. *See, e.g.,* Nancy A. McLaughlin & W. William Weeks, *Conservation Easements and the Charitable Trust Doctrine: Setting the Record Straight*, 10 WYO. L. REV. 73 (2010).

One issue that Congress did not directly address in either section 170(h) or the Senate Report is the possible extinguishment of a tax-deductible perpetual conservation easement in a state court proceeding if the conservation purpose of the easement should become impossible or impractical due to changed conditions. Congress was not, however, unaware of the issue. In anticipation of a congressional hearing on proposed new section 170(h), the Joint Committee on Taxation prepared a report in which it specifically raised the issue of whether section 170(h) ought to include rules to cover the situation "where a transferred partial interest in real property, for which a deduction was allowed because it served a conservation purpose, ceases to be used in furtherance of the conservation purpose."<sup>44</sup> In connection with the congressional hearing, and on behalf of nineteen different land trusts, the president of a prominent land trust advised Congress as follows:

A question raised in the Joint Committee Description . . . is: should rules be provided to take care of the remote contingency that at some time in the future a property subject to a conservation easement might cease to be used for that conservation purpose?

We believe that with a well planned easement program this is most unlikely to occur, but it is not impossible. It is conceivable for example, that a farm, or a natural habitat, might become so closely surrounded by heavy industry at some future time that it would become impossible to continue the original conservation purpose. In such a situation the then owner of the land might, under the common law "change of circumstances" doctrine, obtain equitable relief from the burden of the easement in court. Certainly if that were to happen equity would seem to call for a return to the public of the price originally paid for the public benefit provided by the easement, whether that price had been paid directly by purchase or indirectly by a tax deduction. It also seems very difficult, however, to provide for this unlikely occurrence in the Revenue

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<sup>44</sup> STAFF OF J. COMM. ON TAXATION, 96TH CONG., DESCRIPTION OF MISCELLANEOUS TAX BILLS SCHEDULED FOR A HEARING BEFORE THE SUBCOMMITTEE ON SELECT REVENUE MEASURES OF THE COMMITTEE ON WAYS AND MEANS ON JUNE 26, 1980, JCS-33-80, at 27 (Comm. Print 1980) (providing a list of seven issues that were raised by the bill to enact section 170(h)).

Code itself. We would hope that some Regulation for this purpose could be developed by those most interested, i.e., The Revenue Service and the Treasury Department, which would not interfere with the main operation of the easement program.<sup>45</sup>

Presumably in response to such testimony, Congress opted to leave it to the Treasury to craft rules to address the “most unlikely” of situations, in which the continued protection of easement-encumbered land for conservation purposes becomes impossible or impractical due to changed conditions and the easement is extinguished in a state court proceeding. The Treasury addressed this eventuality in the Treasury Regulations, and it did so in a manner consistent with the mandate in section 170(h) that the conservation purpose of the contribution be protected in perpetuity. Specifically, the “extinguishment” and “division of proceeds” sections of the Treasury Regulations provide that, if a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation can make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as “protected in perpetuity” as required under § 170(h) if the restrictions are extinguished in a judicial proceeding, the donee is paid a minimum percentage share of the proceeds from a subsequent sale or exchange of the underlying property, and the donee uses such proceeds “in a manner consistent with the conservation purposes of the

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<sup>45</sup> *Minor Tax Bills: Hearings Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means*, 96th Cong. 243, 245 (1980) (written statement of Samuel W. Morris, President, French and Pickering Creeks Conservation Trust, Inc., Pottstown, Pa., July 1, 1980, submitted on behalf of nineteen land trusts) [hereinafter *Minor Tax Bills*]. When asked how the National Trust for Historic Preservation in the United States would handle it if it determined that an easement no longer served the conservation purposes for which it was contributed, a lawyer for that organization similarly testified “at common law if the easement no longer serves its purposes I think under State common law governing easements, it might be extinguished. That is the substantive real property consequences.” *Id.* at 223 (testimony of Thomas A. Coughlin III, Chief Counsel, Real Estate, National Trust For Historic Preservation in the United States). The director of another prominent land trust testified:

Today, Mr. Chairman, you have asked about the question of extinguishing easements. We, as an organization, will not extinguish an easement without compensation. It is not our intent, however, to extinguish easements. What we have done by mapping critical areas for water resources is identify those areas that regardless of change in land use in the area are still critical to the water resource.

*Id.* at 248 (statement of William Sellers, Director, Brandywine Conservancy).

original contribution” (in other words, to replace lost conservation values).<sup>46</sup>

Section 170(h) and the legislative history indicate that Congress did not intend for government and nonprofit holders to be free to sell, trade, release, or otherwise transfer and thereby extinguish tax-deductible perpetual conservation easements, whether in whole or in part, to, for example, accommodate the requests of new owners of the subject properties, raise cash for a holder’s general operations, or pursue what a holder might perceive to be better conservation opportunities in other locations. In other words, Congress did not intend to subsidize the acquisition of conservation easements that would be fungible or liquid assets in the hands of their government or nonprofit holders. Congress refused to delegate to government and nonprofit holders the decision regarding the conservation easements that are worthy of the federal subsidy under section 170(h). Instead, Congress crafted the threshold conservation purposes tests and other requirements of section 170(h) and provided detailed explanations of those requirements in the legislative history. It is therefore unsurprising that Congress also refused to delegate to government and nonprofit holders the discretion to sell, trade, release, or otherwise transfer such easements, except for transfers made to other qualified holders that agree to continue to enforce the easements. Satisfaction of the elaborate threshold conservation purposes tests and other requirements in section 170(h) would be a meaningless exercise if, on the day following the donation or any time thereafter, the holder could simply sell, trade, release, or otherwise dispose of the easement, whether in whole or in part.

Congress sought, through section 170(h), to subsidize the acquisition of conservation easements that would *permanently* protect the conservation values of unique or otherwise significant properties. It also sought to restrict the ability of government and nonprofit holders to sell, trade, release, or otherwise transfer such easements, except for transfers made to other qualified holders that agree to continue to enforce such easements. And Congress opted to leave it to the Treasury to craft rules to ensure that the conservation purpose of the contribution of an easement would be protected in perpetuity in the unlikely event that continued use of the subject property for conservation purposes later becomes impossible or impractical and the easement is extinguished in a state court proceeding.

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<sup>46</sup> See Treas. Reg. § 1.170A-14(g)(6); *infra* Part II.C.3.f (discussing these provisions in detail).

### C. Treasury Regulations Interpreting Section 170(h)

On January 14, 1986, the Treasury published final regulations interpreting section 170(h).<sup>47</sup> In the opening paragraph, the Treasury Regulations explain that a charitable income tax deduction under section 170 generally is not allowed for the donation of a partial interest in property, but a deduction may be allowed for the donation of a conservation easement (which is a partial interest in property) if the requirements in the Code and Treasury Regulations are met.<sup>48</sup> A commentator who prepared the original drafts of the Treasury Regulations explained, “[a]s far as Congress and Treasury are concerned, a taxpayer who donates an easement continues to use and enjoy the property, and the requirements for taking an income tax deduction simply must be tighter to ensure that there is also a significant long-term public benefit associated with the donation.”<sup>49</sup>

The opening paragraph of the Treasury Regulations also reiterates the basic requirements under section 170(h), including that “[t]o be eligible for a deduction . . . the conservation purpose must be protected in perpetuity.”<sup>50</sup> The succeeding sections of the Treasury Regulations then set forth numerous detailed requirements intended to ensure that the conservation purpose of a tax-deductible conservation easement will be protected in perpetuity. Those perpetuity requirements, many of which were drawn directly from the Senate Report, are discussed in turn below.<sup>51</sup>

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<sup>47</sup> See T.D. 8069, 1986-1 C.B. 89.

<sup>48</sup> See Treas. Reg. § 1.170A-14(a).

<sup>49</sup> STEPHEN J. SMALL, FEDERAL TAX LAW OF CONSERVATION EASEMENTS 2-2 to -3 (1997). Mr. Small worked for the Service in 1981 and 1982 and prepared the original drafts of the Treasury Regulations interpreting section 170(h). *Id.* at 1-3.

<sup>50</sup> Treas. Reg. § 1.170A-14(a).

<sup>51</sup> An analysis of the validity of the Treasury Regulations interpreting section 170(h) is beyond the scope of this Article. In *Mayo Foundation for Medical Education & Research v. United States*, No. 09-837 (U.S. Jan. 11, 2011), however, the Supreme Court held that *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), provides the appropriate standard of review for evaluating Treasury regulations issued under the general authority of Code section 7805(a) after notice-and-comment procedures. Under *Chevron*, if Congress has not directly addressed the precise question at issue, the regulation must only be a “reasonable interpretation” of the enacted text, and a court is not permitted to disturb the regulation unless it is “arbitrary or capricious in substance, or manifestly contrary to the statute.” *Mayo Foundation*, No. 09-837, slip op. at 7, 12 (U.S. Jan. 11, 2011) (quoting *Household Credit Servs., Inc. v. Pfennig*, 541 U.S. 232 (2004); *Chevron*, 467 U.S. 837).

### 1. *Qualified Organization Requirements*

#### a. *Eligible Donee Requirement*

Consistent with the Senate Report, the Treasury Regulations provide that, to qualify as an “eligible donee” of a tax-deductible conservation easement, the qualified organization to which the easement is conveyed must have a commitment to protect the conservation purposes of the donation and the resources to enforce the restrictions, although the organization need not set aside funds to enforce an easement’s restrictions.<sup>52</sup> The Treasury Regulations also appear to provide a safe harbor of sorts for land trusts with regard to the commitment requirement by providing that a “conservation group organized or operated primarily or substantially for one of the conservation purposes” enumerated in section 170(h), as most land trusts are, “will be considered to have the requisite commitment.”<sup>53</sup> Although the Treasury Regulations provide no further guidance, the Senate Report indicates that the commitment and resource requirements are intended “to limit the deduction only to those cases where the conservation purposes will in practice be carried out.”<sup>54</sup>

#### b. *Restriction on Transfer Requirement*

Consistent with the Senate Report, the Treasury Regulations provide that a deduction will be allowed for the donation of a conservation easement only if the instrument of conveyance prohibits the donee and its successors or assigns from subsequently transferring the easement, whether or not for consideration, unless the transfer is to another eligible donee (as defined immediately above) and the eligible donee agrees that the conservation purposes the contribution was originally intended to

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<sup>52</sup> See Treas. Reg. § 1.170A-14(c)(1); *supra* text accompanying notes 38–40.

<sup>53</sup> Treas. Reg. § 1.170A-14(c)(1). The drafters of the Treasury Regulations reportedly included this safe harbor to ensure that newly established or small conservation organizations that might list conservation purposes as only one of their stated purposes in their corporate charters would nonetheless be deemed to have the requisite commitment. See SMALL, *supra* note 49, at 3–4.

<sup>54</sup> S. REP. NO. 96-1007, at 14 (1980); see *supra* text accompanying notes 39 and 40. For insight into the Service’s position with regard to the commitment and resource requirements, see Priv. Ltr. Rul. 201048045 (Dec. 3, 2010) (“[T]he extent of an organization’s due diligence and monitoring activities, combined with its capacity for and commitment to enforcement when necessary, becomes highly significant in determining whether accepting and holding easements actually furthers a charitable conservation purpose and thus whether an organization with the primary purpose of accepting and holding easements qualifies for exemption under section 501(c)(3).”).



advance will continue to be carried out.<sup>55</sup> Thus, the donee must be prohibited from, for example, selling, releasing, or otherwise transferring the conservation easement back to the donor or to a subsequent owner of the burdened land, which would result in the easement's extinguishment, in exchange for cash that the donee could use to refurbish its offices, increase the salaries of its staff, or fund other projects or programs.<sup>56</sup>

The Treasury Regulations also clarify, however, that the "restriction on transfer" requirement will not be violated if, "in the event of an unexpected change in the conditions surrounding the property that . . . makes impossible or impractical the continued use of the property for conservation purposes," the easement is extinguished, "the property is sold or exchanged," and the donee uses its designated share of the proceeds "in a manner consistent with the conservation purposes of the original contribution" (that is, the easement is extinguished in accordance with the extinguishment and division of proceeds provisions of the Treasury Regulations).<sup>57</sup> The Treasury recognized that extinguishment of a conservation easement involves the *transfer* of the easement to the owner of the burdened land (who, after extinguishment, can engage in previously prohibited uses of the land), and it detailed the circumstances in which such a

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<sup>55</sup> See Treas. Reg. § 1.170A-14(c)(2); *supra* text accompanying note 41.

<sup>56</sup> See *supra* text accompanying note 42 (explaining that the term *transfer* is broadly defined to encompass any mode or method of disposing or parting with property or an interest in property, including by gift, sale, exchange, or release); see also discussion *supra* note 43 (explaining that an easement can be extinguished through a variety of means, including the holder's sale, exchange, release, abandonment, or other transfer of the easement).

<sup>57</sup> Treas. Reg. § 1.170A-14(c)(2). Although the restriction on transfer section of the Treasury Regulations does not itself provide that a judicial proceeding is required to extinguish a conservation easement, it cross-references to the section of the Treasury Regulations that does so provide. See *id.* To make sense of the cross-references, however, one must refer to Proposed Treasury Regulation section 1.170A-13, published in the *Federal Register* on May 23, 1983, because the Treasury failed to update the cross-references in the final Treasury Regulations. See Prop. Treas. Reg. § 1.170A-13, 48 Fed. Reg. 22941-48 (May 23, 1983); see also *Food and Drug Admin. v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000).

It is a "fundamental canon of statutory construction that the words of a statute must be read in their context and with a view to their place in the overall statutory scheme." A court must therefore interpret the statute "as a symmetrical and coherent regulatory scheme," and "fit, if possible, all parts into an harmonious whole."

*Id.* (citations omitted) (quoting *Gustafson v. Alloyd Co.*, 513 U.S. 561, 569 (1995); *Davis v. Mich. Dep't Treasury*, 489 U.S. 803, 809 (1989); *FTC v. Mandel Bros., Inc.*, 359 U.S. 385, 389 (1959)).

transfer would be permissible—in a judicial proceeding, upon a finding of impossibility or impracticality, and with a payment of at least a minimum percentage share of proceeds to the holder to be used to replace lost conservation values.<sup>58</sup>

## 2. *No Inconsistent Use Requirement*

Consistent with the Senate Report, the Treasury Regulations provide that the deduction for a conservation easement donation will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests.<sup>59</sup> The Treasury Regulations then restate, in a slightly modified form, the examples provided in the Senate Report.<sup>60</sup>

The Treasury Regulations further provide that a use that is destructive of conservation interests will be permitted in only one circumstance: “if such use is necessary for the protection of the conservation interests that are the subject of the contribution.”<sup>61</sup> As an example, the Treasury Regulations provide 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.”<sup>62</sup> The Treasury Regulations also confirm that “a donor can continue a pre-existing use of the property that does not conflict with the conservation purposes of the gift.”<sup>63</sup>

The practical effect of these provisions is that, in most cases, a conservation easement will need to protect all significant conservation interests on the property, whether scenic, open space, ecological, or historic.

## 3. *Enforceable in Perpetuity Requirements*

### a. *General Enforceable in Perpetuity Requirement*

Consistent with the Senate Report, the Treasury Regulations provide that the interest in the property retained by the donor “must be subject to legally enforceable restrictions . . . that will prevent uses of the retained

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<sup>58</sup> See Treas. Reg. §§ 1.170A-14(c)(2), -14(g)(6).

<sup>59</sup> See S. REP. NO. 96-1007, at 13 (1980); Treas. Reg. § 1.170A-14(e)(2).

<sup>60</sup> See Treas. Reg. § 1.170A-14(f); *supra* text accompanying notes 34–35.

<sup>61</sup> Treas. Reg. § 1.170A-14(e)(3).

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

interest inconsistent with the conservation purposes of the donation.”<sup>64</sup> The Treasury Regulations also provide that the restrictions can be made legally enforceable by, for example, recording the easement in the land records of the jurisdiction in which the property is located.<sup>65</sup>

To ensure that a conservation easement’s legally enforceable restrictions “will prevent uses of the retained interest inconsistent with the conservation purposes of the donation,” the easement should (1) specifically reserve to the donor only those rights that, even if fully exercised, would not be inconsistent with the conservation purpose of the easement, (2) specifically prohibit activities that would be inconsistent with the conservation purpose of the easement (such as mining and industrial uses), and (3) because it is impossible at the time of conveyance to specify in the deed every conceivable variation of use, activity, or practice that in the future might have an adverse impact on the conservation purpose of the easement, include an overarching restriction prohibiting activities or uses that are inconsistent with the conservation purpose of the easement.<sup>66</sup> The overarching restriction is necessary to prevent the donor or a future landowner from claiming the right to do anything not specifically prohibited by the easement even though the act would be inconsistent with the easement’s conservation purpose.

Moreover, a conservation easement’s legally enforceable restrictions “will prevent uses of the retained interest inconsistent with the conservation purposes of the donation” only if the government or nonprofit holder is prohibited from selling, trading, releasing, or otherwise extinguishing such restrictions. Accordingly, satisfaction of the “general enforceable in perpetuity” requirement depends, in part, on compliance with the “restriction on transfer” requirement.

Finally, the requirement that a tax-deductible easement “prevent uses of the retained interest inconsistent with the conservation purposes of the

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<sup>64</sup> Treas. Reg. § 1.170A-14(g)(1); *supra* text accompanying note 32.

<sup>65</sup> *See id.*; *supra* text accompanying note 37.

<sup>66</sup> *See, e.g.,* Glass v. Comm’r, 471 F.3d 698, 713 (6th Cir. 2006) (quoting Treas. Reg. § 1.170A-14(g)(1) and affirming the Tax Court’s holding that taxpayers were entitled to federal charitable income tax deductions with respect to the donation of two conservation easements in part because the easements contained overarching restrictions prohibiting uses inconsistent with the purpose of the easements); Thomas S. Barrett, *Model Conservation Easement and Commentary*, in *THE CONSERVATION EASEMENT HANDBOOK: MANAGING LAND CONSERVATION AND HISTORIC PRESERVATION EASEMENT PROGRAMS* 147, 176–77 (Janet Diehl & Thomas S. Barrett, eds 1988) (explaining that the model conservation easement prohibits all uses inconsistent with the purpose of the easement and reserves to the grantor the right to engage in all consistent uses).

donation” is in addition to the requirement discussed above that the easement not permit the destruction of other significant conservation interests (the “no inconsistent use” requirement). Where the purpose of a conservation easement is broadly stated (such as to protect significant ecological and natural resources, open space and scenic values, and historical and cultural values), and the easement contains an overarching restriction prohibiting activities or uses that are inconsistent with that purpose, the easement should satisfy both requirements.<sup>67</sup> On the other hand, if the conservation purpose of a conservation easement is not broadly stated—for example, if the easement’s purpose is limited to protecting open space—then to qualify for a deduction the easement should contain an overarching restriction expressly prohibiting any activity that would either (i) be inconsistent with the open space purpose of the easement *or* (ii) destroy other significant conservation interests, unless the destruction of other conservation interests is necessary for the protection of the conservation interests that are the subject of the contribution. If the overarching restriction prohibited only those activities that are inconsistent with the open space purpose of the easement, the landowner could claim the right to engage in any activities not specifically prohibited by the easement and not inconsistent with the protection of open space, even if such activities would destroy “other significant conservation interests,” such as habitat for rare, threatened or endangered species.

*b. Mortgage Subordination Requirement*

The Treasury Regulations provide that, in the case of a contribution made after February 13, 1986, an interest in property that is subject to a mortgage will not be deductible unless the lender subordinates its rights in the property “to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity.”<sup>68</sup> Some have taken the position that this requires a lender to subordinate its rights under an outstanding mortgage on the subject property to only the right of the donee to enforce the conservation easement, thus ensuring that the easement will not be extinguished if the donor defaults on the loan payments and the lender forecloses and takes the property.<sup>69</sup> Under this interpretation, it is argued, the lender could retain priority rights to all proceeds received

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<sup>67</sup> See, e.g., Priv. Ltr. Rul. 200836014 (blessing an easement that had such a broadly stated conservation purpose and provided that the exercise of any right reserved by the grantors “must not be inconsistent with or detrimental to the purpose of the easement”).

<sup>68</sup> Treas. Reg. § 1.170A-14(g)(2).

<sup>69</sup> See, e.g., Barrett, *supra* note 66, at 164–65, 207.

in the event the easement is extinguished, regardless of the cause (whether due to condemnation, casualty event, or other change in conditions).<sup>70</sup> Others have assumed that a lender must subordinate its rights to all of the rights of the holder under the easement, including the right of the holder to its minimum percentage share of proceeds in the event the easement is extinguished.<sup>71</sup> The language of the Treasury Regulations supports the latter interpretation.

The Treasury Regulations do not provide that a lender must subordinate its rights to the right of the holder to enforce the easement. Rather, the regulations provide that the lender must subordinate its rights to the rights of the holder “to enforce the conservation purposes of the gift in perpetuity.”<sup>72</sup> That language embraces all of the elements of a donated easement’s perpetual nature, not just the holder’s right to enforce the particular restrictions in the easement. Thus, the holder’s rights to which a lender must subordinate its rights should necessarily include, among other things, the holder’s right to receive proceeds upon extinguishment of the easement to be used to replace lost conservation values as provided in Treasury Regulation section 1.170A-14(g)(6). This makes sense from a policy perspective because the value attributable to “the gift” that was made for the benefit public and for which a federal subsidy was provided should remain in the charitable sector and be devoted to similar conservation purposes (as opposed to being paid to the landowner’s lender). If the holder is not entitled to receive proceeds upon extinguishment because of a limited subordination agreement, the donation should not be

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<sup>70</sup> See, Barrett, *supra* note 66, at 207 (explaining that such a limited subordination agreement is intended to “neutralize” the provision included in a conservation easement deed to satisfy the division of proceeds requirement of the Treasury Regulations, but admitting that the assumption that such an agreement satisfies the requirements under section 170(h) and the Treasury Regulations is untested). See *infra* Part II.C.3.f (discussing the extinguishment and division of proceeds requirements).

<sup>71</sup> For example, both the Maryland Environmental Trust and the Virginia Outdoors Foundation—which hold or cohold most of the easements conveyed in those states—use a model conservation easement that provides for the lender’s subordination of its rights to all of the rights of the holder under the easement, including, implicitly, the holder’s right to proceeds upon extinguishment. See *Conservation Easement Template*, VA. OUTDOORS FOUND. 16 (July 1, 2010), [http://www.virginiaoutdoorsfoundation.org/VOF\\_land-documents.php](http://www.virginiaoutdoorsfoundation.org/VOF_land-documents.php); *Model Conservation Easement*, MD. ENVTL. TRUST 13, [http://www.dnr.state.md.us/met/land\\_conservation.asp](http://www.dnr.state.md.us/met/land_conservation.asp) (last visited July 22, 2010); Maryland Environmental Trust Model Subordination Agreement (on file with author).

<sup>72</sup> See Treas. Reg. § 1.170A-14(g)(2).

deemed to comply with the statutory mandate that the conservation purpose of the contribution be protected in perpetuity.<sup>73</sup>

In addition, even if the mortgage subordination requirement were interpreted to require that a lender subordinate its rights to only the right of the holder to enforce the easement, Treasury Regulation section 1.170A-14(g)(6) imposes a separate additional requirement—if a change in conditions makes impossible or impractical the continued use of the property for conservation purposes, and the easement is extinguished in a judicial proceeding, the holder must be entitled to a minimum percentage share of the proceeds from the subsequent sale, exchange, or involuntary conversion of the property to be used to replace lost conservation values. That requirement should not be deemed satisfied if the landowner's lender is granted priority rights to the proceeds received following extinguishment because the holder would not be entitled to its minimum percentage share of such proceeds to be used to replace lost conservation values. It is the holder's entitlement to such proceeds that ensures the conservation purpose of the contribution will, in all events, be protected in perpetuity (in other words, that the gift will remain in the charitable sector and be devoted to similar conservation purposes for the benefit of the public).<sup>74</sup>

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<sup>73</sup> See I.R.C. § 170(h)(5)(A). The 2005 version of the Conservation Easement Handbook notes that, although some practitioners think limited subordinations are permissible, "others would argue, at least with respect to extinguishment, that the division of proceeds requirement is what allows 'the conservation purpose' of the grant to 'nonetheless be treated as protected in perpetuity' in the eyes of the IRS, and a lender must therefore subordinate to it as well." See Elizabeth Byers & Karin Marchetti Ponte, *The Conservation Easement Handbook* 456 (2d ed. 2005).

<sup>74</sup> If the lender is granted priority rights to proceeds upon extinguishment, and such proceeds are insufficient to pay both the lender in full and the holder its required minimum percentage share, the holder might have a claim against the property owner for an amount equal to the holder's share. The Treasury Regulations provide, however, that the holder "must be entitled to" its minimum percentage share of "the proceeds" from a sale, exchange, or involuntary conversion of the property, and not that the holder must have a claim against the possibly judgment-proof property owner for an amount equal to such share. The conservation purpose of a contribution should not be deemed protected in perpetuity if the holder has only a claim against the property owner for its required share, as that claim might be worthless.

A taxpayer who obtained a limited subordination agreement in connection with an easement donation should also not be permitted to save the deduction by arguing that, based on the particular facts of the donation, the possibility that the holder would not receive its required minimum percentage share of proceeds following extinguishment is so remote as to be negligible. See *infra* Part II.C.3.c (discussing the "so remote as to be

A recent Tax Court case involving a façade easement, *Kaufman v. Commissioner*,<sup>75</sup> addressed a variant of this issue. *Kaufman* involved a limited subordination agreement pursuant to which the lender subordinated its rights to the right of the holder to enforce the easement but retained priority rights to all insurance and condemnation proceeds.<sup>76</sup> The Tax Court granted the Service's motion for summary judgment, finding that this type of limited subordination agreement violated the Treasury Regulation requirement that the holder of a tax-deductible conservation easement must be entitled to a minimum percentage share of the proceeds received following extinguishment to be used to replace lost conservation values.<sup>77</sup>

*c. Remote Future Event*

*(1) "So Remote as to be Negligible" Rule*

The Treasury Regulations provide that a deduction for a conservation easement donation

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

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negligible" rule). If that were permitted, every donor of a conservation easement involving a mortgage could obtain a limited subordination agreement from the lender, and the Service and the courts would be forced to engage in the intensely factual case-by-case so remote as to be negligible analysis with regard to each such donation to assess satisfaction of the division of proceeds requirement. For the reasons discussed in Part II.C.3.c below, taxpayers should not be permitted to cure their failures to comply with the specific requirements in section 170(h) and the Treasury Regulations by invoking the so remote as to be negligible rule.

<sup>75</sup> 134 T.C. 9 (2010).

<sup>76</sup> *See id.*

<sup>77</sup> If this holding is modified (the taxpayers have reportedly asked the Tax Court to reconsider the issue in the context of the ongoing litigation) and the Tax Court endorses the use of limited subordination agreements, donors and donees likely would be less able to continue to negotiate with lenders for full subordinations, resulting in a possible nationwide race to the bottom with regard to subordination agreements. If the holding stands, and it proves difficult to obtain full subordinations in the historic preservation easement context (where the use of limited subordinations appears to be more common), Congress could consider amending section 170(h) to allow limited subordinations such as that used in *Kaufman* if it can be shown that the chance of defeat of the gift in the event of a condemnation or casualty event is so remote as to be negligible. In other words, Congress could make a special limited "so remote as to be negligible" exception to the division of proceeds requirement, as it did with respect to the surface mining prohibition in the case of severed estate lands discussed in Part II.C.3.d below.

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.<sup>78</sup>

This provision merely restates a rule that applies to all charitable gifts.<sup>79</sup> If, on the date of a charitable gift, the possibility that the gift will be defeated (revert to the donor or the donor's successors in interest) is not so remote as to be negligible, the donor is not entitled to a deduction.<sup>80</sup> In other words, the donor of a charitable gift does not receive a public subsidy in the form of federal tax benefits if, on the date of the gift, more than a negligible probability exists that the gift will later revert to the donor or the donor's successors in interest (that is, be removed from the charitable sector and pass back into the private sector).<sup>81</sup>

In *Briggs v. Commissioner*<sup>82</sup> the Tax Court defined the phrase "so remote as to be negligible" as:

"[a] chance which persons generally would disregard as so highly improbable that one might ignore it with reasonable safety in undertaking a serious business transaction." It is likewise a chance which every dictate of reason would justify an intelligent person in disregarding as so highly improbable and remote as to be lacking in reason and substance.<sup>83</sup>

Assessing the probability that the performance of some act or the happening of some event will defeat a charitable gift also entails an intensely factual case-by-case inquiry. For example, *Briggs* involved a charitable gift of a ranch made to a foundation for the purpose of establishing a cul-

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<sup>78</sup> Treas. Reg. § 1.170A-14(g)(3).

<sup>79</sup> See Treas. Reg. § 1.170A-1(e).

<sup>80</sup> See *id.*

<sup>81</sup> Charitable gifts subject to reverters are sometimes referred to as charitable gifts subject to a condition subsequent. The "so remote as to be negligible" rule also applies to charitable gifts subject to a condition precedent. Thus, the possibility that a charity might never receive a charitable gift (such as a contingent remainder interest) must also be assessed under the so remote as to be negligible rule. See, e.g., Rev. Rul. 85-23, 1985-1 C.B. 327 (ruling deduction not allowable where the actuarial probability that individual *B* would survive individual *A* and thereby divest charity *C* of its contingent remainder interest was greater than 5% and therefore not so remote as to be negligible).

<sup>82</sup> 72 T.C. 646 (1979).

<sup>83</sup> *Id.* at 656-57 (citations omitted) (quoting *United States v. Dean*, 224 F.2d 26 (1st Cir. 1955)) (citing *Estate of Woodworth v. Comm'r*, 47 T.C. 193 (1966)).



tural, educational, and medical center to benefit Native Americans, and subject to a reversion to the donor if the ranch was not so used.<sup>84</sup> The Tax Court held that the gift was not deductible because the possibility that the ranch would revert to the donor was not so remote as to be negligible.<sup>85</sup> In support of its holding, the court explained that the donor had provided no funds to the foundation for establishment of the center, no other forms of financing were readily available, none of the members of the foundation's board of directors had business experience or experience with fundraising, and it seemed probable that the chairman of the board lacked the qualities that would enable her to function as a leader and operate as an organizer and fundraiser.<sup>86</sup>

### (2) *Specific Exception for Marketable Title Acts*

The Treasury Regulations provide that a state's statutory requirement that land use restrictions must be rerecorded every thirty years to remain enforceable (generally referred to as a "marketable title act") will not, by itself, render a conservation easement nonperpetual.<sup>87</sup> In providing this example, the Treasury must have assumed that the possibility that a marketable title act would defeat the gift of a tax-deductible easement was "so highly improbable that it might be ignored with reasonable safety in

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<sup>84</sup> *Briggs*, 12 T.C. at 646-54.

<sup>85</sup> *Id.* at 659.

<sup>86</sup> *Id.* at 657-58. *See also, e.g.*, 885 Inv. Co. v. Comm'r, 9 T.C. 156 (1990) (holding charitable gift of land to a city for use as part of a scenic corridor, which was subject to a reversion if the land was not so used, was not deductible because the possibility that the land would revert to the donors was not so remote as to be negligible; in light of the financial and legal uncertainties associated with establishing and maintaining the scenic corridor, on the date of the gift "a realistic possibility existed that the property would revert"); Estate of Woodworth v. Comm'r, 47 T.C. 193 (1966) (holding bequest to trustees for establishment or maintenance of a Catholic hospital in a South Carolina county was not deductible because the possibility that the bequest would not be effective was not so remote as to be negligible; at the time of the decedent's death, no such hospital was in the county and no evidence suggested that such a hospital would be established, and South Carolina did not recognize the doctrine of *cy pres*, which might have allowed a court to redirect the bequest to a charitable purpose as near as possible to that specified by the decedent rather than having the bequest to charity fail). Although South Carolina does not recognize the doctrine of *cy pres*, it employs the doctrine of deviation to achieve the same result. *See S.C. Dept. of Mental Health v. McMaster*, 642 S.E.2d 552 (2007). In the estate tax context the Service has ruled that a charitable deduction is not allowable if there is a greater than 5% chance, determined under actuarial principles, that the charity's interest will be defeated. *See, e.g.*, Rev. Rul. 85-23, 1985-1 C.B. 327.

<sup>87</sup> *See* Treas. Reg. § 1.170A-14(g)(3).

undertaking a serious business transaction” and “a chance which every dictate of reason would justify an intelligent person in disregarding as so highly improbable and remote as to be lacking in reason and substance.”<sup>88</sup>

The Treasury was not unreasonable in assuming that easement holders would take the simple steps of tracking and rerecording tax-deductible conservation easements to avoid forfeiture of such valuable charitable assets under marketable title acts. The donee of a charitable gift has a fiduciary duty under state law to protect such gift for the benefit of its beneficiaries (in the case of a conservation easement, the general public), and remedies for breach of a fiduciary duty can, in some cases, include personal liability for trustees or directors.<sup>89</sup> Nonprofit holders that permit forfeiture of conservation easements by failing to rerecord such easements might also violate the federal tax law private benefit or private inurement prohibitions, while government holders that permit such forfeitures risk violating state constitutional prohibitions on the conveyance of public assets to private parties without adequate compensation. Moreover, breach of a holder’s fiduciary duty to rerecord a conservation easement as required by a marketable title act could be remedied by restoration of the easement to the holder or a substitute holder on behalf of the public.<sup>90</sup> At least one state supreme court has held that the state’s marketable title act has no application to property conveyed as a charitable gift for the benefit of the public subject to restrictions on its use.<sup>91</sup> The court explained that the state’s marketable title “statutes do not by their terms purport to limit the life of a public charitable trust or to limit the time within which legal proceedings to enforce the rights of the public thereunder may be commenced.”<sup>92</sup>

### (3) *Case Law in the Conservation Easement Context*

The Tax Court has addressed the so remote as to be negligible rule in two cases involving conservation easement donations. However, the first

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<sup>88</sup> *Briggs*, 72 T.C. at 656–57 (quoting *United States v. Dean*, 224 F.2d 26 (1st Cir. 1955)).

<sup>89</sup> See generally GEORGE GLEASON BOGERT & GEORGE TAYLOR BOGERT, *THE LAW OF TRUSTS AND TRUSTEES* § 861 (rev. 2d ed. 1995) (discussing remedies for breach of a fiduciary duty).

<sup>90</sup> See *id.*

<sup>91</sup> See *Dunphy v. Commonwealth*, 331 N.E.2d 883, 884 (Mass. 1975) (involving a 1917 gift of land to a town to “be kept and used as a Public Park in perpetuity for the public good”).

<sup>92</sup> *Id.* at 887.

case, *Stotler v. Commissioner*,<sup>93</sup> involved a donation made in 1979 and, thus, the law in effect at that time governed (section 170(h) was not enacted until 1980). The second case, *Satullo v. Commissioner*,<sup>94</sup> involved a donation made in 1985 and, thus, was governed by section 170(h), but not the Treasury Regulations, which were not published until 1986. Accordingly, the differences between the statutory provisions and the lack of Treasury Regulations must be kept in mind when analyzing these cases. Moreover, both *Stotler* and *Satullo* are Tax Court Memorandum opinions, which is significant because the Tax Court does not treat such opinions as binding precedent<sup>95</sup> and the persuasive value of such opinions depends, in part, on their pertinence to the facts and law in the later case.<sup>96</sup>

(a) *Stotler v. Commissioner*

*Stotler* involved a 1979 donation of a scenic easement to the County of Monterey, California.<sup>97</sup> At the time of the donation, the Code permitted a charitable income tax deduction for the donation of a conservation easement granted in perpetuity to a governmental unit or qualifying charitable organization exclusively for conservation purposes.<sup>98</sup> Unlike section 170(h), however, the deduction provision in effect in 1979 did not

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<sup>93</sup> 53 T.C.M. (CCH) 973 (1987).

<sup>94</sup> 66 T.C.M. (CCH) 1697 (1993).

<sup>95</sup> See, e.g., *Huffman v. Comm'r*, 126 T.C. 322 (2006) (“Memorandum Opinions are not binding”); *Dunaway v. Comm'r*, 124 T.C. 80 (2005) (“Memorandum Opinions of this Court are not regarded as binding precedent” (citing *Nico v. Comm'r*, 67 T.C. 647, 654 (1977), *rev'd. in part on other grounds*, 565 F.2d 1234 (2d Cir. 1977)).).

<sup>96</sup> One source of guidance on the authoritative weight to be given Tax Court decisions explains as follows:

Memoranda decisions . . . do not bind the Tax Court or any of its judges (including Senior judges and Special Trial Judges), and each judge is at liberty to depart from them. . . .

Tax Court decisions—both regular and memoranda decisions—may be persuasive authority, however. Indeed, all courts—from the U.S. district courts to the U.S. Supreme Court—consider the persuasive value of Tax Court decisions. In general, the authoritative weight of a Tax Court decision depends on its pertinence to the facts and law in the later case and how convincing the reasoning of the decision is.

Peter A. Lowy, 100 T.M., *U.S. Federal Tax Research*, A-63.

<sup>97</sup> See *Stotler*, 53 T.C.M. (CCH) at 974.

<sup>98</sup> See *supra* Part II.A.

provide that the conservation purpose of the contribution must be protected in perpetuity.<sup>99</sup>

The Service attempted to disallow the deductions claimed with respect to the easement donation in *Stotler* on a variety of grounds, only two of which are important here.<sup>100</sup> The Service first argued that, “on the date of [the] gift, there was a significant likelihood that the property . . . would revert to the [donors] by virtue of condemnation of the property” (in other words, that the possibility of defeat of the gift through condemnation was “not so remote as to be negligible”).<sup>101</sup> The Service pointed out that, on the date of the gift, the local water management district was considering enlargement of a nearby dam and that enlargement would have necessitated condemnation of a portion of the easement-encumbered land.<sup>102</sup> In addition, the deed of easement provided that, if someone sought to condemn the land, the easement would terminate and the owners of the land would be entitled to compensation for the taking as if the easement had not burdened the land (in other words, the condemning authority would be required to pay the full unrestricted value of the land but the easement holder would receive nothing).<sup>103</sup>

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<sup>99</sup> *See id.*

<sup>100</sup> *See Stotler*, 53 T.C.M. (CCH) at 978–84.

<sup>101</sup> *Id.* at 978–79.

<sup>102</sup> *See id.*

<sup>103</sup> *See Stotler*, 53 T.C.M. (CCH) at 978. The compensation provision in the easement deed was a restatement of a California code provision, and that code provision was intended to ensure that condemning authorities pay the full unrestricted value of easement-encumbered land upon condemnation. *See id.* at 978 (citing CAL. GOV'T CODE § 51095 (West 1981)). The California legislature was apparently concerned that, absent the code provision, condemning authorities might be permitted to pay only the restricted value of easement-encumbered land, which would make the land a cheap and therefore attractive target for condemnation. *But see* Nancy A. McLaughlin, *Condemning Conservation Easements: Protecting the Public Interest and Investment in Conservation*, 41 U.C. DAVIS L. REV. 1897 (2008) [hereinafter *Condemning Conservation Easements*], (arguing that conservation easements should constitute a compensable form of property under any reasonable interpretation of the Takings Clause of the Fifth Amendment to the United States Constitution). Also, while ensuring that condemning authorities are required to pay the full unrestricted value of easement-encumbered land upon condemnation is a laudable goal, depriving the easement holder and, thus, the public of the value attributable to the easement provides a windfall to the property owner at the public's expense and leaves the holder unable to replace lost conservation values. It would have been more appropriate if the compensation provision in the easement deed restated the California code provision and then required that the landowner, upon receiving the condemnation award, pay the holder the portion of the award attributable to the value of the easement.

The Tax Court disagreed with the Service, finding that the possibility that the gift would be defeated by condemnation was so remote as to be negligible.<sup>104</sup> The court pointed out that plans for enlargement of the dam had never been approved and other alternatives were considered.<sup>105</sup> The court also noted that the proposed enlargement of the dam would have necessitated condemnation of only seven of the 1,584 acres subject to the easement.<sup>106</sup> Accordingly, the court held that it could not agree with the Service “that the never-implemented possibility of the enlargement of a dam [that] would result in the condemnation of less than one-half of one percent of the property . . . should cause the denial of the deduction for the contribution of the scenic easement over the entire property.”<sup>107</sup>

A second argument made by the Service in *Stotler* was that the scenic easement was not granted in perpetuity because the landowners retained the right to petition the County of Monterey to abandon the easement.<sup>108</sup> The Service based this argument on a California code provision granting landowners the right to petition the governing body of a city or county for abandonment of an open-space easement.<sup>109</sup> The statute authorized a governing body to abandon an open space easement if (1) it found, *inter alia*, that no public purpose as described in the statute would be served by keeping the subject land as open space, abandonment was consistent with the local general plan, and abandonment was necessary to avoid a substantial financial hardship to the landowner due to unique, involuntary factors and (2) both the city or county planning commission and the governing body of the city or county held a public hearing.<sup>110</sup> The Service argued that the need for increased property tax revenues

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<sup>104</sup> See *Stotler*, 53 T.C.M. (CCH) at 978–79.

<sup>105</sup> See *id.* at 979.

<sup>106</sup> See *id.*

<sup>107</sup> *Id.* The Tax Court also noted that the Service erred in arguing that the property would revert to the donors upon condemnation because the condemning authority would end up with both the land and the easement (which would be extinguished as a result of the condemnation), and the donors “merely retained the right to be compensated.” *Id.* While it was true that the easement itself would not revert to the donors, the value attributable to the easement (i.e., the charitable gift) would revert to the donors, and the possibility of that reversion is what should be assessed under the so remote as to be negligible rule.

<sup>108</sup> See *id.*

<sup>109</sup> See *id.* at 979–80 (citing CAL. GOV’T CODE § 51093 (1983)).

<sup>110</sup> See *id.* at 979–80.

could cause the county to abandon the easement and allow development of the land.<sup>111</sup>

The Tax Court concluded that the possibility of the county's abandonment of the easement as authorized by the statute was so remote as to be negligible and, thus, that possibility did not render the easement non-deductible.<sup>112</sup> The court noted that the county could abandon the easement only if it found that no public purpose would be served by keeping the land as open space and that determination was unlikely given the significance of the property as wildlife habitat, a primary watershed, and a scenic area.<sup>113</sup> The court also noted that, in the eight to ten years prior to trial, only two easements had been abandoned under the statute.<sup>114</sup>

The holding in *Stotler* on the issue of whether an applicable state statutory termination process renders an easement nondeductible should carry no persuasive weight in interpreting the perpetuity requirements in section 170(h) and the Treasury Regulations. In *Stotler*, the Tax Court was interpreting the deduction provision in effect in 1979,<sup>115</sup> and the enactment of section 170(h) in 1980 made significant changes to the deduction provision.<sup>116</sup> Additionally, in analyzing the perpetuity issue in *Stotler*, the court focused solely on the requirement in the 1979 Code that a conservation easement be granted in perpetuity, apparently believing that the exclusively for conservation purposes requirement was irrelevant.<sup>117</sup> That belief, as Congress made clear with the enactment of sec-

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<sup>111</sup> *See id.* at 980.

<sup>112</sup> *See id.* at 979.

<sup>113</sup> *See id.* at 980.

<sup>114</sup> *See id.* at 980–81. The Tax Court distinguished *Briggs v. Commissioner*, 72 T.C. 646 (1979), and similar cases on two grounds: In those cases (1) the possibility of the happening of the event that could defeat the gift was shown to not be so remote as to be negligible, and (2) the donor imposed the condition that could cause the defeat of the gift. *See id.* at 981. While the first ground on which the court distinguished the cases was clearly relevant, the second—the genesis of the condition that could cause defeat of the gift—should not have been relevant. The so remote as to be negligible rule is intended to prevent donors from obtaining tax benefits for the donation of charitable gifts where more than a negligible chance exists that the gifts will revert to the donor or the donor's successors in interest. Whether the donor in *Stotler* imposed the condition that could have caused such a reversion or merely took advantage of an existing statute or other set of rules that set forth such condition should not have mattered. The only relevant inquiry should have been whether the gift was likely to remain in the charitable sector and, thus, was worthy of a public subsidy.

<sup>115</sup> *See id.* at 978.

<sup>116</sup> *See supra* Part II.A.

<sup>117</sup> *See Stotler*, 53 T.C.M. (CCH) at 978.

tion 170(h) and its new protected in perpetuity requirement in 1980, was incorrect.<sup>118</sup>

The conservation easement at issue in *Stotler*, which the County of Monterey could abandon (in other words, extinguish) in certain circumstances, would not have complied with the new mandate in section 170(h) that the conservation purpose of the contribution be protected in perpetuity. The easement did not expressly prohibit the transfer of the easement except (1) to another eligible donee that agreed to continue to enforce the easement or (2) in the context of a judicial approved extinguishment upon a finding of impossibility or impracticality and with a payment to the holder of at least the Treasury Regulation's required minimum percentage of proceeds to be used "in a manner consistent with the conservation purposes of the original contribution."<sup>119</sup> The donation also likely failed to satisfy the other requirements in section 170(h) and the Treasury Regulations intended to ensure that the conservation purpose of a contribution will be protected in perpetuity.<sup>120</sup>

The enactment of section 170(h) in 1980, as well as the subsequent publication of the Treasury Regulations in 1986, fundamentally changed the rules of the game with regard to tax-deductible conservation easement donations and did so in a manner intended to provide significantly greater protection of the public interest and investment in such donations. Moreover, for the reasons discussed immediately below, taxpayers should not be permitted to invoke the so remote as to be negligible rule to cure failures to comply with the new requirements for the deduction in section 170(h) and the Treasury Regulations.

(b) *Satullo v. Commissioner*

The second case in which the Tax Court applied the so remote as to be negligible rule in the conservation easement context was *Satullo v. Commissioner*.<sup>121</sup> *Satullo* involved a 1985 donation of a façade easement encumbering various units in a condominium building in Atlanta, Geor-

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<sup>118</sup> See *supra* Part II.A.

<sup>119</sup> See Treas. Reg. §§ 1.170A-14(c)(2), -14(g)(6) (as amended in 2009); see also *supra* Part II.C.1.b (discussing the restriction on transfer requirement); *infra* Part II.C.3.f (discussing the extinguishment and division of proceeds requirements).

<sup>120</sup> See *supra* Parts II.C.2, 3.a-b (discussing the no inconsistent use, general enforceable in perpetuity, and mortgage subordination requirements); *infra* Parts II.C.3.d-e (discussing the mining restrictions, baseline documentation, donee notice, donee access, and donee enforcement requirements).

<sup>121</sup> 66 T.C.M. (CCH) 1697 (1993).

gia.<sup>122</sup> The façade easement was not recorded until 1988, and the lender holding a mortgage on the building did not subordinate its rights to the rights of the easement holder.<sup>123</sup>

The Tax Court agreed with the Service that the façade easement was not deductible because the conservation purpose of the easement was not protected in perpetuity as required under section 170(h).<sup>124</sup> Because of the timing of the donation (1985) and the publication of the Treasury Regulations (1986), the court's opinion requires some explanation. The requirement in the Treasury Regulations that a lender subordinate its rights in the subject property to the right of the donee to enforce the conservation purposes of the gift in perpetuity applies only to donations made after February 13, 1986.<sup>125</sup> Accordingly, the subordination requirement did not apply to the donation in *Satullo*. Other important requirements did apply to the donation, however, including the requirement in section 170(h) that the conservation purpose of the contribution be protected in perpetuity. Because the lender had recorded its security interest in the building before the recording of the easement, and the lender did not subordinate its rights to the rights of the easement holder, the lender had a priority interest in the property and the easement was subject to extinguishment in foreclosure.<sup>126</sup> As a result, the court determined that the donors could not demonstrate that the contribution was protected in perpetuity, and the court noted that its conclusion was supported by the fact that a large percentage of the holder's easements (38%-45%) had already been lost in foreclosure proceedings.<sup>127</sup>

The court also noted, however, that the Treasury Regulations provide that a deduction for an easement donation will not be disallowed merely because the gift 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.<sup>128</sup> Because subordination was not a requirement in 1985, a showing that the possibility of a foreclosure defeating the easement was so remote

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<sup>122</sup> See *id.* at 1698.

<sup>123</sup> See *id.* at 1699.

<sup>124</sup> See *id.* at 1700.

<sup>125</sup> See Treas. Reg. § 1.170A-14(g)(2) (as amended in 2009); *supra* Part II.C.3.b.

<sup>126</sup> See *Satullo*, 66 T.C.M. (CCH) at 1701.

<sup>127</sup> See *id.*

<sup>128</sup> See *id.* at 1701 (citing to Treas. Reg. § 1.170A-14(g)(3)).



as to be negligible might have saved the deduction.<sup>129</sup> Given that the donee had already lost between 38% and 45% of its easements due to foreclosure, however, the court found that the possibility that foreclosure would similarly defeat the easement at issue in *Satullo* was far from so remote as to be negligible.<sup>130</sup>

Had the donation in *Satullo*, for which a subordination agreement from the lender was not obtained, been made after February 13, 1986, when the Treasury Regulations specifically required subordination, the deductions should have been disallowed regardless of how remote the possibility that foreclosure would defeat the easement. The specific requirements in the Code and Treasury Regulations establish bright-line rules that promote efficient and equitable administration of the federal tax incentive program.<sup>131</sup> If individual taxpayers could fail to comply

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<sup>129</sup> Such a showing would not necessarily have saved the deduction because the easement was not recorded for three years following its donation and, therefore, arguably did not satisfy the requirement in Treasury Regulation section 1.170A-14(g)(1), which provides that the interest in the property retained by the donor “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.” The court in *Satullo* noted that “Georgia law clearly provides that until an easement is recorded its intended property restrictions are legally unenforceable.” *Id.* at 1701.

<sup>130</sup> *See id.*

<sup>131</sup> For a discussion of the benefit of bright-line rules in another context, see, e.g., *Wyly v. United States*, 662 F.2d 397 (5th Cir.1981). *Wyly* involved the interpretation of Code section 267, which, in general, precludes the deduction of losses resulting from sales or transfers of property between related parties. At issue in *Wyly* were sales of stock by parents to trusts set up to benefit their children. The parents conceded that, pursuant to the terms of the trust instruments and state law, there was a remote possibility that the corpus of the trusts would revert to them (i.e., if all four of their children predeceased them leaving no descendants), and, thus, the sales were technically made between *related parties* as that term is defined in the statute. Analogizing to the so remote as to be negligible rule applicable to charitable income and estate tax deductions under Code sections 170 and 2055, however, the parents argued that the actuarially insignificant probability of the trust corpus reverting to them should not be used to defeat the deductibility of their losses. The Fifth Circuit disagreed, explaining that “the taxpayers’ argument that they are entitled to avoid the plain language of these loss disallowance provisions by arguing that they had only an actuarially insignificant chance of sharing in any of the trust property must be rejected.” *Id.* at 402. The court quoted an earlier case in which it had explained “We do not read Section 267 as seeking out devils alone. The basic legislative command of the section is that losses incurred from family transactions are not to be taxable events. This blanket approach relieves the taxing authorities of many complicated and complex melioristic decisions in family transactions. Though we do not

with such requirements and claim that their donations are nonetheless deductible because the possibility of defeat of the gift is so remote as to be negligible, the Service and the courts would be required to engage in an almost endless series of factual inquiries with regard to each individual conservation easement donation.<sup>132</sup>

In addition, when Congress desired to soften a specific requirement in section 170(h) by application of the so remote as to be negligible rule, it did so expressly. As discussed immediately below, Congress amended section 170(h) in 1984 to provide a special exception to the surface mining prohibition in cases where it can be shown, with respect to certain land, that the possibility of such mining is so remote as to be negligible.<sup>133</sup> A similar so remote as to be negligible exception is not provided with respect to the subordination or other specific requirements in section 170(h) and the Treasury Regulations. Accordingly, taxpayers should not be permitted to cure their failures to comply with such requirements by invoking the so remote as to be negligible rule. Rather, the rule should be

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applaud harsh results (though defining the result in this case as 'harsh' would be no easy task), we recognize that simplicity can be a valid congressional rationale for banning transactions by type."

*Id.* (quoting *Merritt v. Comm'r*, 400 F.2d 417, 421 (5th Cir. 1968)).

<sup>132</sup> For example, a difficult factual inquiry might have to be made to determine the probability that the gift of an easement would not be defeated despite the donor's failure to:

- (1) specify that the easement is granted in perpetuity,
- (2) record the easement in the land records of the jurisdiction in which the property is located,
- (3) obtain a subordination agreement from the lender,
- (4) restrict future transfers by the holder,
- (5) prohibit inconsistent uses,
- (6) provide baseline documentation to the holder,
- (7) agree to notify the holder of the exercise of potentially harmful reserved rights,
- (8) provide the holder with the right to enter the property at reasonable times for inspection purposes,
- (9) provide the holder with the right to enforce the easement by appropriate legal proceedings,
- (10) agree that the donation gives rise to a property right immediately vested in the donee with a minimum proportionate value, or
- (11) provide for the payment of a minimum percentage share of proceeds to the holder upon extinguishment of the easement to be used by the holder in a manner consistent with the conservation purposes of the original contribution.

<sup>133</sup> See I.R.C. § 170(h)(5)(B)(ii) (1984).

confined to assessing the probability, on the date of the donation of a conservation easement, that an act or event that is not the subject of a specific requirement in section 170(h) or the Treasury Regulations will defeat the gift.

*d. Mineral Restrictions*

Section 170(h) as originally enacted provided that, in the case of a contribution of any interest where there is a retention of a *qualified mineral interest* (defined as subsurface oil, gas, or other minerals and the right to access such minerals), the conservation purpose will not be treated as protected in perpetuity if at any time there may be extraction or removal of minerals by any surface mining method.<sup>134</sup> This surface mining prohibition presented a problem for conservation easement donations with respect to land where the mineral estate had been severed from the surface estate. In some locations, separation of the estates was common and had occurred many years before the proposed donation of the conservation easement. In addition, in many cases the often unknown owners of the mineral estate were unlikely to exercise their extraction rights because either no known mineral deposits existed or extraction of any known deposits was not commercially feasible. To permit landowners owning such severed estate lands to claim tax benefits for conservation easement donations, Congress amended section 170(h) in 1984 to create a special rule pursuant to which a deduction for the donation of a conservation easement as to severed estate lands would be allowed provided (1) the separation of the estates occurred before June 13, 1976, and (2) the possibility of surface mining occurring on the property (and consequent negative impact on the conservation purposes of the easement) was so remote as to be negligible.<sup>135</sup> In other words, Congress created a special so remote as to be negligible exception to the surface mining prohibition that applied in certain limited circumstances.

The Treasury Regulations, which were issued in 1986, incorporated the statute's limited so remote as to be negligible exception to the surface mining prohibition.<sup>136</sup> The Treasury Regulations explain that determining whether the probability of surface mining is so remote as to be negligible is a question of fact that must be made on a case-by-case basis, and relevant factors to consider include geological, geophysical, or economic

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<sup>134</sup> See I.R.C. § 170(h)(5)(B) (1980).

<sup>135</sup> See I.R.C. § 170(h)(5)(B)(ii) (1984).

<sup>136</sup> See Treas. Reg. § 1.170A-14(g)(4)(ii)(A).

data showing either the absence of mineral reserves on the property or the lack of commercial feasibility of surface mining at the time of the contribution.<sup>137</sup> The Treasury Regulations also confirmed that, if the ownership of the surface and mineral estates first became separated after June 12, 1976, no deduction was allowed unless surface mining on the property was completely prohibited.<sup>138</sup> In 1997, Congress amended section 170(h) again, this time to provide that the special so remote as to be negligible exception to the surface mining prohibition applies to severed estate lands regardless of the date on which the two estates separated.<sup>139</sup>

These mineral extraction provisions illustrate two important points. First, the so remote as to be negligible rule involves an intensely factual case-by-case inquiry. Second, when Congress and the Treasury wish to provide a special so remote as to be negligible exception to a specific requirement in the Code and Treasury Regulations, they do so expressly.

*e. Baseline Documentation, Donee Notice, Donee Access, and Donee Enforcement Requirements*

The Treasury Regulations provide that, in the case of a donation made after February 13, 1986, if “the donor reserves rights the exercise of which may impair the conservation interests associated with the property” (such as the right to extract subsurface minerals), “the donor must make available to the donee, prior to the time the donation is made, documentation sufficient to establish the condition of the property at the time of the gift” (generally referred to as “baseline documentation”).<sup>140</sup> With respect to a donation involving such reserved rights, the Treasury Regulations further provide:

- [1] [t]he donor must agree to notify the donee, in writing, before exercising any reserved right . . . .
- [2] The terms of the donation must provide a right of the donee to enter the property at reasonable times for the purpose of inspecting the property to determine if there

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<sup>137</sup> See Treas. Reg. § 1.170A-14(g)(4)(ii)(A)(3).

<sup>138</sup> See Treas. Reg. § 1.170A-14(g)(4)(ii)(B).

<sup>139</sup> See I.R.C. § 170(h)(5)(B)(ii) (1997).

<sup>140</sup> Treas. Reg. § 1.170A-14(g)(5)(i). The Treasury Regulations provide that such documentation may include maps, aerial photographs, and on-site photographs, and “must be accompanied by a statement signed by the donor and a representative of the donee clearly referencing the documentation and in substance saying ‘This natural resources inventory is an accurate representation of [the protected property] at the time of the transfer.’” Treas. Reg. § 1.170A-14(g)(5)(i)(A-D).

is compliance with the terms of the donation. Additionally, [3] the terms of the donation must provide a right of the donee to enforce the conservation restrictions by appropriate legal proceedings, including, but not limited to, the right to require the restoration of the property to its condition at the time of donation.<sup>141</sup>

These requirements are intended to ensure that donees have the information as well as access and enforcement rights needed to enforce conservation easements in perpetuity on behalf of the public.

*f. Extinguishment and Division of Proceeds Requirements*

With regard to extinguishment, the Treasury Regulations provide:

“[I]f a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation . . . can 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 [1] the restrictions are extinguished by judicial proceeding and [2] all of the donee’s proceeds (determined . . . [as described below]) 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.<sup>142</sup>

This provision is referred to herein as the “extinguishment provision.”

With regard to the division of proceeds upon extinguishment, the Treasury Regulations provide:

[I]n case of a donation made after February 13, 1986, for a deduction to be allowed . . . , at the time of the gift the donor must agree that the donation of the [conservation easement] 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

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<sup>141</sup> Treas. Reg. § 1.170A-14(g)(5)(ii).

<sup>142</sup> Treas. Reg. § 1.170A-14(g)(6)(i).

the [conservation easement] at the time of the gift, bears to the value of the property as a whole at that time.<sup>143</sup>

That minimum proportionate value, which is generally expressed as a percentage, must remain constant.<sup>144</sup> The Treasury Regulations further provide:

[W]hen a change in conditions give[s] rise to the extinguishment of a [conservation easement] under [the] paragraph [above], the donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to [the minimum] proportionate value of the [conservation easement], unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior [conservation easement].<sup>145</sup>

These provisions are collectively referred to herein as the “division of proceeds” provision.

*(1) Operation of Division of Proceeds Provision*

The division of proceeds provision is presumably intended to operate as follows. Assume that at the time of the donation of a conservation easement the value of the property unencumbered by the easement (the before value) is \$1 million, the value of the property encumbered by the

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<sup>143</sup> Treas. Reg. § 1.170A-14(g)(6)(ii).

<sup>144</sup> *See id.*

<sup>145</sup> *Id.* The Treasury cannot dictate the amount of just compensation payable under state law in a condemnation proceeding. The Treasury can and did, however, dictate that the donee must be entitled to at least a minimum percentage share of the proceeds received as a result of the extinguishment of an easement to be used to replace lost conservation values. The Treasury then exempted a donation from this requirement in the event of an involuntary conversion (i.e., a condemnation or casualty event) if state law provides that the donor is entitled to the full proceeds from such a conversion without regard to the easement. The Treasury presumably included this qualification to the division of proceeds requirement because of the existence of state statutes such as that discussed in *Stotler*, which provide that, upon condemnation of easement-encumbered land, the landowner is entitled to the full unrestricted value of the land as if the easement did not exist. *See supra* note 103 and accompanying text. It would, however, have been more consistent with the mandate in section 170(h) that the conservation purpose of a contribution be protected in perpetuity if, in such cases, the donor were required to agree in the easement deed to give the donee a portion of the condemnation award at least equal to the donee’s minimum percentage share.

easement (the after value) is \$600,000, and the value of the easement is thus \$400,000. The easement in this example represents 40% of the value of the property at the time of its donation and, according to the division of proceeds provision, (1) the donor must agree, at the time of the gift, that the donation gives rise to a property right, immediately vested in the donee, with a fair market value that is *at least* equal to that proportionate value and (2) that proportionate value, expressed as a percentage, must remain constant.

Assume also that, some years later, an unexpected change in conditions gives rise to the extinguishment of the easement.<sup>146</sup> At the time of extinguishment, the value of the land encumbered by the easement is still \$600,000, but the value of the land unencumbered by the easement has risen to \$2 million. The value of the easement is thus \$1.4 million. In this case, the easement has disproportionately appreciated in value relative to the value of the property as a whole since the easement's donation and represents 70% of the value of the property as a whole at the time of its extinguishment.

Pursuant to the division of proceeds provision, the donee must be entitled to a portion of the proceeds that is *at least* equal to the minimum percentage value of the easement established at the time of its donation (in this example, 40%).<sup>147</sup> Thus, limiting the holder's share of proceeds upon extinguishment to that minimum percentage (40% of \$2 million, or \$800,000) appears to be permissible, even though the easement appreciated in value relative to the value of the property as a whole and upon extinguishment is worth \$1.4 million.

It would be more consistent with the statutory mandate that the conservation purpose of a contribution be protected in perpetuity if, upon extinguishment, the holder were entitled to at least the minimum percentage of proceeds from the sale, exchange, or involuntary conversion of the subject property, but in no event less than the value of the easement immediately before its extinguishment, as determined by an appraisal. If that formula were applied to the facts in the example, the holder would

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<sup>146</sup> Such a change in conditions might, for example, be (1) condemnation of the subject land for use as part of a highway expansion, which would make continued use of the land for conservation purposes impossible or impractical, (2) intense commercial or industrial use of surrounding properties that renders continued use of the subject land for conservation purposes impossible or impractical, or, (3) in the case of a façade easement protecting a historic building, a casualty event, such as a fire or flood, that makes continued use of the property for historic preservation purposes impossible or impractical.

<sup>147</sup> See Treas. Reg. § 1.170A-14(g)(6)(ii).

be entitled to at least 40% of the \$2 million sales proceeds, or \$800,000, but in no event less than the value of the easement immediately before its extinguishment, or \$1.4 million. Such an entitlement to proceeds on the part of the holder would (1) be consistent with the characterization of the easement as a property right vested in the donee, (2) avoid creating perverse incentives on the part of property owners to attempt to terminate easements to benefit from the spread between the appreciated value of the easement and the minimum amount of proceeds payable to the holder upon extinguishment, and (3) be more likely to leave holders with sufficient proceeds with which to replace lost conservation values. Some holders of conservation easements already require that the easements they accept entitle them, upon extinguishment, to the greater of the minimum percentage or the appreciated value of the easement.<sup>148</sup>

The next question is what is required if a conservation easement depreciates in value relative to the value of the property as a whole after the easement's donation. Assume, in our example, that at the time of extinguishment the value of the land encumbered by the easement is \$1.5 million, the value of the land unencumbered by the easement is \$2 million, and, thus, the value of the easement is \$500,000. In this case, the easement has depreciated in value relative to the value of the property as a whole since the easement's donation and represents only 25% of the value of the property as a whole at the time of its extinguishment.

Pursuant to the division of proceeds provision, however, the holder must be entitled to a portion of the proceeds *at least* equal to the proportionate value of the easement established at the time of its donation, or 40%. Thus, upon a subsequent sale of the unencumbered property for \$2 million, the holder must be entitled to at least \$800,000 of the sale proceeds, even though the value of the easement at the time of its extinguishment was only \$500,000. In other words, the division of proceeds provision mandates that the holder receive a minimum (or floor) percentage share of the proceeds following extinguishment, regardless of any depreciation in the value of the easement relative to the value of the property as a whole after the donation. This provision may have its roots, in part, in the Treasury Department's concern about valuation abuse (i.e., overstatement of the value of easements at the time of their donation) because it helps to protect the public investment in tax-deductible ease-

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<sup>148</sup> See, e.g., Virginia Outdoors Foundation Conservation Easement Template, *supra* note 71; Maryland Environmental Trust Model Conservation Easement 14-15, *supra* note 71.



ments in the event of such abuse.<sup>149</sup> This provision also helps to ensure that the easement holder will receive sufficient proceeds with which to replace lost conservation values regardless of changes in the economic value of the development and use rights restricted by the easement.

(2) *Uniform National Requirements*

Although the extinguishment and division of proceeds provisions raise a number of interesting interpretive issues, one of the more important issues is whether those provisions represent the only way in which a tax-deductible conservation easement may be permissibly extinguished, or if states, localities, or even government and nonprofit holders are free to craft their own extinguishment policies and procedures. A number of factors, discussed below, support the argument that the extinguishment and division of proceeds provisions should be interpreted as establishing uniform national requirements for the extinguishment of tax-deductible conservation easements—requirements that may be supplemented, but not supplanted, by extinguishment policies and procedures crafted by states, localities, or individual holders.

First, if Congress had intended to grant tax benefits with respect to conservation easements that could be extinguished according to state and local policies and procedures, such as those found in the California statute at issue in *Stotler*, it presumably would have expressly done so. In section 170(h), Congress specifically deferred, at least in part, to state and local policies with regard to satisfaction of the open space conserva-

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<sup>149</sup> For example, assume a landowner donates a conservation easement with respect to land valued at \$1 million and claims a deduction based on an appraisal indicating that the value of the easement is \$800,000 (i.e., the donor claims the easement is worth 80% of the value of the land at the time of its donation). Then a number of years later, after the statute of limitations has run on the donor's deduction, the easement is extinguished in a judicial proceeding and the easement is (and likely was at the time of its donation) worth only 10% of the value of the land. Absent the minimum percentage requirement in the Treasury Regulations, the holder would receive only 10% of the proceeds upon a subsequent sale of the land (or \$100,000, assuming no change in the value of the unencumbered land) to replace lost conservation values, even though the public may have invested as much as \$400,000 in the easement in the form of foregone tax revenues (\$400,000 is the amount of income tax the donor otherwise would have paid at an assumed rate of 50% absent the \$800,000 deduction). The top marginal income tax rate when the Treasury Regulations were issued in 1986 was 50%, and this example assumes the deduction was fully claimed in the year of the donation and was not subject to any restrictions or limitations. See generally Robert A. Wilson, *Personal Exemptions and Individual Income Tax Rates, 1913-2002*, SOI BULL., June 2002, at 220, available at <http://www.irs.gov/pub/irs-soi/02inpetr.pdf>.

tion purposes test, which refers to the preservation of land “pursuant to a clearly delineated Federal, state, or local governmental conservation policy.”<sup>150</sup> But even there, Congress did not leave the decision regarding satisfaction of the open space conservation purposes test solely to state or local policy. Rather, section 170(h) requires the donor to separately establish that the donation “will yield a significant public benefit.”<sup>151</sup>

In addition, as discussed above in Part II.B, Congress specifically considered whether section 170(h) ought to include rules to address the possible extinguishment of conservation easements.<sup>152</sup> In considering this issue, Congress received testimony from land trusts explaining that perpetual conservation easements are subject to extinguishment in state court proceedings if their purposes become impossible due to changed conditions, but because of land trusts’ well-planned easement acquisition programs, such extinguishments were “most unlikely to occur.”<sup>153</sup> And a representative from one prominent land trust, speaking for nineteen such organizations, suggested that rules addressing this most unlikely of occurrences be provided in the Treasury Regulations rather than section 170(h), so as not to interfere with the main operation of the easement program.<sup>154</sup>

Instead of deferring to “clearly delineated state and local policies” or the discretion of government and nonprofit holders with regard to extinguishment, Congress provided in section 170(h) that tax-deductible conservation easements must be granted in perpetuity exclusively for one or more of the four conservation purposes enumerated in the Code and such

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<sup>150</sup> I.R.C. § 170(h)(4)(A)(iii)(II). Congress explained “this provision is intended to protect the types of property identified by representatives of the general public as worthy of preservation or conservation.” S. REP. NO. 96-1007, at 11 (1980).

<sup>151</sup> I.R.C. § 170(h)(4)(A)(iii)(II). The Treasury Regulations further provide that acceptance of a conservation easement by an agency of a state or local government “tends to establish the requisite clearly delineated governmental policy, although such acceptance, without more, is not sufficient.” Treas. Reg. § 1.170A-14(d)(4)(iii)(B). The Treasury was concerned that, while some states and localities might have a rigorous process for review of conservation easement acquisitions, others may have no process at all, or political or other factors that have very little to do with the conservation purposes of the gift might influence the process. See SMALL, *supra* note 49, at 8-5. Accordingly, the Treasury determined that permitting a conservation easement to qualify under section 170(h) based on an acceptance by a state or local government agency would be inappropriate because such acceptance might mean nothing at all. See *id.* These same concerns are relevant in the extinguishment context.

<sup>152</sup> See *supra* notes 44-45 and accompanying text.

<sup>153</sup> *Minor Tax Bills*, *supra* note 45, at 223, 245.

<sup>154</sup> See *id.*

conservation purposes must be protected in perpetuity. In the Senate Report accompanying the legislation, Congress explained that it intended to limit the deduction under section 170(h) to perpetual conservation easements that (1) preserve unique or otherwise significant land areas or structures, (2) prevent uses of the property that are inconsistent with the conservation purposes of the easement or destructive of other significant conservation interests, and (3) are enforceable by the holder against all parties in interest.<sup>155</sup>

Congress also made it clear that it intended “to limit the deduction [under section 170(h)] only to those cases where the conservation purposes will in practice be carried out.”<sup>156</sup> To that end, Congress specified that tax-deductible conservation easements must be donated only to entities that have the commitment and the resources to enforce the easements and such entities must be prohibited from transferring the easements except to other qualified organizations that agree to continue to enforce the easements.<sup>157</sup> In other words, Congress sought, through section 170(h), to subsidize the acquisition of conservation easements that would permanently protect the conservation or historic values of unique or otherwise significant properties and to restrict the ability of government and nonprofit holders to sell, trade, release, or otherwise dispose of such easements.<sup>158</sup> Congress also opted, presumably in response to the testimony of land trusts, to leave it to the Treasury to craft rules to address the most unlikely of situations, in which the continued protection of easement-encumbered land for conservation purposes becomes impossible or impractical due to changed conditions and the easement is extinguished in a state court proceeding.<sup>159</sup>

There being no hint in either section 170(h) or the legislative history of an intention on the part of Congress to defer to individual state and local policies or government and nonprofit holders with regard to the extinguishment of tax-deductible conservation easements, it was appropriate for the Treasury, in crafting the Treasury Regulations, to also not do so.<sup>160</sup> It was also appropriate for the Treasury to craft rules addressing

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<sup>155</sup> See S. REP. NO. 96-1007, at 11-14 (1980).

<sup>156</sup> *Id.* at 14.

<sup>157</sup> *See id.*

<sup>158</sup> *See supra* Part II.B.

<sup>159</sup> *See id.*

<sup>160</sup> *See, e.g.,* SMALL, *supra* note 49, at 8-4.

[T]he flexibility of the regulation writers at the IRS is limited by the congressional intent behind a statute. In [section 170(h)], Congress

the remote possibility that a conservation easement might be extinguished under state law if its conservation purpose became impossible or impractical, and to craft those rules in a manner that carries out the statutory mandate that the conservation purpose of the contribution be protected in perpetuity.<sup>161</sup> Accordingly, the extinguishment and division of proceeds provisions should be viewed as an acknowledgment by the Treasury that even expressly perpetual conservation easements may be subject to extinguishment under state law if their purposes become impossible or impractical due to changed conditions, and such donations will nonetheless be treated as protected in perpetuity as required under section 170(h) provided (1) the restrictions are extinguished in a judicial proceeding, (2) the holder is entitled to at least a minimum percentage share of the proceeds from the sale, exchange, or involuntary conversion of the property, and (3) the holder uses such proceeds “in a manner consistent with the conservation purposes of the original contribution” (in other words, to replace lost conservation values).<sup>162</sup>

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had a number of opportunities to say “Acceptance of an easement by a governmental agency satisfies the requirement of clearly delineated governmental policy,” but no hint of such a congressional attitude appears anywhere in the legislative history.

*Id.* Congress also had the opportunity to say that extinguishment pursuant to the process set forth in a state statute, such as the statute authorizing abandonment in *Stotler*, satisfies the protected in perpetuity requirement, but no hint of such a congressional attitude appears anywhere in the legislative history.

<sup>161</sup> See *supra* Part II.C.3.f.

<sup>162</sup> *Id.* This understanding of the extinguishment and division of proceeds provisions comports with that of a commentator who prepared the original drafts of the Treasury Regulations. That commentator explained that such provisions “represent[ed] a recognition by the Service that perpetual may not really be perpetual” and that “economic and natural conditions on or around a property may change, posing legal problems for a donee organization holding a once-important property right.” SMALL, *supra* note 49, at 16-4. The commentator further explained:

This section of the Regulation makes it clear to the donee organization that in such a situation the restrictions can be extinguished by judicial proceedings and the property can be sold or exchanged, as long as the subsequent application of the proceeds follows the rules of [the division of proceeds provision]. To those who suggest this may be a cumbersome way to deal with the problem, I would respond that these restrictions are supposed to be perpetual in the first place, and the decision to terminate them should not be made solely by interested parties. With the decision-making process pushed into a court of law, the legal tension created by such judicial review will generally tend to create a fair result.

*Id.*

This does not mean that federal tax law requirements preempt any requirements or conditions that state law may impose on the transfer or termination of conservation easements. Rather, it means that landowners wishing to take advantage of the federal tax incentives offered for conservation easement donations should be required to draft their easements and otherwise structure their donations to satisfy the requirements imposed under federal tax law, and any additional conditions or limitations imposed under state law should also apply and provide an added layer of protection of the public interest and investment in such gifts.<sup>163</sup> The drafters of the Uniform Conservation Easement Act (UCEA), which has been adopted in twenty-four states and the District of Columbia, recognized this, explaining in their Prefatory Note:

The [UCEA] enables the structuring of transactions so as to achieve tax benefits which may be available under the Internal Revenue Code, but parties intending to attain them must be mindful of the specific provisions of the income, estate and gift tax laws which are applicable.<sup>164</sup>

It is also worth noting that the extinguishment and division of proceeds provisions mirror the state law doctrine of *cy pres*, pursuant to which the purpose of a charitable gift may be modified (1) in a judicial proceeding, (2) upon a finding by the court that the purpose of the gift has become impossible or impractical due to changed conditions, and (3) provided the holder uses the gift or the proceeds attributable thereto for a charitable purpose similar to that specified by the donor.<sup>165</sup> The extinguishment and division of proceeds provisions are distinguishable from

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<sup>163</sup> See, e.g., JAMES WYSE, INTRODUCTION TO CONSERVATION EASEMENTS FOR THE NON-LAWYER, EASEMENT PROVISIONS IN BRIEF 7 (2007), available at <http://www.anjec.org/pdfs/EasementCD-EasementProvisionsinBrief.pdf>. Explaining the following on the Association of New Jersey Environmental Commissions website:

Under Section 170(h) of the Internal Revenue Code, a conservation easement must state that it cannot be terminated except through a judicial proceeding, and then only if the court determines it is impossible to accomplish the conservation purposes of the easement. . . .

Bear in mind that [New Jersey law] imposes *additional* newspaper notice, public hearing and [Department of Environmental Protection] approval requirements as a precondition to the “release” of all or any portion of a conservation restriction.

*Id.* (emphasis added).

<sup>164</sup> UNIF. CONSERVATION EASEMENT ACT, Commissioners’ Prefatory Note, 12 U.L.A. 165, 166 (2008).

<sup>165</sup> See generally, e.g., RONALD CHESTER & GEORGE GLEASON BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 431 (3rd ed. 2005) (discussing the doctrine of *cy pres*).

the real property law doctrine of changed conditions because of the requirement that the holder receive compensation upon extinguishment and use such compensation in a manner consistent with the conservation purposes of the original contribution.<sup>166</sup>

It is not surprising that the Treasury incorporated into the Treasury Regulations an extinguishment provision that mirrors the doctrine of *cy pres*. In the event of extinguishment of a conservation easement, the congressional mandate in section 170(h) that the conservation purpose of the contribution be protected in perpetuity can be complied with only if the holder receives proceeds attributable to the easement and uses those proceeds to replace the lost conservation values. In addition, Congress, the Treasury, and the charitable conservation organizations testifying in support of the new section 170(h) were aware of the status of tax-deductible conservation easements as charitable gifts, and were at least passingly familiar with the state laws governing the administration and enforcement of such gifts. At the congressional hearings on proposed new section 170(h), and in response to the Treasury's concern that charitable conservation organizations might not properly enforce conservation easements, nineteen land trusts submitted an appendix to their testimony in which they acknowledged the status of tax-deductible conservation easements as charitable grants and noted the power and duty of courts of competent jurisdiction and state attorneys general to enforce such grants.<sup>167</sup>

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<sup>166</sup> See RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 7.11 cmt. c (1998) (providing for the application of the doctrine of *cy pres* to conservation easements and noting that, in other instances where changed conditions lead to the termination of a servitude, such as in residential subdivisions, there is seldom an entitlement to damages).

<sup>167</sup> See *Minor Tax Bills*, *supra* note 45, at 238, 242 (Appendix to Testimony of French and Pickering Creeks Conservation Trust, the Brandywine Conservancy, and other Conservation Organizations in re H.R. 7318 on June 26, 1980). When faced with a request to terminate a conservation easement (or modify it in a manner contrary to its stated conservation purpose, such as to permit the subdivision and development of the land), courts should look to the applicable state's case and statutory law addressing the doctrine of *cy pres* or its equivalent in applying the impossibility or impracticality standard, rather than the real property law doctrine of changed conditions. Conservation easements eligible for federal charitable income, gift, or estate tax incentives are, by definition, charitable gifts. Accordingly, the policies underlying the doctrine of *cy pres*—protection of the public interest and investment in charitable assets and deference to donor intent so as not to chill future donations—are relevant. Applying the impossibility or impracticality standard under the real property law doctrine of changed conditions to the modification or termination of conservation easements would be inappropriate. That doctrine developed to adjust the rights and duties of parties to private agreements when conditions change and, as a result, generally does not recognize or protect the public

Finally, the companion article to this Article, which will be published in the Winter 2010 edition of this Journal, reinforces the conclusion that section 170(h) and the Treasury Regulations should be interpreted as establishing uniform national requirements for the creation, transfer, and termination of conservation easements—requirements that may be supplemented, but not supplanted, by the creation, transfer, and termination policies and procedures crafted by states, localities, or individual holders. The companion article discusses the over one hundred state statutes authorizing the creation or acquisition of conservation easements across the fifty states and the District of Columbia, and explains that such statutes contain widely divergent creation, transfer, and termination provisions that were not, for the most part, crafted with an eye toward complying with federal tax law requirements. The companion article discusses the negative efficiency, equity, and other policy implications associated with providing a federal subsidy for the donation of conservation easements that could be created, transferred, and terminated pursuant to widely divergent state statutory provisions—implications Congress did not consider in enacting section 170(h). The companion

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interest or investment in land use restrictions or accord deference to the intent of the restrictions' grantor. The American Law Institute recognized this when it promulgated the *Restatement (Third) of Property*, which applies a special set of rules based on the doctrine of *cy pres* to the modification and termination of conservation easements, explaining “[b]ecause of the public interests involved, these servitudes are afforded more stringent protection than privately held conservation servitudes, which are subject to modification and termination under § 7.10 [the property law doctrine of changed conditions].” See *Restatement (Third) of Prop.: Servitudes* § 7.11 cmt. a. Both the Uniform Conservation Easement Act and the Uniform Trust Code also contemplate the application of the doctrine of *cy pres* to conservation easements.

The Act leaves intact the existing case and statute law of adopting states as it relates to the modification and termination of easements and the enforcement of charitable trusts” and “independently of the Act, the Attorney General could have standing [to bring an action affecting a conservation easement] in his capacity as supervisor of charitable trusts.

UNIF. CONSERVATION EASEMENT ACT § 3 cmt., 12 U.L.A. 185 (2008).

Even though not accompanied by the usual trappings of a trust, the creation and transfer of an easement for conservation or preservation will frequently create a charitable trust. The organization to whom the easement was conveyed will be deemed to be acting as trustee of what will ostensibly appear to be a contractual or property arrangement. Because of the fiduciary obligation imposed, the termination or substantial modification of the easement by the “trustee” could constitute a breach of trust.

UNIF. TRUST CODE § 414 cmt. (amended 2000), 7C U.L.A. 512–13 (2006).

article also explains the difficulties associated with attempting to invoke the so remote as to be negligible rule or the substantial compliance doctrine to validate deductions for the donation of conservation easements that are transferable or terminable pursuant to state statutory processes and standards that differ from those under federal tax law.

### III. SWAPS

In some quarters it has been argued that holders of tax-deductible conservation easements should be permitted to engage in swaps (sometimes referred to as “trades”), which involve the removal of land from an easement’s restrictions in exchange for the protection of some other land. Proponents argue that swaps should be acceptable because they provide flexibility and do not result in any net loss of conservation value. However, a swap involves the extinguishment of an easement as to the land removed without a judicial proceeding, a finding of impossibility or impracticality, the holder’s entitlement to at least a minimum proportionate share of proceeds (whether in cash or in kind), or the holder’s required use of such proceeds in a manner consistent with the conservation purposes of the original contribution. A swap also involves a prohibited transfer of restrictions by the easement holder to the landowner, who after the swap can engage in previously prohibited uses on the newly unencumbered land. Indeed, the goal of swaps is generally to free a portion of the land from the easement’s restrictions so that such portion can be put to previously prohibited uses. The ability to remove all or a portion of land from a conservation easement also permits the destruction of significant conservation interests on the removed land and allows uses of the donor’s retained interest that are inconsistent with the conservation purposes of the donation. Accordingly, conservation easements that permit swaps do not satisfy the extinguishment, division of proceeds, restriction on transfer, no inconsistent use, or general enforceable in perpetuity requirements of the Treasury Regulations.<sup>168</sup>

Moreover, to be eligible for the federal subsidy under section 170(h), a conservation easement must satisfy one or more of the fairly elaborate conservation purposes tests as well as the myriad other requirements in section 170(h) and the Treasury Regulations at the time of its donation.<sup>169</sup> If swaps were permissible, the owner of the land and the holder of the easement could, on the day following the donation or any time thereafter,

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<sup>168</sup> See generally Part II.C.

<sup>169</sup> See generally Part II.



agree to remove ten, fifty, or even one hundred percent of the original land from the protection of the easement in exchange for the protection of some other land, and the new land and the provisions governing its protection would not have to meet the threshold conservation purposes tests or any of the other requirements in section 170(h) and the Treasury Regulations.<sup>170</sup> Permitting swaps would thus render satisfaction of the threshold conservation purposes tests and other requirements in section 170(h) and the Treasury Regulations a meaningless exercise, and the conservation purposes of tax-deductible conservation easements would not be protected in perpetuity as Congress intended.<sup>171</sup>

*Bjork v. Draper*<sup>172</sup> illustrates an attempted swap. *Bjork* involved a conservation easement that had been conveyed to a land trust as a tax-deductible charitable gift for the purpose of retaining the lawn and landscaped grounds of an historic home “forever predominantly in its scenic and open space condition.”<sup>173</sup> The easement donors later sold the land, subject to the easement, to new owners.<sup>174</sup> The land trust then agreed with the new owners to amend the easement to remove 809 square feet of the protected grounds from the easement in exchange for the new owners’ agreement to encumber 809 square feet of a lot adjacent to the original protected parcel.<sup>175</sup> The 809 square feet removed from the easement represented 3.2% of the 25,000 square feet originally protected

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<sup>170</sup> Those other requirements include, for example, specifying that the easement is granted in perpetuity, recording the easement in the land records of the jurisdiction in which the property is located, restricting future transfers by the holder, prohibiting inconsistent uses, obtaining a subordination agreement from the lender, providing baseline documentation to the holder, agreeing to notify the holder of the exercise of reserved rights, providing the holder with access and enforcement rights, and agreeing that the conveyance creates a property interest immediately vested in the donee with a minimum percentage value and that, in the event the easement is later extinguished, the holder will be entitled to at least that minimum percentage of any proceeds and will use such proceeds to replace lost conservation values. *See generally* Part II.C.

<sup>171</sup> The Service should consider making an exception for swaps that are *de minimis* in terms of both the amount of land removed from the easement and the effect of the removal on the conservation purposes of the original easement. As discussed below with regard to amendments, however, government and nonprofit holders should not be granted the discretion to agree to *de minimis* swaps unless there are mechanisms in place to ensure that they will not abuse such discretion and, thus, that the public interest and investment in the easements will be protected.

<sup>172</sup> 886 N.E.2d 563 (Ill. App. Ct. 2008), *appeal denied*, 897 N.E.2d 249 (Ill. 2008).

<sup>173</sup> *Id.* at 566.

<sup>174</sup> *See id.* at 568.

<sup>175</sup> *See id.*

by the easement.<sup>176</sup> The parties executed the swap to allow the new owners to construct a driveway turnaround on the 809 square feet of formerly protected grounds, an action expressly prohibited by the easement.<sup>177</sup>

The removal of the land from the easement at issue in *Bjork* constituted a partial extinguishment of that easement without court approval or a finding of impossibility or impracticality, as well as a prohibited transfer of restrictions to the new owners of the land, who after the amendment could engage in previously prohibited activities on the removed land.<sup>178</sup> The removal also permitted construction of a garage, carport, or other visible structure on the formerly protected land in contravention of the scenic and open space purposes of the easement.<sup>179</sup> The Illinois Appellate Court invalidated the amendment, explaining, in part:

Here, the easement set forth in section 1 that its purpose was to assure that the property would be “retained forever predominantly in its scenic and open space condition, as lawn and landscaped grounds.” Section 3 provided that this purpose would be achieved, in part, by “expressly prohibit[ing]” “[t]he placement or construction of any buildings whatsoever, or other structures or improvements of any kind.” Section 15 provided that the easement could “only be terminated or extinguished, whether in whole or in part, by judicial proceedings in a court of competent jurisdiction.”

The trial court’s construction of the easement [which validated the amendment] essentially rendered the above provisions meaningless.<sup>180</sup>

*Bjork* illustrates not only an impermissible swap but also the importance of the provisions included in tax-deductible conservation easements to comply with the requirements of section 170(h) and the Trea-

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<sup>176</sup> *See id.*

<sup>177</sup> *See id.* at 574.

<sup>178</sup> There also is no indication that the land trust obtained an appraisal of the value of the restrictions that were released or the restrictions on the other 809 square feet that were received in exchange. Accordingly, whether the land trust received the required minimum percentage share of proceeds upon extinguishment of the easement on the original 809 square feet or conveyed an impermissible private benefit to the new owners of the land is unclear.

<sup>179</sup> *See id.* at 572.

<sup>180</sup> *Id.* at 574.

sury Regulations. The language quoted above providing that the easement could only be terminated or extinguished, whether in whole or in part, by judicial proceeding is consistent with the extinguishment provision in the Treasury Regulations and was important to the court's holding that the "amendment," which removed land from the easement and thereby extinguished the easement in part outside of a judicial proceeding, was not permissible.<sup>181</sup> The court in *Bjork* did acknowledge, however, that amending a conservation easement may be appropriate in some circumstances, which Part IV addresses.<sup>182</sup>

#### IV. AMENDMENTS

Because tax-deductible conservation easements are to endure in perpetuity, or at least until circumstances have changed so profoundly that continued protection of the land for conservation purposes is no longer possible or practicable, one can reasonably assume that at least some of these instruments will need to be amended from time to time to respond to changing conditions. The requirements in section 170(h) that a conservation easement be granted in perpetuity and its conservation purpose be protected in perpetuity should be interpreted to establish the basic parameters for a permissible grant of amendment discretion to the government or nonprofit holder of the easement. The conservation purpose of an easement would not be protected in perpetuity if the holder has the discretion to amend the easement in ways that adversely impact or change such purpose. On the other hand, the conservation purpose of an easement would not be jeopardized if the holder has the discretion to agree to only those amendments that further, or are at least consistent with such purpose, provided mechanisms are in place to ensure that

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<sup>181</sup> See *id.* at 569.

<sup>182</sup> See *id.* at 572.

Although the easement sets forth that the conservation values of the property are to be protected in perpetuity, it does not logically follow that the language of the easement could never be amended to allow that to occur. Indeed, it is conceivable that the easement could be amended to add land to the easement. Such an amendment would most likely enhance the conservation values of the property.

*Id.* For a more detailed discussion of the *Bjork* case, see Nancy A. McLaughlin & W. William Weeks, Hicks v. Dowd, *Conservation Easements, and the Charitable Trust Doctrine: Setting the Record Straight*, 10 WYO. L. REV. 73, 86-88.

holders do not abuse such discretion and, thus, the public interest and investment in easements will be protected.<sup>183</sup>

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<sup>183</sup> Just what those mechanisms should be is beyond the scope of this Article. Two points are, however, worth noting. First, the Service's current requirement that nonprofit holders report their conservation easement transfer, modification, and termination activities annually as part of their Form 990 filings is of limited usefulness for the following reasons: (1) at the time the Form 990 is filed, the transfers, modifications, and terminations, whether permissible or not, have already been executed; (2) the Service lacks the authority to declare an improper transfer, modification, or termination null and void, enjoin a holder's future wrongdoing, or replace the holder with a holder that will administer the easement consistent with its stated terms and purpose—those key remedies are the province of state courts; (3) the Service can threaten a holder with loss of status as an eligible donee, revocation of tax-exempt status, or intermediate sanctions for improper transfers, modifications, or terminations, but the circumstances under which the Service could make good on such threats are unclear, and those remedies would not restore an improperly transferred, modified, or terminated easement or prevent a holder from taking similar actions with respect to the other easements it holds; (4) some holders reportedly creatively interpret the Form 990 reporting requirement to, for example, exclude swaps, regardless of the size of the acreage removed from the easement or the impact of the transaction on the conservation values of the original encumbered parcel; (5) government entities, which accept and hold thousands of conservation easements, are not subject to the reporting requirement; and (6) given the number of conservation easements encumbering millions of acres across the fifty states, the Service likely could not investigate even a fraction of the reported transfers, modifications, and terminations. See Michael Luo & Stephanie Strom, *Donors' Names Remain Secret as Roles Shift*, N.Y. TIMES, Sept. 20, 2010, A1, available at <http://www.nytimes.com/2010/09/21/us/politics/21/money.html> ("The I.R.S. division with oversight of tax-exempt organizations 'is understaffed, underfunded and operating under a tax system designed to collect taxes, not as a regulatory mechanism,' said Marcus S. Owens, a lawyer who once led that unit.").

Second, because the task of ensuring that government and nonprofit holders administer conservation easements consistent with their stated terms and purposes over the long term will fall primarily to state attorneys general and state courts, a more effective approach would be to also require holders to report their transfer, modification, and termination activities to the attorney general of the state in which the subject land is located and to do so before the transfer, modification, or termination is effected. This is not a perfect solution, as some attorneys general will be more interested in and have more capacity for oversight than others. Such notifications would, however, at least provide attorneys general with the opportunity to review proposed transfers, amendments, and terminations to ensure that such actions are either within the holder's discretion or effected through the appropriate process, such as a judicial proceeding for a termination. The New Hampshire Attorney General's Office, in collaboration with the largest land trust in New Hampshire, has issued guidance recommending that holders provide such notifications to the New Hampshire Attorney General. See *Amending or Terminating Conservation Easements: Conforming to State Charitable Trust Requirements, Guidelines for New Hampshire Easement Holders*, CTR. FOR LAND CONSERVATION ASSISTANCE, <http://clca.forestsociety.org/pdf/amending-or-terminating-conservation-easements.pdf>. In Maine, the conservation easement enabling statute, which was amended in

Many conservation easement instruments are drafted to include an amendment clause that grants the holder the discretion to simply agree with the owner of the land to amend the easement in certain circumstances. To comply with the requirements of section 170(h) and the Treasury Regulations, the typical amendment clause authorizes only those amendments that (i) are consistent with the conservation purpose of the easement and (ii) do not affect the easement's perpetual duration. Such clauses also generally provide that an amendment may not adversely affect the qualification of the easement or the status of the holder under section 170(h), the Treasury Regulations, and any applicable state law.<sup>184</sup> Such a clause should permit the amendment of a conservation easement to, for example, correct ministerial errors, add land to the easement, or eliminate development or use rights reserved by the donor. Whether such a provision will or should be interpreted to grant the holder the discretion to agree to "trade-off" amendments—amendments that both negatively impact and further the conservation purpose of the easement, but the net effect of which would arguably be consistent with or enhance the conservation purpose of the easement—is an open question.

In a report on The Nature Conservancy issued in 2005, the staff of the Senate Finance Committee explained that "[m]odifications to an easement held by a conservation organization may diminish or negate the

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2007, provides that "[a] conservation easement may not be terminated or amended in such a manner as to materially detract from the conservation values intended for protection without the prior approval of the court in an action in which the Attorney General is made a party." ME. REV. STAT. ANN. tit. 33, § 477-A.2.B (Supp. 2010).

<sup>184</sup> The typical amendment clause generally provides as follows:

Amendment. If circumstances arise under which an amendment to or modification of this Easement would be appropriate, Grantors and Grantee are free to jointly amend this Easement; provided that no amendment shall be allowed that will affect the qualification of this Easement or the status of Grantee under any applicable laws, including [state statute] or Section 170(h) of the Internal Revenue Code, and any amendment shall be consistent with the purpose of this Easement and shall not affect its perpetual duration. Any such amendment shall be recorded in the official records of \_\_\_\_\_ County, [state].

THOMAS S. BARRETT & STEFAN NAGEL, MODEL CONSERVATION EASEMENT AND HISTORIC PRESERVATION EASEMENT, 1996: REVISED EASEMENTS AND COMMENTARY FROM "THE CONSERVATION EASEMENT HANDBOOK" 22 (1996). Holders contemplating amendments must also consider the general prohibition under state law on the use of charitable assets for other than charitable purposes, the federal tax law private benefit and private inurement prohibitions (applicable to nonprofit holders), and state constitutional prohibitions on the conveyance of public assets to private persons without adequate consideration (applicable to government holders).

intended conservation benefits, and violate the present law requirements that a conservation restriction remain in perpetuity.”<sup>185</sup> The staff noted that “[m]odifications made to correct ministerial or administrative errors are permitted under present . . . Federal tax law.”<sup>186</sup> But the staff expressed concern with regard to trade-off amendments, such as an amendment to an easement that would permit the owner to construct a larger home on the encumbered property in exchange for more limited use of the property for agricultural purposes.<sup>187</sup> The staff explained that trade-off amendments “may be difficult to measure from a conservation perspective” and the “weighing of increases and decreases [in conservation benefits] is difficult to perform by TNC and to assess by the IRS.”<sup>188</sup>

In addition to the concerns expressed by the Senate Finance Committee staff, government and nonprofit holders may be subject to financial, political, and other pressures that could cause them to agree to trade-off amendments that are contrary to the conservation purpose of the ease-

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<sup>185</sup> 1 STAFF OF S. COMM. ON FIN., 109TH CONG., REPORT OF STAFF INVESTIGATION OF THE NATURE CONSERVANCY, 9 (Comm. Print 2005), available at <http://finance.senate.gov/library/prints/?id=6ef24253-998a-4052-a32a-d0520c467c2d> (last visited Sept. 25, 2010).

<sup>186</sup> *Id.* at 9 n. 20.

<sup>187</sup> *See id.* pt. 2 at 5. The type of trade-off amendment described in the text can be referred to as a trade-off “within the four corners” of a conservation easement. Another type of trade-off amendment could involve permitting a previously prohibited activity on the protected land (or a portion of that land) in exchange for adding adjacent or nearby land to the easement. That type of “outside the four corners” trade-off amendment could arguably comply with the mandate that the conservation purpose of an easement be protected in perpetuity if protection of the adjacent or nearby land would provide “spillover” benefits to the original protected land and result in a net neutral or enhancing effect on the conservation purpose of the original easement. For example, the amendment in *Bjork* could possibly have been structured as such. That is, the easement might have been amended to both (1) allow construction of the driveway turnaround on 809 square feet of the protected grounds that was not visible from the adjacent roadway, but without removing that land from the easement, and (2) add an additional 809 square feet from the adjacent lot to the easement. If the easement remained on the 809 square feet on which the driveway turnaround was constructed (and thereby continued to prohibit the construction of a garage, carport, or other visible structure on that land), the driveway turnaround was not visible from the roadway and thus did not negatively impact the scenic purpose of the easement, and the additional 809 square feet from the adjacent lot was visible from the roadway and its protection enhanced the scenic nature of the area, such a trade-off amendment arguably would have had a net neutral or enhancing effect on the open space and scenic purpose of the original easement. Appraisals would have to be obtained, however, to assess whether such an amendment would confer a net economic benefit on the landowner.

<sup>188</sup> *Id.*

ment and the public interest.<sup>189</sup> That said, in some cases trade-off amendments may provide the flexibility needed to respond to changing conditions and accommodate new uses of the land that are consistent with the conservation purposes of the easement, thereby enabling the current owners to be better stewards of the land. Accordingly, the Service could consider sanctioning an amendment provision that specifically authorizes trade-off amendments, provided the net effect of any such amendment is consistent with or enhances the conservation purpose of the original easement (that is, the conservation purpose of the easement is protected in perpetuity), and mechanisms are in place to ensure that the holder does not abuse such discretion.<sup>190</sup>

## V. CONCLUSION

Section 170(h) and the Treasury Regulations contain a complex web of requirements intended to ensure that a federal subsidy is provided only with respect to conservation easements that *permanently* protect unique or otherwise significant properties. Such requirements are also intended to ensure that, in the unlikely event changed conditions make continued use of the subject property for conservation or historic preservation purposes impossible or impractical and the easement is extinguished in a state court proceeding, the holder will receive proceeds and use those proceeds to replace the lost conservation or historic values. These requirements should be interpreted as establishing uniform national perpetuity standards for tax-deductible conservation easement donations—standards that may be supplemented, but not supplanted, by conservation easement transfer, modification, and termination policies and procedures that may be crafted by states, localities, or individual holders.

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<sup>189</sup> For example, easement holders agreeing to questionable amendments sometimes argue that they have an interest in maintaining good relations with the property owner, and the property owner is usually a subsequent owner—i.e., not the donor of the easement. Although easement holders clearly have an interest in maintaining good relations with the owners of protected properties, they owe their primary duties to the donor of the easement (to enforce the easement in accordance with its terms and stated purpose) and to the public, as beneficiary of the gift of the easement. Holders can easily lose sight of this, however, as the current owner is likely to have a loud and insistent voice, while the donor may be dead or have relocated. Moreover, because the public often has no physical or even visual access to the property, the holder may feel confident that amendments or terminations will go undetected.

<sup>190</sup> See *supra* note 183.

