NOTES

Incentivizing Conservation: Restructuring the Tax-Preferred Easement Acceptance Process to Maximize Overall Conservation Value

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The rapid development of private land in the United States has prompted a corresponding increase in the use of conservation easements as a vital element of U.S. land preservation and conservation policy. The federal government incentivizes these easements through an income-tax deduction for donations of qualifying easements to nonprofit land trusts. There are many advantages to the current structure of the tax incentive: it allows for local control of easement decisions, minimizes certain administrative costs of the program, and does not subject conservationists to reliance on the annual congressional appropriations process for easement funding. Despite these benefits, the tax deduction fails to properly incentivize conservation in some important ways. The nature of easements as partial interests in property makes valuation difficult, often resulting in an allocation of tax benefits based on lost economic development potential rather than on conservation value. Donee organizations often lack sufficient resources to enforce their easements in perpetuity, and claimed deductions are not always effectively monitored. To preserve the benefits of the current incentive structure while mitigating the primary concerns associated with the deduction, this Note proposes imposing a variable annual cap on the value of easements that may be accepted by individual donee land trusts. Structured like a financial capitalization requirement, this annual cap would increase in proportion to a land trust’s financial capacity to enforce its easements, thereby addressing each of the primary drawbacks associated with the current deduction while still retaining its crucial role as a primary federal incentive for land conservation.

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INTRODUCTION

The increasingly rapid development of private land in the United States has prompted a correspondingly similar increase in the use of conservation easements as tools of land preservation. A conservation easement is a servitude that empowers its holder to perpetually prevent the owners of the underlying land from violating the terms of the easement, which typically restrict the owner’s ability to develop the land. Incentives to encourage donations of conservation easements by private landowners exist at the federal, state, and local levels, most notably in Section 170(h)¹ of the Internal Revenue Code (the Code), which provides an income-tax deduction for taxpayer donations of perpetual property easements serving one or more statutory “conservation purposes.”² Between 2003 and 2009 (the last year for which data are available), taxpayers claimed in total more than $11 billion in tax deductions for conservation easements.³

The structure of the federal tax incentive—an income tax deduction equivalent to the fair market value of the landowner’s forsaken right to develop the property in question—has been the subject of criticism since the early days of

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¹. Subsequent references by section number only.
its enactment;\(^4\) this criticism has only intensified in recent years, as the public has become increasingly aware of seemingly abusive easement donation transactions.\(^5\) For example, in a 2009 case, *Kiva Dunes Conservation, LLC v. Commissioner*, the Tax Court upheld a golf course developer’s $29 million deduction for donation of an easement limiting future use of a golf course property to that of a *golf course*, park, or agricultural enterprise.\(^6\) In other words, the golf course owner was able to continue operating the golf course as a golf course—just as had been the case during the seven years prior to the claimed deduction—while simultaneously receiving a $29 million tax benefit deemed by the Tax Court to approximate the loss in the golf course’s property value due to encumbrance by the easement.\(^7\)

Public discomfort with tax incentives like that claimed in *Kiva Dunes* is often twofold. First, there is a perceived disconnect between the size of the tax benefit in comparison to the conservation benefits actually attained by the easement—if the *Kiva Dunes* property was going to operate as a golf course for the foreseeable future regardless of whether or not a federal tax deduction was available to its developer, there is significant doubt as to whether the deduction furthered any discernable conservation goal. Second, common sense often suggests that a taxpayer has overestimated his loss in property value due to the donated easement, thus resulting in a larger-than-deserved tax deduction. This second concern was validated with unusual clarity in a recent First Circuit decision in which taxpayers donating an easement on their home claimed a $220,000 tax deduction—based on an appraisal demonstrating the easement would decrease the property value of their home by the same amount—but were nonetheless assured that the creation of the easement was “‘very unlikely’... [to] affect the marketability of the property,” in large part because local zoning laws already provided for restrictions similar to those imposed by the donated easement.\(^8\)

Following a review of the drawbacks and virtues of the federal income tax deduction for conservation easements, this Note proposes a modification of Section 170(h) that would both preserve the benefits of administering the incentive through the tax system and mitigate some of the most significant

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7. See id. at 1187.

problems with the incentive as it is currently structured. Part I provides an overview of the current income tax deduction for conservation easements, including the statutory requirements a taxpayer must satisfy in order to qualify for a deduction. Part II outlines the primary drawbacks of the current deduction structure, including problems inherent in the easement valuation process, the inability of donee organizations to enforce easements in perpetuity, and the inability of the Internal Revenue Service (IRS) to effectively monitor claimed deductions. Despite these issues, there are benefits to administering the conservation easement incentive through the tax code rather than through a direct-spending program. Part III analyzes these benefits and provides a summary of the primary proposals that have been advanced to address the problems with the current tax deduction. Part IV proposes a new approach in which the tax incentive is left in place, but an annual cap is imposed on the value of easements that may be accepted by individual donee land trusts. By limiting the tax-deductible easement donations an individual land trust may accept to a proportion of its available enforcement resources, this proposal would allow for retention of the benefits associated with the incentive’s current structure as a tax deduction while simultaneously addressing the valuation, perpetuity, and enforcement concerns raised by the current Section 170(h) structure. Part V briefly concludes.

I. OVERVIEW OF THE TAX DEDUCTION

Section 170(h) provides a charitable income tax deduction for donations of qualified conservation contributions. An easement must satisfy three basic requirements in order to be deemed a “qualified conservation contribution”: (i) it must be donated to a qualified organization, (ii) it must be granted in perpetuity, and (iii) it must serve one or more of four statutorily prescribed “conservation purposes.” With respect to the first requirement, the qualified organization to which the easement is donated must be a governmental unit, a public charity, or a supporting organization of a public charity.

Typically, taxpayers donate easements to land trusts—public charities of varying size and scope, many with a local focus, organized to hold land and easements for conservation purposes—while retaining the underlying property and all use of the property not prohibited by the terms of the easement. The easement itself—a bundle of property rights enforceable by the land trust holding it—is a creature of state law; nearly every state has passed legislation enabling enforcement of conservation easements.

12. See id.
The second statutory requirement—perpetuity—precludes extinguishment of an easement unless the donee land trust can demonstrate that changed conditions have made using the encumbered property for conservation purposes “impossible or impractical”; even then, the land trust must use proceeds of the sale or exchange of the easement to further other conservation purposes.13

The third statutory condition requires that the donated easement further a sufficient conservation purpose. Specifically, the donated easement must advance: (i) “the preservation of land areas for outdoor recreation by, or education of, the general public,” (ii) “the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,” (iii) “the preservation of open space . . . [which] will yield a significant public benefit,” where such preservation is either for “the scenic enjoyment of the general public” or “pursuant to a clearly delineated Federal, State, or local governmental conservation policy,” or (iv) “the preservation of an historically important land area or certified historic structure.”14 Thus, although commonly referred to as a singular, “conservation easement” tax incentive, the Section 170(h) deduction is structured to incentivize four distinct types of conservation: (i) outdoor recreation or education, (ii) natural habitat protection, (iii) open space protection, and (iv) historical preservation.

Under current law, donors of most easements (for example, those for which the underlying land is long-term capital-gain property) may deduct the value of the easement to the extent of 30% of the donor’s “contribution base” (a function of adjusted gross income)15 in the year of the donation and may carry forward any unused deductions for the following five years.16 Notably, for tax years 2006 through 2011, the availability of the incentive was enhanced, with deductions in any tax year generally allowed to the extent of 50% of a donor’s contribution base (increased to 100% in the case of certain persons engaged in farming or ranching), and the carry-forward period extended to fifteen years from five.17 These temporary enhancements were an attempt by Congress to make the deduction available to taxpayers lacking sufficient taxable income to fully deduct the value of a donated easement within the standard 30%, five-year window that applies to other donations of long-term capital-gain property to public charities.

IRS data show that the total value of donated easements during years 2003 through 2009 ranged between $1.02 billion and $2.18 billion annually.18 Assum-

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15. A taxpayer’s contribution base is equal to his adjusted gross income (AGI) prior to adjustment for any net operating loss carryback. I.R.C. § 170(b)(1)(G).
ing all easement donors were subject to a 39.6% marginal rate, the annual revenue loss associated with the easement deduction ranged between approximately $400 million and $860 million during the same time period.19

II. PROBLEMS WITH THE DEDUCTION AS CURRENTLY STRUCTURED

The income tax deduction for conservation easements has been subject to criticism since the early days of its enactment.20 This Part outlines the primary problems with the incentive as it is currently structured. As discussed in further detail in the following sections, the Section 170(h) deduction is not structured in a way to encourage donation of easements with maximum conservation value, the perpetuity requirement imposed as a prerequisite to receiving the deduction is often unsatisfied, and the enforcement burden on the IRS is too high relative to the size of the tax expenditure.

A. THE INCENTIVE IS NOT STRUCTURED TO MAXIMIZE OVERALL CONSERVATION VALUE

This section analyzes the ways in which the Section 170(h) deduction fails to maximize the overall conservation value of donated easements. First, the size of the deduction—based on the fair market value of a donor’s forsaken development rights—is not tied to the donation’s conservation value. Second, the deduction overcompensates many donors and incentivizes donations in cases where development of the underlying property was not at risk. Third, additional state and local tax incentives provided to easement donors exacerbate many of the problems inherent in the structure of the federal deduction. Fourth, the difficulty of valuing partial interests in property makes easement valuations particularly prone to abuse. Finally, the incentive’s structure as a tax deduction rather than a credit means that taxpayers lacking significant taxable income are not incentivized to make easement donations.

1. The Size of the Deduction Is Not Commensurate with Conservation Value

For charitable donations of property interests, taxpayers are typically entitled to a tax deduction based on the fair market value of the donated property.21 The fair market value of full interests in real property is typically calculated based on sales of comparable properties, and this is the IRS’s preferred method of


20. Miscellaneous Tax Bills Hearing, supra note 4, at 12 (statement of Daniel I. Halperin, Deputy Assistant Secretary, Treasury Department) (“While valuation problems arise under other parts of section 170, the difficulties with valuing partial interests in real property may be particularly acute, especially where such interests have no impact on the donor’s current enjoyment of the property... [and] for a taxpayer who does not have [an] intention to sell or develop... [an easement donation] may have no material impact on the continuing enjoyment of the property...”).

valuation for donated easements. However, because there is no private market for the purchase and sale of conservation easements, data on sales of comparable easements are often unavailable. Instead, the typical process for valuing conservation easements is the “before and after” method, under which an easement is valued based on the difference between (i) the value of the property immediately prior to donation of the easement and (ii) the value of the property immediately following donation of the easement.

For example, a taxpayer who donates an easement prohibiting any development on his pasture is entitled to a deduction equal to the fair market value of the pasture without any development restrictions minus the fair market value of the pasture subject to the development restrictions. Because both the “before” and “after” calculations are based on fair market value, the value of the easement itself, at least for purposes of calculating the resulting tax deduction, is an economic value representing the right to develop the encumbered property.

This method of valuation is problematic for several reasons. First, economic development potential is not necessarily linked to the conservation value of a particular easement. Although tax deductions resulting from other types of charitable donations are at least roughly equivalent to the benefits ultimately flowing to the public through the donee charity—for instance, a donation of $100 cash increases an organization’s ability to further its charitable purposes by exactly $100—the tax deduction resulting from a conservation easement donation is not necessarily related to the conservation value it provides to the donee charity and, as a result, to the public at large.

The right to develop a small plot on an already-bustling city block may have very high economic value, and the right to develop a plot of equal size located in the rural countryside may be of little economic value. However, the conservation value of the rural plot may be far greater than that of the city plot; for

23. To the extent comparable easement sales data are available, the data are often not the product of a free market and thus are not useful for valuation purposes. See, e.g., Browning v. Comm’r, 109 T.C. 303, 319 (1997) (finding that records from a local government’s easement purchase program were not comparable because the prior transactions were structured as bargain sales).
26. See Eagle, supra note 19, at 74–75 (noting that the parting costs borne by donors of used clothing are often significantly less than the market value of the donated clothing); Halperin, supra note 25, at 38–40 (noting that although donations of certain property interests do not always result in benefits to charity exactly equivalent to the corresponding Section 170 deductions, the IRS has mitigated this concern in many areas, such as by limiting the charitable deduction to basis in the case of tangible personal property not connected with a donee organization’s charitable purposes and by limiting deductions for used cars donations to the charity’s subsequent sale proceeds).
instance, the rural plot might plausibly provide for outdoor recreation by the public, natural habitat preservation, and scenic enjoyment, while the city plot may provide for only one of these conservation objectives. Nevertheless, the lost tax revenue associated with the city plot owner’s donation of a conservation easement on his land will be far greater than the lost revenue resulting from a similar donation by the country plot owner.

One specific way in which Section 170(h) fails to optimize the overall conservation value of land subject to easement is with respect to the location of individual donated easements. Conservation experts have found that large tracts of undeveloped land provide critical conservation benefits—such as “ecological health, agricultural continuity, and . . . open spaces”—that cannot be replicated with smaller tracts of undeveloped land spread intermittently throughout developed areas.\(^\text{27}\) For example, “10,000 acres of contiguous easements typically do more to preserve critical wildlife habitat than 10 isolated easements over 1,000 acre parcels.”\(^\text{28}\) However, because Section 170(h) provides a tax deduction available equally to any landowner who wishes to donate an easement, tax incentives are provided without regard to the additional conservation value that attaches to plots of land adjacent to encumbered open spaces.

Similarly, public access is cited by some commentators as a paramount benefit provided by conservation easements.\(^\text{29}\) However, Section 170(h) provides equivalent tax benefits for encumbrances that provide public access and those that do not, such as those that qualify for a deduction based on “scenic enjoyment”—but not access—by the public.\(^\text{30}\) Although no national data are available regarding the percentage of Section 170(h) easements that provide full rights of entry to the public, a Massachusetts study showed that only 32% of the easements surveyed provided for some level of public access,\(^\text{31}\) suggesting that to the extent public access is a primary goal of the easement deduction, the statute is not currently structured to best accomplish that goal.

2. The Deduction Overcompensates Some Donors and Targets Donations Where Development of the Underlying Property Was Not at Risk

At the root of the disconnect between the conservation value of a particular easement and the tax incentive provided for its donation—based on the underlying conservation value of the land subject to easement—the statute’s overcompensation of some donors and its targeting of donations where development of the underlying property was not at risk.


\(^{31}\) See Bray, supra note 29, at 163.
ing property’s economic development value—is the taxpayer’s ability to self-structure his own easement. Section 170(h) and the related regulations provide no specific standard that an easement must satisfy in order to qualify for a tax deduction; as long as the easement fulfills one of the four statutory conservation purposes, the donor-taxpayer can retain certain development rights associated with the property, such as the ability to develop residential lots on the property, to install water and utility lines, to farm, to remove timber, and to conduct equestrian activities. This ability to self-structure means a potential donor will naturally seek to encumber those development rights she values least while retaining the rights she values most.

This result is particularly problematic given the way in which the Section 170(h) deduction is calculated. Professor Josh Eagle has demonstrated that the average tax deductions for conservation easement donations far surpass the average deduction sizes for other types of donated real and personal property. Specifically, for tax years 2003 to 2006, the average conservation easement donation was 117 times the size, in dollar value, of the average charitable donation and three times the size of the average real-estate donation. After analyzing and dismissing other possible explanations for the apparent outsized generosity of easement donors, Professor Eagle concluded that the large relative size of easement donations is due to the fact that easement donors are giving away something that is of relatively little value to them in comparison to the tax incentives they receive in return. Because donors are able to structure easements to give away only those development rights they are already unlikely to use, they are often able to obtain a significant tax benefit with little accompanying sacrifice.

Though it is true that encumbrance by a perpetual easement reduces a property’s market value and thus represents some financial sacrifice on the part of the donor, the donor is often able to significantly delay realization of the sacrifice. Although the donor gets the benefit of the tax deduction in the year the easement is donated, the lost proceeds on a future sale of the property are not internalized until that property is actually sold by the donor, by which time the time value of money may have significantly ameliorated the financial impact of the reduced sales price. For example, although Section 170(h) would provide an easement donor with a $100 tax deduction this year for a corresponding $100 reduction in the value of his property, if the donor does not sell the property for thirty years then the value in today’s dollars of his $100 sacrifice is actually less


33. See Eagle, supra note 19, at 48–49.

34. See id. at 74–82.
than $24, assuming a 5% discount rate. In other words, a full current deduction does not properly account for the reduced present values of those financial sacrifices not realized by donors until some point in the future.

Professor Eagle notes that the disconnect between conservation value and sacrifice on the part of easement donors leads to perverse results. A donor’s decision whether to donate an easement is presumably made by balancing the tax and nontax benefits of the donation against her costs of parting with the right to develop the encumbered property in the way prohibited by the contemplated easement. The lower a donor’s parting costs—that is, the less likely she was to develop the property regardless of the easement—the more likely it is that those parting costs are less than the tax benefits associated with the easement donation. Section 170(h) thus perversely provides the greatest incentive and financial benefit to those donors who were least likely to develop their land in the absence of any tax incentive. The Treasury in some cases is losing tax revenue to pay for easements on land that was unlikely to be developed anyway (at least under current ownership) and in other cases is paying much more than required to compensate the property owner for her costs of parting with the development rights at issue.

3. The Federal Deduction Is Not the Only Tax Benefit Available to Easement Donors

Many conservation easement donors realize federal, state, and local tax benefits in addition to the Section 170(h) deduction. Most significantly, a number of states provide their own income tax incentives for easement donations, many of which track federal law by granting state tax benefits only to those donations that qualify for a deduction under Section 170(h). Unlike Section 170(h), however, some states provide tax credits rather than deductions. For example, Virginia—the state that currently provides the greatest tax benefits to conservation easement donors—allows an unlimited state tax credit equal to 40% of an easement’s value. In addition, the Virginia tax credit is fully transferable, meaning that a donor lacking sufficient taxable income to utilize

35. See id. at 74.
36. See id. at 83.
37. See id. at 82.
39. See, e.g., COLO. REV. STAT. § 39-22-522(2) (2011) (providing a state tax credit only for those easements qualifying as qualified conservation contributions pursuant to Section 170(h)). But see MASS. GEN. LAWS ch. 184, § 32 (2011) (requiring approval of individual easements by a relevant arm of the state government).
40. Tax deductions and tax credits reduce taxpayer liability in different ways. A tax deduction is a reduction in the amount of taxable income on which a taxpayer is taxed. Conversely, a tax credit is applied after a taxpayer’s tax liability has been calculated and directly reduces that liability, typically on a dollar-for-dollar basis.
his easement credit can sell the credit to another taxpayer—one who does have enough taxable income to take advantage of the credit—and thus realize its full benefit.42

In addition to tax benefits provided by the states, the Code provides for a federal estate tax exclusion of up to 40% of the value of land encumbered by an easement, subject to a $500,000 cap, if certain conditions are met.43 And at the local level, donors benefit from reduced property tax liability following donation of an easement because the encumbrance reduces the market value of the underlying property. Some localities also provide additional benefits—for instance in the form of reduced property tax rates—to land encumbered by qualifying easements.44

These additional federal, state, and local incentives, which provide monetary compensation to easement donors beyond that provided by the Section 170(h) deduction, exacerbate the valuation and overcompensation problems noted in the preceding sections. A donor who qualifies for both the federal and Virginia easement incentives receives combined federal and state income tax benefits equal to approximately 75% of an easement’s value45 before accounting for any savings due to the federal estate tax exclusion and lowered property taxes. This means that in some cases, a taxpayer can actually profit from an easement donation because he receives federal, state, and local tax benefits which are in total greater than the value of the donated easement.46 In other words, a donor can recoup more than 100% of the fair market value of the donated easement through combined federal, state, and local tax saving. Considered in context with the likelihood that the Section 170(h) deduction in many cases overcompensates donors in relation to their costs of parting with surrendered development rights, the stacked benefits available to donors in certain cases further suggests that the federal government is overpaying for the conservation benefits provided to society by means of the Section 170(h) deduction.

42. See id. As one might expect, any statement regarding the benefits of transferability should be qualified by noting that easement credits typically sell at a discount from face value.

43. I.R.C. § 2031(c) (2006). Relevantly, in order for an estate to benefit from the exclusion, the original donation must have been eligible for a Section 170(h) deduction, the easement must prohibit commercial recreational activity, and the easement must have been donated by the decedent, his estate, or a family member. See id.

44. See, e.g., N.Y. TAX LAW § 606(kk)(5) (McKinney 2012) (providing an annual credit of up to $5,000 to offset property taxes paid on easement-encumbered property); OR. REV. STAT. § 308A.303 (2011) (providing property-tax benefits for owners of land designated for open-space classification); VA. CODE ANN. §§ 58.1-3230 to -3231 (2011) (providing special property-tax treatment for land devoted to agricultural use, horticultural use, forest use, and open-space use).

45. This estimation assumes a taxpayer facing a 35% marginal federal rate.

4. Easement Valuations Are Prone to Abuse

Easement valuations are particularly prone to abuse. In a normal two-party, arms-length transaction, the competing interests of buyer and seller ensure that a reported sales price approximates fair market value. In the case of easement donations, however, there is no buyer and both the donor property owner and donee land trust are incentivized to report as high a valuation as possible. The donor landowner wants to maximize his tax deduction. The donee land trust, hoping to successfully complete any given donation transaction, may naturally seek to assist the donor in obtaining his desired tax benefit, which is often the driving force behind the donation.\(^47\) Land trusts may also hope that land-rich donors pleased with sizeable tax deductions will donate additional easements in the future.\(^48\) In addition, some land trusts that require proportional cash contributions in connection with easement donations—typically to support future enforcement efforts—may attempt to maximize appraisal values as a means of increasing cash donations.\(^49\)

Beyond these misaligned incentives, easement valuations based on the before and after approach are more easily abused than standard comparable transaction valuations because appraisers using the before and after method can both underestimate the value of the property after encumbrance and overestimate the value of the property before encumbrance.\(^50\) Underestimation of the “after” property value occurs most frequently because the percentage diminution

\(^{47}\) In order to claim a Section 170(h) deduction, a taxpayer must find a qualifying charity—most typically a land trust—that agrees to accept and enforce the donated easement. § 170(h)(2)(C) (2006). A land trust can assist a taxpayer in obtaining a desired valuation either by accepting an easement donation in spite of what the land trust knows is an inflated valuation or by actively assisting the donor in obtaining an inflated appraisal. \(^^{47}\) See, e.g., Kaufman v. Shulman, 687 F.3d 21, 23 (1st Cir. 2012) (“A [land trust] representative advised the [donors] that the [land trust] could help the couple qualify for a tax deduction equal to 10 to 15 percent of the fair market value of their home and that the [land trust] ‘as part of our service . . . will be handling all the red tape and paperwork.’”)

\(^{48}\) See \(^{48}\) See \(^{48}\) See \(^{48}\) See \(^{48}\) PIDOT, supra note 11, at 31.

\(^{49}\) See \(^{49}\) See \(^{49}\) See \(^{49}\) See \(^{49}\), e.g., Donating a Conservation Easement, COLORADO OPEN LANDS, http://www.coloradoopenlands.org/site/landownerServices/donatingEasement.php (last visited Nov. 20, 2012) (noting that land trusts may “request a one-time cash contribution to endow the perpetual monitoring of the property”).

\(^{50}\) See Nancy A. McLaughlin, Conservation Easements: Federal Tax Incentives and the Meaning of Perpetuity, in ALI-ABA COURSE OF STUDY: SOPHISTICATED ESTATE PLANNING TECHNIQUES § II.B.5 (2009). It should be noted that the IRS has been working, in recent years, to address many of the valuation problems discussed herein. With respect to charitable deduction valuations generally, the Treasury has issued proposed regulations requiring a “qualified appraisal” to substantiate any valuation in excess of $500,000. See Prop. Treas. Reg. § 1.170A-17, 73 Fed. Reg. 45908 (Aug. 7, 2008). More specifically, the IRS has indicated that the “qualified appraisal” standard would not be satisfied, for instance, by an appraiser who ignored local ordinances restricting façade modification when calculating the loss in property value attributable to a historical façade easement. I.R.B. 2008-40 (Oct. 6, 2008). These proposed regulations have not yet been made final, however, and recent case law under the existing appraisal regulations suggests valuation abuse persists. \(^{50}\) See, e.g., Butler v. Comm’r, 103 T.C.M. (CCH) 1359 (2012) (finding that, because taxpayers had acted in good faith reliance on qualified attorneys and appraisers, they were not liable for accuracy-related penalties when the valuations of taxpayers’ appraisers were not upheld).
value assumed to result from the easement is based on comparable percentage diminutions of other pieces of property not similar in nature to the property being appraised.\footnote{See McLaughlin, supra note 50, at § II.B.5. Comparable sales data are often not available for property encumbered by restrictions similar to those imposed by the donated easement. “After” valuations thus tend to rely on comparisons to property with restrictions dissimilar to those imposed by the donated easement, providing an opportunity for manipulation of the “after” property value.} Overestimation of the “before” property value typically occurs when the appraiser bases the before value of the property not on comparable sales but instead on the highest and best use of the property.\footnote{See id. For example, an accepted method of determining the “before” property value for a large tract of land for which there is not reliable market data is to assume that the land is subdivided, developed, and sold in smaller lots. The number of variables that must be estimated in order to complete such an analysis often leads to manipulation of the underlying property value.}

Accepted by the Tax Court,\footnote{See, e.g., Glick v. Comm’r, 73 T.C.M. (CCH) 1925 (1997). The Tax Court determined fair market value of the “before” property value based on subdivision development method, accepting the taxpayer’s estimates of the number of lots into which property could be subdivided, the average sales price of the lots, and the time required to sell the lots. Id.} this “subdivision” form of valuation allows an appraiser to calculate the pre-easement value of a property based on its hypothetical subdivision and development.\footnote{See McLaughlin, supra note 50, at § II.B.5.c.} These valuations are necessarily dependent on the intricacies of local zoning law—a landowner could not realistically develop a residential subdivision on property lacking any water rights, for instance—but the IRS is ill-equipped to verify the multitude of local zoning assumptions often implicit in conservation easement appraisals.\footnote{See STAFF OF THE JOINT COMM. ON TAXATION, 110th CONG., OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES 285 (Comm. Print 2005), available at https://www.jct.gov/publications.html?func=startdown&id=1524; Steven T. Miller, Comm’r, Tax Exempt & Gov’t Entities Div., Internal Revenue Serv., Remarks Before the Spring Public Lands Conference (Mar. 28, 2006).} To exacerbate the problem, donor appraisals are often based on faulty assumptions that developers will benefit from pro-development changes in zoning law.\footnote{See PIDOT, supra note 11, at 27–31.} In the end, the complexity of easement valuations often results in a battle of the experts, with the IRS facing a significant disadvantage in terms of appraisal resources.\footnote{See, e.g., Butler v. Comm’r, 103 T.C.M. (CCH) 1359 (2012). In Butler, a taxpayer presented appraisals prepared by four different appraisers and attempted to impeach the sole IRS appraiser. For each of the taxpayer’s three donated easements, the Tax Court found the easement valuation to be higher than that determined by the IRS appraiser. Id.} Overall

\footnote{See, e.g., Lisa Provence, Prime Real Estate: What Will $10 Million Buy?, Hook (Jan. 21, 2010), http://www.readthehook.com/84037/cover-prime-real-estate-what-will-10-million-buy (noting that of the ten most expensive houses in Albemarle County, only four are not under conservation easement and that anecdotally, market values have not suffered due to encumbrance; rather, protection “only makes the area more desirable” (internal quotation marks omitted)).}
taxpayer compliance suffers when the Code is perceived as unfair.\textsuperscript{59} As both federal and state tax benefits have increased over the past decade, so too have instances of seemingly excessive valuations, which typically accrue to high-income taxpayers or entities under their control. Reports of overvaluations have sparked public interest,\textsuperscript{60} and although the precise impact of these inequities on overall taxpayer compliance is impossible to measure, the multitude of reported abuses suggests Section 170(h) is a net detriment to voluntary taxpayer compliance.

5. The Deduction Fails to Incentivize Taxpayers Lacking Significant Taxable Income

A primary objective in the formulation of U.S. tax policy is that the Code equitably distribute tax burden across all taxpayers. Most policymakers agree that an income tax system should treat taxpayers with equal abilities to pay equally, thus advancing horizontal equity, and that taxpayers with differing abilities to pay should be treated differently, referred to as vertical equity.\textsuperscript{61} The construction of the conservation easement incentive as a tax deduction undermines vertical equity.

First, taxpayers in lower income tax brackets are less likely than taxpayers in higher brackets to have sufficient taxable income to fully utilize the offset provided by a deduction. Although the increased allowable annual deduction and carryover period provided during tax years 2006 to 2011 mitigated this concern to some extent, those provisions expired in 2011 and have not been extended to future years. Regardless, the increased benefits did not solve the vertical equity problem in all cases, such as for a farmer who has no taxable income but does have valuable property that could be encumbered by a conservation easement. Moreover, due to the time value of money, a low-income taxpayer who requires fifteen years over which to utilize his deduction necessarily realizes a smaller benefit than does a high-income taxpayer who can utilize his entire deduction in the year in which the donation is made.

Second, the deduction is worth more to taxpayers in higher income brackets than it is to taxpayers in lower income brackets. An individual taxed at the 35% marginal rate realizes a $35 tax savings when donating a conservation easement worth $100, whereas an individual taxed at a 15% marginal rate realizes tax savings of only $15 for donating an easement of equal value. Thus, even if the taxpayer at the lower marginal rate has sufficient taxable income to utilize the full deduction to which he is entitled, he receives a smaller tax benefit than does

\textsuperscript{59} NAT’L TAXPAYER ADVOCATE, ANNUAL REPORT TO CONGRESS 411 (2008), available at http://www.irs.gov/pub/irs-util/08_tas_arc_legrec.pdf (“Studies have found that the perception that the code is unfair may reduce voluntary compliance.”).

\textsuperscript{60} See, e.g., Phillips, supra note 5; Provence, supra note 58.

the higher bracket taxpayer for an easement donation of equal value. This outcome is directly counter to the general goal of vertical equity advanced by other fundamental aspects of our tax system.

B. ALTHOUGH SECTION 170(H) PAYS TAXPAYERS FOR PERPETUAL RESTRICTIONS, PERPETUITY IS NEITHER POSSIBLE NOR REALISTIC

In order to qualify for a tax deduction, Section 170(h) requires that an easement be granted “in perpetuity.” For the perpetuity requirement to have force, donee land trusts must be willing and able to enforce easements far into the future. Easement enforcement requires that a land trust first monitor the underlying property to ensure the property owner is not in violation of the easement terms. If an easement violation occurs, state conservation statutes grant the land trust the power to enforce the easement in court against the holder of the underlying land.

Despite the Section 170(h) perpetuity requirement, neither the statute nor the regulations specify the standards an organization must satisfy in order to establish its ability to enforce in perpetuity. In addition, courts have been reluctant to read the perpetuity requirement too strictly. Easement enforcement can break down—resulting in loss of the perpetual conservation objectives that formed the justification for the original tax incentive—when the donee land trust chooses not to enforce particular easements or shuts its operations entirely. The land trust may halt enforcement due to lack of funding or capitulation to the desires of a succeeding owner of the underlying land. In many states, an easement is forfeited if the land trust fails to enforce; in other cases, state law allows for amendment of the easement upon agreement of the parties.

Despite the relatively recent proliferation of conservation easement donations, there are already many examples of land trusts failing to enforce perpetual easements, even though the donors originally benefited from federal

63. See Jessica Owley, Changing Property in a Changing World: A Call for the End of Perpetual Conservation Easements, 30 STAN. ENVTL. L.J. 121, 161 (2011). Many easements have provisions granting the easement-holding land trust the right to enter the property in order to monitor easement compliance. See id.
64. See id. at 137–38.
65. See, e.g., Land Conservation Hearing, supra note 5, at 10–11.
66. See, e.g., Kaufman v. Shulman, 687 F.3d 21, 28 (1st Cir. 2012) (finding no threat to perpetuity despite subordination of a land trust’s rights to fire insurance proceeds); Comm’r v. Simmons, 646 F.3d 6, 8–10 (D.C. Cir. 2011) (finding the perpetuity requirement was satisfied despite easement terms allowing the donee land trust to consent to changes in the easement restrictions or abandon “some or all of its rights” under the easement).
67. See Pidot, supra note 11, at 22–23 (noting that easements may also be legally forfeited when the easement holder fails to prevent foreclosure of the burdened property or fails to properly rerecord an easement with the state).
68. See Owley, supra note 63, at 156.
tax deductions.\textsuperscript{69} This trend may be a result of the rush of at least some land trusts to get “as many acres under conservation easement as possible” without regard to an organization’s capacity to enforce those easements.\textsuperscript{70}

In 2005, the Land Trust Alliance found that more than 80\% of land trusts surveyed “considered it likely that some of their holdings will \textit{not} continue to be protected in 100 years, while only 8 percent considered this unlikely.”\textsuperscript{71} Although the IRS recently enhanced tax-exempt organizations’ required reporting documents to collect information on land trusts’ monitoring resources and written monitoring policies,\textsuperscript{72} the forms pose only inquiries and do not stipulate minimum requirements. Moreover, IRS focus on land trust monitoring efforts related to a particular easement does nothing to change the fact that the easement donor has long since benefited from a tax deduction equal to the value of an allegedly \textit{perpetual} easement.\textsuperscript{73} To the extent that Section 170(h) easements are not properly monitored and enforced, tax revenue is ceded to donors of those easements in exchange for a promise of perpetual conservation that is later broken.

C. THE IRS ENFORCEMENT BURDEN IS TOO HIGH RELATIVE TO THE SIZE OF THE TAX EXPENDITURE

In addition to land trusts’ enforcement responsibilities associated with the specific terms of a given easement, the IRS plays an important role in monitoring and enforcing donor compliance with the statutory requirements of the tax deduction itself. As reports of easement deduction abuse have become more common, the IRS has significantly increased its Section 170(h) enforcement efforts.\textsuperscript{74} For example, following a spike in valuation abuse in connection with Colorado’s adoption of transferable state tax credits, it was reported that the IRS opened more than 200 audits related to Colorado easements alone.\textsuperscript{75}

\textsuperscript{69} See Sonoma Land Trust Successfully Defends Easement, LAND TRUST ALLIANCE, http://www.landtrustalliance.org/conservation/conservation-defense/conservation-defense-news/sonoma-landtrust-successfully-defends-easement/ (last visited Nov. 20, 2012) (land trust negotiated settlement with land owner allowing the owner to place dredge materials on the encumbered land in violation of the original terms of the easement); see also Owley, supra note 63, at 162 (noting a 1999 San Francisco study that found 43 violations among the 315 conservation easements surveyed).

\textsuperscript{70} Owley, supra note 63, at 161 n.168.

\textsuperscript{71} See PIDOT, supra note 11, at 18 (emphasis added).


\textsuperscript{73} See Halperin, supra note 25, at 36–38 (“Of course, the failure to enforce the easement would in most cases have no impact on the donor’s deduction.”).

\textsuperscript{74} See Miller, supra note 55, at 2.

The IRS has also adopted an aggressive litigation strategy with respect to the Section 170(h) deduction. From June 1, 2010, to May 31, 2011, charitable contributions were the tenth most commonly litigated issue in the Tax Court, and all but one of the five charitable contribution cases in which the court ruled on a valuation issue involved easement deductions.

The percentage of litigated charitable deduction valuation cases relating to easement donations is strikingly high considering that conservation easements constitute less than one percent of total claimed charitable contribution deductions. Moreover, because the IRS often faces a disadvantage in contesting easement holders on valuation—due to donors who preemptively engage the most respected local appraiser or who significantly deplete the pool of available experts by hiring multiple appraisers—the IRS primarily contests easement deductions on procedural grounds, such as failure to properly document the easement transaction or perpetuity requirement.

This is troubling for two reasons. First, the courts have not been universally receptive to these procedural arguments. Second, IRS focus on administrative inadequacies misses the larger point—in order to best serve the conservation objectives the statute aims to achieve, scarce enforcement resources should be focused on those easements with valuations that most significantly diverge from the conservation purposes they allegedly promote. In sum, Section 170(h)’s susceptibility to abuse requires that the IRS devote an outsized portion of scarce enforcement resources to investigation of easement donations; despite this focus of enforcement efforts, the IRS’s ineffectiveness in contesting valuations means that these resources are not combatting abuse of the deduction in the most effective manner possible.

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76. See David van den Berg, IRS Scrutinizing Conservation Easements, 137 TAX NOTES 19 (2012).
78. See id. at 673. Five of the twenty-seven issued opinions ruled on valuation, and four of those five cases were easement cases.
80. See, e.g., Butler v. Comm’r, 103 T.C.M. (CCH) 1359 (2012) (noting that a taxpayer presented testimony of four experts at trial but the IRS presented none); Kiva Dunes Conservation v. Comm’r, 97 T.C.M. (CCH) 1818 (2009) (noting that a taxpayer’s expert performed “more appraisal work in [the county] than any other appraiser”). This valuation disadvantage faced by the IRS may be a fundamental problem that more generally calls into question IRS and judicial reliance on appraisals for valuation in connection with Section 170(h) and other tax provisions that require valuation of property.
81. See van den Berg, supra note 76 (noting that the 2012 Tax Court decisions “largely address perpetuity, subordination, the contemporaneous written acknowledgment, and whether the appraisal . . . is qualified”).
82. See, e.g., Kaufman v. Shulman, 687 F.3d 21, 28 (1st Cir. 2012) (finding for a taxpayer in an IRS challenge to an easement on the grounds that it failed to satisfy the Section 170(h) perpetuity requirement); Comm’r v. Simmons, 646 F.3d 6, 12 (D.C. Cir. 2011) (same).
III. OVERVIEW OF PROPOSED REFORMS

This Part summarizes the primary Section 170(h) reform proposals and analyzes the extent to which each addresses the valuation, perpetuity, and enforcement concerns outlined in Part II.

A. PROPOSED REFORMS AIMED AT ADDRESSING SECTION 170(H) VALUATION CONCERNS

1. Changes that Leave the Deduction in Place but Enhance Statutory or Regulatory Requirements with Respect to Valuation

Numerous proposals address the disconnect between claimed deduction amounts and conservation value, as outlined in section II.A.1, by leaving the tax deduction in place and merely altering the statutory and regulatory requirements with respect to valuation. Certain proposals have attempted to partially address Section 170(h)’s valuation problems by eliminating altogether deductions frequently connected with the most egregious instances of abuse. For instance, the sole alteration to the easement deduction set forth in President Obama’s 2013 budget was the elimination of Section 170(h) deductions for golf-course easements.83 In a similar vein, the Staff of the Joint Committee on Taxation in 2005 proposed eliminating deductions for façade easements on personal residences,84 and Jeff Pidot has suggested abolishing the availability of deductions for easements prohibiting development solely in the donor’s backyard.85 Although adoption of these proposals would eliminate certain specific instances in which overcompensation of the donor and valuation abuse are particularly likely and would perhaps improve the public image of the program, the fundamental valuation problems underlying Section 170(h) would remain.

Other proposals have focused on valuation abuse in a broader sense. Among the changes it proposed to Section 170(h) in 2005, the Staff of the Joint Committee on Taxation suggested limiting the allowable federal tax deduction to 33% of an easement’s value.86 This was an attempt to eliminate overcompensation of the many donors who personally value their ceded development rights significantly less than the amount by which they are compensated under the current regime, which allows a deduction equal to 100% of an easement’s value.87 Though it addresses the overcompensation issue in some instances, setting an arbitrary percentage threshold fails to address the problem that any valuation based on the market value of the development rights of the...
encumbered property necessarily fails to approximate the true conservation value of that property. Moreover, as noted by Professor Eagle, leaving the current valuation system intact while decreasing the relative magnitude of the allowable deduction provides exactly the wrong incentive—those donors most likely to develop may find that the cost–benefit analysis shifts in favor of development when the available easement deduction is cut by two-thirds, whereas those donors who had no desire to develop regardless of available tax incentive would still receive a net benefit from a deduction limited to 33% of the easement’s value.88

In an attempt to target for federal incentives those easements with the highest conservation value, some experts have proposed making availability of the federal deduction contingent on some form of state or local approval mechanism.89 Massachusetts, which requires approval of individual easements by a relevant state agency,90 is often cited as a model for this approach. The primary benefit noted in favor of such proposals is that increased state or local involvement in approval of the easement would ensure that taxpayers receive at least some conservation benefit of local value in exchange for the forsaken tax revenue. As with the Staff of the Joint Committee’s 33% proposal, however, a local approval mechanism is a crude tool for approximating an easement’s conservation value. Such approval provides only a binary yes-or-no switch; although a state or locality could choose to approve only those easements satisfying a certain threshold conservation value, easements within that group would still be incentivized based on the market values of the development rights, without regard to their relative conservation values. Moreover, under such a system, the federal tax deduction would likely not be available on a consistent basis to taxpayers living in different states, and past experience suggests that not all states would provide a thoughtful review of conservation value.91

2. Proposals that Would Fundamentally Alter the Structure of the Current Tax Incentive

Several proposals have suggested a more fundamental restructuring of the federal tax incentive. For example, Professor Roger Colinvaux has proposed replacing the Section 170(h) deduction with a nonrefundable tax credit and doing away with valuation of the easement as a partial property interest

88. See Eagle, supra note 19, at 84–85.
89. See Korngold, supra note 19, at 1068–69; Jeff Pidot, Conservation Easement Reform: As Maine Goes Should the Nation Follow?, LAW & CONTEMP. PROBS., Fall 2011, at 1, 25.
90. MASS. GEN. LAWS ANN. ch. 184, § 32 (West 2012).
altogether.92 Instead, he advocates basing the amount of the tax credit on a percentage of the total value of the property prior to encumbrance, with the percentage variable based on the conservation characteristics of the donated easement.93 Under this model, easements of “high” conservation value would entitle their donors to a higher tax credit as a percentage of underlying property value than would easements of “low” conservation value.94

In contrast to replacement of the Section 170(h) deduction with a tax credit, others, including Professor Daniel Halperin, suggest replacing the deduction with a direct-grant program, administered by an expert federal agency such as the Bureau of Land Management, that would evaluate and rank proposed easement donations, allocating funds to those with the highest conservation value.95 In other words, rather than the current tax-deduction program, under which a landowner donating a qualifying easement may automatically claim the allowed deduction on his tax return, a direct-grant program would require prospective easement donors to apply for a fixed pool of government grants.96 Those easement donors whose applications were accepted would then receive grant payments directly from the government—rather than tax deductions—in exchange for their donations of the easements in question.97

These and other similar proposals at least partially address the fundamental flaw in the current deduction valuation process—namely that the size of a donor’s deduction reflects neither true conservation value nor likelihood that an unencumbered property will in fact be developed. A tax credit variable based on the underlying conservation attributes of a donated easement would explicitly align the size of a given federal tax outlay with the conservation benefits it provides to the public and in doing so would necessarily lessen the overcompensation of donors sacrificing little in exchange for their donations. A direct-spend program with a federally managed ranking system would similarly funnel federal outlays to those easements deemed to have the highest conservation value. Moreover, by moving away from a valuation system based on the

93. See id. at 49–52.
94. See id.
95. See Daniel Halperin, A Better Way to Encourage Gifts of Conservation Easements, 136 TAX NOTES 307, 311–12 (2012); Halperin, supra note 25, at 45–47. To the extent a grant program is infeasible, Professor Halperin suggests that measures be taken to “approximate the direct-expenditure approach as nearly as possible,” such as by replacing the current tax deduction with a capped tax credit program, with credits allocated by an expert agency rather than by the IRS. See Halperin, supra note 25, at 47–48; see also PARKER, supra note 28, at 20–22 (advocating for replacement of the current tax incentive with a direct-grant program, with grants allocated based on ranked applications and pursuant to a matching funds requirement).
96. Under Professor Halperin’s proposal, for example, the grant applications would be reviewed and judged—and the “winning” applications selected—by an expert federal agency, such as the Bureau of Land Management. See Halperin, supra note 25, at 45–47.
value of lost development rights, both proposals would mitigate the easement valuation abuses that currently plague administration of the deduction.

In addition, these proposals at least partially address the concerns outlined in section II.A.5, namely that Section 170(h) undermines vertical equity because its availability is dependent on a taxpayer having taxable income and its value is dependent on a taxpayer’s marginal rate.98 In contrast with a tax deduction, a nonrefundable tax credit—such as the one proposed by Professor Colinvaux—would increase vertical equity by making the tax incentive fully available to all taxpayers regardless of the magnitude of their tax liability. A refundable tax credit99 or direct-spending program would additionally ensure that the tax incentive is available to all taxpayers on an equal basis regardless of their applicable marginal rate.

3. Benefits of Administering the Conservation Incentive Through the Tax System

Although these proposals address many of the concerns with the easement deduction, there are benefits to the current structure of Section 170(h). First, elimination of the deduction in favor of a direct-spending program would force land trusts and the conservation community to rely on Congress to annually appropriate funds for the grant program.100 At best, this would result in a significant decrease in predictability for land trusts reliant on some form of federal incentive to encourage easement donations;101 at worst, subjecting easement incentives to the appropriations process could result in a temporary or permanent lapse in federal support for the donation of conservation easements.

In addition, the Section 170(h) deduction is open-ended, voluntary, and equally available to all taxpayers satisfying the statutory requirements.102 A direct-spending program or capped tax credit program,103 by contrast, would by political necessity involve allocation of a fixed dollar amount of funds. Although such a program could incorporate measures to ensure local participation in the easement approval process,104 some form of aggregate ranking or alloca-

98. See Halperin, supra note 95, at 312 (noting that “a deduction will always be an inadequate incentive for individuals who have little or no taxable income,” such as the many farmers whose land is deemed to have high conservation value by land trusts and other experts).
99. Although Professor Colinvaux formally proposes a nonrefundable tax credit in order to address concerns of “administrative complexity,” he acknowledges that “[i]n theory, the credit should be refundable.” See Colinvaux, supra note 92, at 59.
100. See Surrey & McDaniels, supra note 97, at 54–65.
101. See Eagle, supra note 19, at 87.
103. The potential revenue impact of an uncapped refundable credit likely renders it a politically unpalatable reform option. See, e.g., Colinvaux, supra note 92, at 59. Given this, it is likely that replacement of Section 170(h) with a refundable tax credit would require limiting allowable credits to a fixed dollar amount.
104. For example, a federal grant program could condition grant availability on a prospective easement donor’s ability to find a local land trust willing to accept the donated easement. See, e.g., Mass. Exec. Office of Energy & Env'tl. Affairs, Massachusetts Conservation Land Tax Credit, 2013
tion would be required at the federal level if demand for federal grant or credit dollars exceeded the annual funds appropriated by Congress. The imposition of such a federal decision-making function would counteract the benefits of local control intrinsic in the current deduction. A virtue of the current open-ended deduction is that decisions regarding which easement donations to accept are made at the local rather than federal level; a taxpayer may claim a Section 170(h) deduction so long as a qualifying land trust is willing to take on and agree to enforce the easement donation. Thus, assuming the statutory conservation purpose requirement is satisfied, the decision whether an easement has conservation value sufficient to justify use of a land trust’s enforcement resources is made by a land trust with local expertise and direct knowledge of the needs of the local community.

Moreover, a federal ranking system such as the one proposed by Professor Colinvaux would likely benefit residents of some localities more than others. For example, an incentive that valued easements for public hiking trails more highly than easements prohibiting development on farmland might benefit residents in a densely populated state, lacking significant farmland but with a population especially appreciative of hiking trails, much more than it would benefit residents of a more rural state, with significant farmland but few residents willing to donate land with public hiking access. Creating a rigid structure of approved categories at the federal level would also result in loss of the individual tailoring of easements often cited by conservation groups as a primary benefit of the existing deduction structure.

In addition, a tax deduction minimizes, in certain respects, the share of overall easement administration costs borne by the government. While it must be acknowledged that a grant-based model might involve overall savings to the...

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105. It is true that states or localities could take on primary responsibility for ranking program applicants, for instance by allocating fixed numbers of grants or credits to state agencies as is done in the low-income housing tax credit program. See Halperin, supra note 95, at 312. Even in the prototypical case of the low-income housing tax credit, however, federal law administered by a federal agency still bears on the state prioritization and allocation process. See I.R.C. § 42(h)(5) (2012) (requiring state agencies to allocate at least 10% of credits to federally qualified tax-exempt organizations); Allocating Housing Tax Credits, DEP’T OF HOUS. & URBAN DEV., http://portal.hud.gov/hudportal/HUD?src=/program_offices/comm_planning/affordablehousing/training/web/lihtc/basics/allocating (last visited Dec. 3, 2012) (noting that state agencies must prioritize projects that “serve the lowest income families” and “are structured to remain affordable for the longest period of time”).


107. Of course, preserving the role of land trusts as gatekeepers of the federal conservation easement incentive comes at a cost; experience shows that not all local land trusts can be relied upon to further conservation goals above all others, and local abuse is likely to persist if the incentive remains administered through the tax system. See, e.g., supra note 47 and accompanying text. However, given the costs of aggregate ranking of easements at the federal-agency level, as discussed herein, an incentive administered through the tax system is still preferable to one provided in the form of direct grants.
government—in comparison to the current Section 170(h) deduction—if the appropriations cap limited grant outlays to some dollar amount below the current level of claimed Section 170(h) deductions, a tax-deduction model minimizes the government’s share of overall easement administration costs in comparison to the share of costs borne by private parties.\textsuperscript{108} Although the current system requires use of IRS resources for administration and enforcement, costs of appraisal are borne by taxpayers. Monitoring costs, enforcement costs, and costs of evaluating conservation purpose are partially borne by land trusts. The IRS can rely on existing infrastructure\textsuperscript{109} and devote individual attention only to those deduction claims where satisfaction of the statutory requirements is not obvious. Imposition of an application-based grant or credit model would necessarily require at least some federal outlay to provide resources for ranking and ultimate prioritization of easement applications\textsuperscript{110} and would likely increase costs for donors and land trusts because resources would need to be devoted to grant applications.\textsuperscript{111} A competitive application process might also disadvantage those donors lacking the knowledge or resources to prepare competitive applications and appraisal packages.

One consideration mitigating against the benefits of a deduction-based approach is that the IRS is perhaps not as well equipped to analyze easement valuations—and thus enforce valuation abuse on the part of easement donors—as would be a federal agency with expertise in the valuation of land and conservation easements, such as the Bureau of Land Management.\textsuperscript{112} Under a direct-grant program, such an expert agency would manage easement valuation rather than the IRS, enabling better optimization of agency expertise. While this consideration is not without merit, adoption of the proposal outlined in Part IV would enable retention of the benefits of the tax-Incentive approach while shifting some of the burden of valuation enforcement away from the IRS and towards local land trusts, already proficient in valuing easements and conservation attributes.

\textsuperscript{108} See Halperin, supra note 25, at 45–46 (“In comparison to a direct-spending program, which would need to evaluate and rank applications in order to allocate limited funds, it seems likely that integrating the program with the tax system would minimize administrative costs.”).

\textsuperscript{109} See Surrey & McDaniel, supra note 97, at 108 (noting that tax expenditure proponents view the IRS as an “effective administrative mechanism already in place to be utilized”). Of course, it is also important to acknowledge that use of IRS resources to monitor claimed deductions is not without consequences, namely potential harm to the IRS’s other tax administration duties. See id.

\textsuperscript{110} See, e.g., Eagle, supra note 19, at 87–88; Halperin, supra note 25, at 45; Korngold, supra note 19, at 1055–56.

\textsuperscript{111} See Eagle, supra note 19, at 87.

\textsuperscript{112} A principal factor distinguishing a grant program from a tax expenditure is whether the program will be administered by the IRS or by another federal agency. See Surrey & McDaniel, supra note 97, at 117; David A. Weisbach & Jacob Nussim, The Integration of Tax And Spending Programs, 113 Yale L.J. 955, 992–97 (2004); see also Halperin, supra note 25, at 45–47 (concluding that an expert federal agency would be better equipped to value conservation easements than the IRS).
Another line of proposed reforms addresses the viability of easement donations as perpetual restrictions on development, seeking to improve enforcement and thus better correlate the value to the public of perpetual easement donations with the cost of the federal deduction. Some experts have suggested tightening the standards land trusts must satisfy in order to be eligible to accept Section 170(h) donations, such as requiring that qualifying land trusts have a threshold level of reserve funds or that donors contribute cash in connection with easements in order to fund future enforcement efforts. Along similar lines, in 2005, the Senate Finance Committee Staff proposed that the IRS be granted authority to impose excise taxes on land trust officers and directors for failure to enforce and monitor easement obligations.

Other proposals have focused on backstopping enforcement for land trusts that disband or lack sufficient resources to enforce and monitor their easements. For example, giving more state attorneys general explicit power to enforce private conservation easements would lessen the enforcement burden on struggling land trusts. Similarly, creation of state-funded backup enforcement networks or automatic transfer of unenforced easements to state agencies could avoid the problems that arise when perpetual development restrictions lapse due to donee inattention. Absent combination with other reforms, however, these proposals are insufficient because they fail to address Section 170(h)’s fundamental valuation problems, although each at least partially ameliorates the enforcement concerns outlined in section II.B.

Ideally, any reform of the federal tax incentive for conservation easements should address, as identified in Part III, each of the three primary problems associated with the current Section 170(h) deduction—its valuation approach based on economic development, the lack of perpetual enforcement in many cases, and the inability of the IRS to properly monitor claimed tax benefits—while leaving intact its current structure as a tax incentive administered by the IRS. As noted in section III.A.3, maintaining the current structure of the incentive as one administered through the tax system is preferable because it preserves the ability of donors and land trusts to adapt easements to best suit local needs (rather than having qualifying easements ranked or chosen by a federal agency), maximizes the ability of landowners and land trusts to individu-
ally tailor easements, minimizes transaction costs associated with the easement incentive program, and does not subject the program to an unpredictable annual appropriations process.

This Part sets forth a proposal that Section 170(h) be amended to impose an annual cap on the dollar value of Section 170(h)-qualifying easements a land trust may accept from donor taxpayers in any given year. Specifically, the amount of the cap should be variable by land trust and increase as a land trust’s financial capacity to enforce its easements increases. Fashioned to function in a manner similar to that of a financial capitalization requirement, the purpose of such an annual cap is threefold and addresses each of the current Section 170(h) problems outlined in Part II. First, an annual cap would force those land trusts currently taking on annual easements in excess of their permitted caps to rank proposed easement donations and reject acceptance of the lowest ranked easements, presumably those with the lowest conservation values. As explained further below, this would address many of the valuation problems inherent in the current Section 170(h) structure while maintaining individual choice and local control of easement decisions. Second, because the amount of easements a land trust could take on in any given year would increase in proportion to the land trust’s financial capacity to enforce those easements, the annual cap would ensure that easements are donated only to those land trusts able to enforce the easements in perpetuity. Third, an annual cap would shift administration of the statutory “conservation purposes” test to land trusts and away from the IRS, allowing the IRS to focus its attention instead on an area that it already has the expertise and capacity to monitor—the financial status of land trusts.

A. THE PROPOSAL ADDRESSES VALUATION PROBLEMS INHERENT IN SECTION 170(H)

With respect to the valuation problems posed by Section 170(h), imposing an annual cap on land trust donees’ ability to accept easements offers several advantages. Rather than accepting all easement donations without regard to their relative conservation benefits in an attempt to get “as many acres under conservation easement as possible,” the imposition of an annual cap would force land trusts to weigh the relative benefits of each proposed easement donation against the costs of accepting the easement. (Here, the costs to the land trust would be equal to the appraised value of the easement because the appraised value would decrease on a dollar-for-dollar basis the remaining easement donations a land trust could accept before hitting the annual cap.) Because many land trusts would be forced to reject at least some proposed easement donations, a market for the acceptance of easement donations would effectively be created, which would necessarily force easement valuations to better approximate conservation value.

For example, an easement donor who hopes a land trust with capped ability

117. Owley, supra note 63, at 161–168; see also supra note 70 and accompanying text.
to accept easements will accept his donation will not be solely incentivized by the desire to increase his easement appraisal and resulting tax deduction. Rather, because the availability of the deduction would be dependent on the land trust’s determination that the donor’s easement is a better relative conservation value than other proposed easement donations, the donor would be at least partially incentivized to ensure that his appraised easement value bore some connection to the conservation attributes of the easement. Moreover, the land trust’s incentives with respect to appraisal value would no longer be aligned with the donor’s. Rather, the donee land trust would be incentivized to obtain the lowest possible appraised value for the easement because this would free up its capacity to take on other easements before hitting the annual cap. These contradicting incentives with respect to appraisal value would allow the easement valuation process to better approximate a market transaction than is currently the case under Section 170(h).

Imposition of an annual cap could be accomplished most straightforwardly by layering the cap on top of the existing Section 170(h) tax deduction for individual donors. However, to the extent Congress wished to address the existing deduction’s failure to fully incentivize donations by taxpayers lacking significant taxable income, imposition of the annual cap could be accompanied by replacement of the Section 170(h) deduction with a tax credit program. Given the problems of vertical equity outlined in section II.A.5, implementing the annual cap in connection with replacement of the Section 170(h) deduction with a tax credit would be the most preferable course. Absent legislative appetite for replacement of the current deduction with a credit program, however, implementation of the annual cap in connection with existing Section 170(h) would still address the most significant of the problems plaguing the current incentive.

The optimal manner in which to address such a credit’s impact on federal tax revenue is outside the scope of this Note. However, the ability of Congress, under the proposal set forth herein, to adjust the annual cap on easement donations would provide a workable lever by which to control revenue on an ongoing basis should a credit be adopted in connection with imposition of an annual cap.

Beyond addressing many of the valuation problems posed by Section 170(h), this proposal also has the benefit of leaving the relative ranking of different easements’ conservation benefits in the hands of local land trusts. Rather than imposing tighter conservation standards at the federal level or allowing a federal agency to rank and accept certain easements—which, as explained in section III.A.3, might benefit some regions at the expense of others and would limit local tailoring and individual choice—local land trusts would be free to accept easements tailored to individual donors’ specific needs, so long as the resulting easement was of sufficient conservation value to the local community. Moreover, if forced to choose between easements, land trusts—relying on local knowledge and expertise—would likely take into account the extent to which
proposed easement properties were likely to be developed in the absence of any tax incentive, giving preference to those properties most likely to be developed in the near term.118

B. THE PROPOSAL ADDRESSES SECTION 170(H)’S PERPETUITY REQUIREMENT

By tying the size of the annual cap on easements a land trust may accept to its financial capacity to enforce those easements, the proposal would increase the likelihood that donated easements would be enforced in perpetuity, thus ameliorating one of the primary concerns with the current Section 170(h) deduction. Specifically, the annual cap could be set to a fixed numerical factor of the annual cash donations raised by a land trust that are available to be used for future easement enforcement and monitoring (the qualifying liquid donations). For example, land trusts could be limited to accepting total annual Section 170(h) easement donations not in excess of three times the value of their qualifying liquid donations.119 Most fundamentally, this aspect of the annual cap would ensure that land trusts do not take on many more easements than they have the capacity to enforce—a frequent reality of the current tax incentive, which wastes foregone tax revenue by paying for easements that are enforced for only a short period of time rather than in perpetuity.

This aspect of the annual cap would incentivize land trusts to raise cash donations earmarked for future easement enforcement because increasing the amount of qualifying liquid donations would directly increase the quantity of easements a land trust was eligible to accept in any given year. This might well result in an increasing number of land trusts that require donors to offer cash in connection with easement donations. Further, capping the ability of individual land trusts to accept easements based on their financial capacity to enforce those easements would put land trusts with the greatest enforcement resources at an advantage. Because those land trusts would have higher annual caps, they would be able to accept more and higher value easements. Prospective easement donors would thus be naturally steered to donate to these better capitalized land trusts, resulting in a greater concentration of easements held by land trusts with sufficient enforcement resources.

118. For example, when forced to accept only some easement donations available to it, a land trust focused on protecting open space from commercial development would likely discount the relative value of a donor’s proposed donation of a development easement on his backyard or golf course because development of either tract of land would be unlikely in the near-term.

119. The applicable factor could initially be set to keep the cost of lost Section 170(h) tax revenue approximately constant in comparison with that of recent years and could then be adjusted in future years as necessary. Alternatively, the factor could initially be set based on an estimate of the present value of funds necessary to enforce an easement in perpetuity. To protect land trusts from the uncertainty that might result from short-term swings in qualifying liquid donations collected in any given year, the applicable factor could be based on a rolling five-year average of a land trust’s qualifying liquid donations. Cf. I.R.C. § 4942(i) (2006) (stating that the private foundation mandatory distribution requirement allows for calculation of the required annual distribution amount based on a rolling five-year average).
C. THE PROPOSAL CORRELATES DEDUCTION ENFORCEMENT WITH EXISTING IRS CAPABILITIES

As outlined in Part II, in addition to land trust enforcement concerns related to the Section 170(h) perpetuity requirement, one problem with the current easement incentive structure is that the IRS is not well equipped to contest easement-valuation appraisals. By shifting IRS enforcement efforts to a cap based on cash donations raised by Section 501(c)(3) land trusts, the annual cap proposal would allow both the IRS and land trusts to focus on their relative areas of expertise. The IRS has significant experience evaluating the financial viability of Section 501(c)(3) public charities. Adding a single additional data point—annual qualifying liquid donations—to the existing annual reporting requirements of nonprofit land trusts, which are already under the purview of the IRS Tax Exempt and Government Entities Division, would not be an overly burdensome administrative change. Evaluation of a financial data point such as a land trust’s annual qualifying liquid donations is exactly the type of accounting determination the IRS is able and best equipped to enforce. Moreover, imposition of a cap on the overall value of easements a land trust can accept would incentivize land trusts to negotiate fairer easement values than are agreed to under current law. In effect, the cap would incentivize land trusts to help police easement valuation abuse by donors, an area land trusts—many of them familiar with local land attributes and zoning restrictions—are much better equipped to handle than is the IRS.

D. ADDRESSING POTENTIAL DRAWBACKS OF THE PROPOSAL

One potential criticism of this proposal is that land trusts that raise significant cash contributions might be unaffected by the imposed cap. For instance, in the example above in which land trusts were limited to accepting annual easements of aggregate value not in excess of three times their qualifying liquid donations, a cash-rich land trust consistently raising qualifying liquid donations in excess of the dollar value of easements it accepts in any given year would not be directly affected by the imposed cap. One answer to this criticism is that the proposed cap is still an improvement over the current system. Though the cash-rich land trust might not be directly affected by the cap, other land trusts with fewer resources would be affected and thus forced to better account for conservation value of accepted easement donations.

In addition, the cash-rich land trust is better positioned than is a resource-strapped land trust to enforce its easements in perpetuity, so there is less risk that a donation it accepts will fail to provide perpetual value to taxpayers. Moreover, because resource-strapped land trusts will not be able to accept donations from all prospective easement donors, some donors turned away by

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120. See generally Boris I. Bittker & Lawrence Lokken, Federal Taxation of Income, Estates and Gifts § 100 (1999).
resource-strapped trusts may naturally seek acceptance of their donations by a cash-rich land trust. If enough prospective donors so gravitated, the cash-rich land trust would ultimately become susceptible to the easement donation cap.\footnote{Implicit in this analysis is an assumption that the cash-rich land trust would accept at least some easement donations from prospective donors turned away by the resource-strapped land trust.}

Regardless, a higher percentage of total easement donations would be directed toward land trusts with greater enforcement resources—an important and necessary benefit of any proposed Section 170(h) reform.

Another concern is that even if a land trust has sufficient financial resources, it might fail to engage in meaningful monitoring and enforcement of the easements under its purview.\footnote{A useful inquiry in this regard would be a study of whether lack of enforcement on the part of land trusts results more often from lack of resources or, alternatively, lack of desire to engage in meaningful monitoring. Available information—such as documentation of IRS review of land trusts’ tax-exempt status—suggests that neither lack of resources nor lack of desire to engage in meaningful monitoring is the sole cause of monitoring deficiencies and that the two are often intertwined. See, e.g., I.R.S. Priv. Ltr. Rul. 11-10-020 (Mar. 11, 2011) (denying a land trust tax-exempt status due in part to lack of “resources and... staff to monitor the conservation easements” and in part to demonstrated lack of commitment to conservation purposes); I.R.S. Priv. Ltr. Rul. 11-09-030 (Mar. 4, 2011) (denying a land trust tax-exempt status due to failure to properly monitor with no mention of the organization’s available resources); I.R.S. Priv. Ltr. Rul. 10-48-045 (Dec. 3, 2010) (denying a land trust tax-exempt status due in part to lack of “sufficient resources to fund effective monitoring or enforcement efforts”); I.R.S. Priv. Ltr. Rul. 10-44-026 (Nov. 5, 2011) (revoking a land trust’s tax-exempt status due in part to lack of “financial resources to enforce the easements” and in part due to failure to ensure easement contributions served a statutory-conversation purpose). IRS-exempt status determinations, however, likely represent some of the most egregious cases of insufficient monitoring; more robust study in this area would be a helpful contribution to the general effort to improve the current easement incentive regime.}

The annual cap proposal addresses this concern to some extent by incentivizing land trusts to increase cash donations, which would result in increased reliance on cash donors and accountability to a broader range of local constituencies than under the current system. With more stakeholders invested in its success, a land trust might find it more difficult to shirk its enforcement duties.\footnote{See \textit{PARKER}, supra note 28, at 22.}

Even if such a land trust nevertheless failed to sufficiently enforce its easements, under the annual-cap proposal, more local stakeholders would be on hand to lobby for enforcement through other available—although currently underused—means.

For example, although exercised sparingly to date, the IRS has the authority to revoke the tax-exempt status of a land trust that fails to fulfill its charitable purposes by neglecting easement enforcement.\footnote{See \textit{Treas. Reg. §§ 1.501(c)(3)-1(c)(1), 1.170A-14(c) (1983); see, e.g., I.R.S. Priv. Ltr. Rul. 10-48-045 (Dec. 3, 2010).}

Similarly, although not widespread, some states provide for third-party enforcement of easements in cases where the responsible land trust fails to enforce.\footnote{See, e.g., Jessica E. Jay, \textit{Third-Party Enforcement of Conservation Easements}, 29 Vt. L. Rev. 757, 771–79 (2005) (noting, for example, that the Mississippi Attorney General has standing to enforce conservation easements, Illinois has a statute granting similar authority to local governments, and the.
ensure the annual cap proposal achieves the enforcement objective it is designed to address. In addition, basic procedural reforms adopted at the state level simultaneously with implementation of the annual-cap proposal—for example, a requirement that conservation easements be registered with the state and made publicly available in a registry format—could provide a further check on land trust enforcement efforts.

Finally, land trusts with dual charitable purposes might try to avoid the imposed annual restriction by artificially increasing their qualifying liquid donations, for example by padding a qualifying liquid donations account with funds earmarked for a charitable purpose other than conservation easement enforcement. While this risk is likely to be present with regard to capitalization requirements imposed in any industry or context, the concern in this case is mitigated by the IRS’s significant experience in monitoring special-purpose funds of tax-exempt entities. Enforcement of the Code provisions governing nonprofit organizations already requires the IRS to differentiate between distinct asset designations within single entities, as is the case, for example, with respect to certain intermediate sanctions imposed on private foundations. This expertise on the part of the IRS ensures it is well-positioned to monitor segregated funds earmarked for easement enforcement and to identify and curb any potential abuse of land trusts’ reporting of qualifying liquid donations.

CONCLUSION

The deduction for conservation easements is difficult to enforce and prone to abuse. Valuations based on lost economic development potential do not correlate with conservation value and in some cases result in significant overcompensation of easement donors. Moreover, the IRS is ill-equipped to successfully contest certain forms of valuation abuse. Although the unique benefits provided by the conservation easement deduction are conditioned on the expectation of perpetual conservation benefits, donee organizations often lack the resources and incentives to actively enforce donated easements.

Various proposals have been set forth to address one or more of these concerns with the current deduction. Although many proposals provide an improvement over the status quo, few address all three of the primary concerns outlined in Part II. Those proposals that do provide a comprehensive approach to reform do so by replacing the Section 170(h) deduction with a capped credit or grant.

Maryland Attorney General maintains an active role in easement enforcement despite lack of any specific statutory authority.

126. See, e.g., Pidot, supra note 11, at 12 (noting that recording easements in state registries “would enable long-term tracking and scrutiny, which is especially important if the easement holder ceases to exist or fails to perform its responsibilities”).

127. See, e.g., I.R.C. § 4942(e)(1)(A) (2006) (requiring segregation of foundation assets used “directly in carrying out the foundation’s exempt purpose”); I.R.C. § 4944(c) (requiring distinction between a foundation’s “program-related investments” and other jeopardizing investments).
program. However, there are benefits to retaining the incentive’s current form as a tax deduction.

To preserve the benefits of the current tax deduction while mitigating the three primary concerns plaguing its success, this Note proposes imposition of a variable annual cap on the value of easements that may be accepted by individual donee land trusts. Structured to function in a manner similar to that of a financial capitalization requirement, the annual cap would limit the tax-deductible easements a land trust may accept in proportion to the enforcement resources available to the land trust and in doing so would address the valuation, perpetuity, and enforcement concerns inherent in the current deduction structure.