

Amending Grants of Conservation Easement



Legal Considerations for Land Trusts

This guide informs easement holders of legal matters to consider under Pennsylvania law and the Internal Revenue Code when making decisions regarding the amendment of grants of conservation easement.

Content and Relationship to Other Guidance 1

Basic Constraints on Amendment 2

Freedom to Amend 2

Holder Duties under the Grant 3

Legal Constraints 3

General Rules for Amendment, Release or Termination of Grant 3

Amendment of Grant 3

Release of Easement 4

What Is Being Enforced? What is Being Amended? 4

Enforcement 4

Differentiating Amendments That Do or Do Not

Raise Enforcement Issues 5

Responsibilities for Amendment Decisions 6

Duty to Manage Charitable Assets Responsibly 6

Board Generally Must Approve 7

Fiduciary Duty of Directors to Make a Business

Judgment in Good Faith 7

Risks to Holder's Status as a Qualified Organization under IRC Charitable Gift Rules 8

Commitment to Protect 8

Resources to Enforce 9

Risks to Holder's Status as a Tax Exempt Charity under IRC Charitable Exemption Rules 9

Private Inurement 10

Private Benefit 12

Application to Easement Amendments 12

Illustration of Application of Qualitative and Quantitative Tests 13

Quantitative Test Invalid as Applied to Easement Amendments? 14

Administrative Rule Must Be Consistent with Statute and Regulations 14

Quantitative Test Disregards Public Benefit 15

Before-and-After Valuation Inappropriate for Purposes of Weighing Public vs. Private Benefit 15

Consideration of Non-monetary Public Benefit is Required by IRC Charitable Exemption Rules 17

Harmonize Quantitative Test with Other Avenues of Inquiry to Evaluate Permissible (or Impermissible) Private Benefit 17

Apply Standard Applicable to Excess Benefit Transactions 17

Apply Standard Applicable to Private Inurement Inquiry 18

Apply the Private Benefit Test so as to be Consistent with Governance Responsibilities of Directors 18

Strategies to Minimize Risk of Adverse Consequences to Holder 18

Indemnity 18

Agreement to Unwind 19

Opinion of Tax Counsel 19

Letter Ruling 19

Attorney General No-action Letter 19

Resources at ConservationTools.org 19

Content and Relationship to Other Guidance

This guide informs easement holders of legal matters to consider regarding the amendment of grants of conservation easement. It examines Pennsylvania law, including the Conservation and Preservation Easements Act (the "CPEA"),¹ and the Internal Revenue Code (the "IRC"), specifically the charitable exemp-

¹ The Pennsylvania Conservation and Preservation Easements Act, the act of June 22, 2001 (P.L. 390, No. 29) (32 P.S. §§5051-5059) was enacted in its final form as House Bill 975, PN 2294. <http://conservationtools.org/guides/show/89>.

tion² and charitable gift³ rules administered by the Internal Revenue Service (the “Service”). The guide [The Nature of the Conservation Easement and the Document Granting It](#)⁴ addresses basic concepts critical to an understanding of this guide and the terms contained within.⁵ Together, these guides provide the legal basis for the provisions set forth in the [Model Conservation Easement Amendment Policy](#).⁶

Basic Constraints on Amendment

An inquiry into legal considerations begins with basic questions:

- *Freedom to amend.* May Pennsylvania landowners and easement holders⁷ change the legal document⁸ by which they, or their land ownership interests, are bound?

² 26 IRC §501(c)(3), accompanying regulations, and guidance pertaining to private benefit and private inurement rules published online by the Internal Revenue Service will be referred to in this guide as the “IRC charitable exemption rules.”

³ 26 IRC §170(h) and accompanying regulations will be referred to in this guide as the “IRC charitable gift rules.”

⁴ The “[Nature of the Conservation Easement](#)” for short. Pennsylvania Land Trust Association (2014). <http://conservationtools.org/guides/show/138>.

⁵ Readers are urged to review the concepts covered in the [Nature of the Conservation Easement](#) in part because a number of terms are sometimes misused or defined within the frameworks of bodies of law (contract law or trust law) that are inapplicable to the law governing conservation easements and other servitudes—the law of servitudes.

⁶ Pennsylvania Land Trust Association (2014). http://conservationtools.org/libraries/1/library_items/1317.

⁷ Easement holders are referred to in this guide as “holders.” Only governmental entities and land trusts meeting specific criteria may be holders under the CPEA (§2).

⁸ The legal document by which a conservation easement is granted to holder is referred to in this guide as the “grant.” [Nature of the Conservation Easement](#) explains that the grant is not the conservation easement but rather the instrument used to convey the property interest which is the conservation easement; as reviewed later in the guide, an amendment of the grant may or may not change the conservation easement.

- *Holder duties under the grant.* Is the freedom of holder to amend the grant constrained by standards contained within the grant and, if so, who has the power to enforce applicable standards safeguarding enforceability of the easement in perpetuity?
- *Legal standards.* What other legal standards may be applicable to amendment decisions and what are the potential consequences to holder of failing to abide by these standards?

Freedom to Amend

The terms of any recorded document affecting Pennsylvania real estate may be changed by recordation of an amendment of such document signed by the parties to the original document or their successors in interest. The text of the grant may be changed the same as any other real estate document.

- *Beneficiary may intervene.* A holder of third-party enforcement rights⁹ (called in the Model Grant and this guide, a “beneficiary”¹⁰) may seek to enjoin or set aside an amendment entered into without such beneficiary’s approval if the

⁹ A *third-party right of enforcement* is defined in §3 of the CPEA as “a right provided in a conservation easement to enforce any of its terms, granted to a governmental body, charitable corporation, charitable association or charitable trust, which, although eligible to be a holder, is not a holder.”

¹⁰ The beneficiary of a servitude is the person benefited by an easement or covenant running with the land. The beneficiary of a trust is the person for whose benefit the trustee holds and administers the trust property. These are two separate concepts. It is illogical to conclude that because a conservation easement has a beneficiary and a trust has a beneficiary, then a conservation easement must be a kind of trust subject to equitable trust principles. The issue of whether the grant creates a public trust is discussed in the guide [Not a Public Trust: The Land Trust-Held Conservation Easement in Pennsylvania](#) published by the Pennsylvania Land Trust Association at <http://conservationtools.org/guides/show/136>. The issue of whether the grant creates a charitable trust is discussed in the guide [Not \(Usually\) a Charitable Trust: The Conservation Easement in Pennsylvania](#) published by the Pennsylvania Land Trust Association at <http://conservationtools.org/guides/show/137>.

amendment impairs the interest of beneficiary in the easement.

- *Original grantors may not intervene.* Individuals who granted the conservation easement but no longer own any of the eased property are not recognized as the holder of a third-party right of enforcement with respect to the easement; and are not afforded access to Pennsylvania courts to intervene in any matter affecting the conservation easement.¹¹

Holder Duties under the Grant

The holder of a conservation easement holds a property interest of perpetual duration in the land itself. The grant operates not only to convey this interest to the holder but also to establish certain covenants running with each of the concurrent interests held, respectively, by holder and landowners. The covenants running with holder's interest in the land (the "holder covenants") may safeguard the public interest in the long-term viability of conservation easements with inclusion of one or more of the following:

- *Safeguard on transfer.* A covenant not to transfer holder's interest in the conservation easement to anyone not eligible to be a holder under Pennsylvania law and the charitable gifts rules under the IRC.
- *Safeguard on extinguishment.* A covenant to assure that holder is entitled to proceeds of a condemnation or other extinguishment of the easement in an amount commensurate with the value of the easement and will invest those proceeds in furtherance of its conservation purposes.
- *Safeguard of conservation purposes.* A covenant to enforce the conservation easement in furtherance of its conservation purposes.
- *Forfeiture remedy.* A limitation on holder's interest in the conservation easement allowing a court of competent jurisdiction to cause a forfeiture and a

transfer to a successive holder if the holder fails to abide by these covenants.

Legal Constraints

The Attorney General, if not named as a beneficiary in the grant, may petition the court of competent jurisdiction to recognize it as an intended beneficiary of the holder covenants. In addition, as explained in [Nature of the Conservation Easement](#), the Attorney General has oversight authority over charitable assets, including conservation easement assets, to prevent squandering, waste and dissipation.

If the holder, by amending the grant, confers impermissible benefits to the landowners, the IRS charitable exemption rules may be applied to jeopardize the status of the holder as an exempt organization. This guide reviews these rules (the private benefit rule and the private inurement rule) in detail.

General Rules for Amendment, Release or Termination of Grant

Subject to the legal constraints on amending grants of conservation easements discussed below, the general rules governing amendment, release or termination of grants of conservation easement under Pennsylvania law are as follows:

Amendment of Grant

Pennsylvania law

Pennsylvania law permits amendment of the grant as any other real estate document.¹² Amendments of real estate documents are recorded in the public records of the county in which the land is located and are binding upon the signatories to the amendment and their successors and assigns as owners of their respective interests in the land described in the amendment.¹³

¹¹ See the guides [Nature of the Conservation Easement](#), [Who Has Standing?](#) and [Holders, Beneficiaries and Backup Grantees](#), all published by the Pennsylvania Land Trust Association at <http://ConservationTools.org>, for additional discussion of beneficiary and standing issues.

¹² The CPEA provides in §4(a) that "a conservation easement ... may be ... modified, terminated or otherwise altered or affected in the same manner as other easements."

¹³ 21 P.S. §42 *et seq.*

Grant provisions regarding amendment

A grant may place limitations on a landowner and holder's freedom to amend the grant. For example, the 6th edition of the [Model Grant of Conservation Easement and Commentary](#) (the "Model Grant")¹⁴ allows amendment of the grant at the discretion of holder and the approval of owners, provided:

that the Amendment is consistent with and in furtherance of the Conservation Objectives; will not result in any private benefit prohibited under the Code; and otherwise conforms to Holder's policy with respect to Amendments.¹⁵

Release of Easement

Pennsylvania law permits release of the conservation easement and termination of covenants as any other real estate document.¹⁶ However, other legal considerations discussed in this guide bear on the holder's decision to take such action. The content of this section is limited to formal requirements of Pennsylvania law.

Voluntary release and termination

If a conservation easement is to be released in whole or in part, the conveyancing procedure to evidence on the public records the reversion of that interest back to the landowners is to record a release of the conservation easement as to the land described in such release.¹⁷ A properly drafted release will also include a termination of the covenants included in the grant as applied to the land described in the release.

¹⁴ Pennsylvania Land Trust Association (2011).

http://conservationtools.org/libraries/1/library_items/323.

¹⁵ Ibid at §5.03.

¹⁶ CPEA §4(a).

¹⁷ Conveyancing procedures are mentioned here to correct a misconception that has crept into amendment discussions. A "swap" of land subject to an easement is not the exchange of one legal description of the eased property for another. The land area no longer subject to the easement must be released from the easement by the holder. Concurrently, the landowners grant and convey an easement on the replacement land area to holder. The parties then confirm the new legal description as the eased property. The use of recognized conveyancing procedures is important not only for clarity of the public records but also to ensure that the parties recognize that a swap involves the release of land from the operation of the grant.

Involuntary release by exercise of power of eminent domain

A conservation easement, like any other real estate interest, may be taken by lawful exercise of the power of condemnation or right of eminent domain¹⁸ or by a voluntary purchase and sale in lieu of condemnation.¹⁹ The holder is entitled to just compensation as provided by law or, if a particular allocation of damages is provided in the grant, in accordance with the agreed upon allocation.²⁰

Holder has no obligation under Pennsylvania law to contest a taking of eased property by eminent domain.²¹ The Model Grant provides holder with the right to receive condemnation proceeds commensurate with the easement value as per the IRC charitable gift rules. The IRC charitable gift rules do not require holders to contest governmental takings of eased property by the power of eminent domain. The decision to contest, or not, is a decision in the purview of the holder's board based upon facts, circumstances, costs and benefits of the taking in question.

What Is Being Enforced? What is Being Amended?

Enforcement

Amendment discussions often center on concerns for enforcing conservation easements in perpetuity. But what does it mean to enforce an easement?

The conservation easement is an interest in the land. As discussed in [Nature of the Conservation Easement](#), the interest may be described, in plain language, as the power to block land uses within a particular land area that are inconsistent with the conservation purposes of the easement. Enforcing the easement means to exercise the power conveyed to holder to conserve the land in accordance with the purposes of the easement as set forth in the grant. This enforcement is not continuous with enforcing perpetual adherence to the

¹⁸ CPEA §5(d)(1)(i).

¹⁹ CPEA §5(d)(1)(ii).

²⁰ CPEA §5(d)(2).

²¹ CPEA §5(d).

covenants contained in the original grant. These covenants *potentially* can be changed without detriment to the conservation purposes set forth in the grant and hence without diminishment or change to the conservation easement itself.²²

Differentiating Amendments That Do or Do Not Raise Enforcement Issues

An amendment to the grant—the instrument that established the conservation easement—may or may not change the conservation easement. As such, it may or not raise enforcement issues. The central questions in analyzing a potential amendment are:

1. Whether the amendment may be reasonably expected to materially affect one or more of the key components of the definition of a conservation easement; and
2. If so, whether the effect is adverse to or supportive of the conservation objectives.²³ The different standards applied to different types of amendments under the [Model Conservation Easement Amendment Policy](#) are tied to this initial, and very important, determination. A potential amendment that would materially and adversely affect a conservation easement raises far greater concerns and requires far greater scrutiny than other amendments.

Does the change affect key components of the definition of a conservation easement?

An amendment to the grant materially and adversely changes a conservation easement if it:

- Inhibits holder's *power* to act swiftly and decisively to block activities, uses and improvements inconsistent with conservation objectives or changes

²² Moreover, the concept of easement enforceability in perpetuity under the IRC charitable gift rules refers to preserving the long-term viability of the holder's power to block inconsistent land uses. That result may be achieved whether or not the text of the original grant is preserved.

²³ From this point forward, the conservation purposes of a particular easement are usually referred to as "conservation objectives" so as to differentiate them from the generic conservation purposes described in the IRC charitable gift rules.

one or more of the holder covenants so as to preclude a beneficiary from exercising remedies to preserve the viability of holder's easement power. Examples:

- An amendment that bars entry to the property without the consent of the landowners regardless of exigent circumstances;
- An amendment that relieves holder of any responsibility to enforce the easement in perpetuity;
- An amendment that removes an identified beneficiary from the grant.
- Materially changes the description of the *particular land area defined as the eased property* such that it releases, or otherwise fails to protect, land material to the maintenance and attainment of conservation objectives. Example:
 - An amendment that releases eased land in exchange for a grant of easement on a different parcel changes the easement.²⁴

²⁴ The swap may or may not be material depending upon the acreage released and the conservation values (if any) associated with the released land. The conservation value of the land proposed to be substituted is important to determine whether the exchange is in the best interest of holder in light of its charitable mission and purpose; however, it is irrelevant for purposes of determining whether the proposed release changes the easement and, if so, whether the change is adverse or neutral to or supportive of the conservation objectives.

Example: A release of all or substantially all of the eased property materially changes the land area subject to the easement and is adverse to the conservation objectives inasmuch as the released property is afforded no protection. On the other hand, a release of a few feet along the property line upon which a neighbor's driveway encroaches is not a material change to the eased area and is neutral to achievement of conservation purposes.

Example: A release of all or substantially all of the eased land by taking in condemnation for construction of a public highway is a material change in the easement and is adverse to the conservation objectives. However, a taking of additional right-of-way along a public road for installation of underground public utilities may not be material or, if it is, the temporary disturbance followed

- Abandons one or more *conservation objectives*²⁵ of the easement. Example:
 - Elimination of the objective to preserve natural habitat within a woodland (for example, to allow conversion to agricultural land) is material and, if preservation of natural habitat remains feasible, adverse to achievement of conservation objectives.
- Makes changes to landowner covenants²⁶ of the grant that are detrimental to the achievement of the *conservation objectives*. As discussed in [Nature of the Conservation Easement](#), the landowner covenants set out the program of land uses that are understood by the granting landowner and the holder at the time of the grant to be consistent or inconsistent with the conservation purposes of the easement. Examples:
 - An amendment that permits subdivision and residential development on five-acre lots is a material diminution of holder's power to block land uses inconsistent with the conservation ob-

by restoration of natural features in accordance with an approved plan may be found neutral to or supportive of the conservation objectives.

This discussion pertains to changes in the description of the eased land *by amendment*; it does not address swap provisions contained in the original grant. Courts have found that grants that authorize the removal of land from the easement in exchange for other land do not meet IRC charitable gift rules that require the easement to protect a specific property in perpetuity in order to qualify for a tax deduction under §170. *Belk v. Commissioner*, 140 T.C. 1 (2013), *aff'd*, 774 F.3d 221 (4th Circuit 2014); *Balsam Mountain Investments, LLC. et al. v. Commissioner*, T.C. Memo- 2015-43 (March 12, 2015).

²⁵ The viability of the easement's conservation objectives is key to enforceability in perpetuity. Thus, to reduce the scope of the easement by eliminating a conservation objective that remains pertinent and viable with respect to the eased property is a material change to the easement and is adverse to achievement of its conservation objectives.

²⁶ The landowner covenants clarify the operation of the easement but are not, themselves, the conservation easement. In the Model Grant the landowner covenants comprise the text of Article II Transfer, Subdivision, Article III Improvements, and Article IV Activities and Uses.

jective of protecting scenic views of undeveloped fields and meadows. On the other hand, an amendment does not affect holder's power to block inconsistent land uses if the change is to move a building envelope from one site agreed to be consistent with conservation objectives to another site consistent with the same objectives.

- Regarding a conservation easement with the conservation objective of preserving natural woodland habitat, an amendment that would allow for intensified logging operations regardless of impact on the habitat is detrimental to the achievement of the conservation objective. On the other hand, replacing the forestry practices stipulated in the grant with management practices newly identified for optimal preservation of natural woodland habitat and endorsed by reputable conservation professionals may be of no detriment to the conservation objectives.

Is the effect adverse to or supportive of conservation objectives?

If there is a change that affects a key component of the nature of a conservation easement, the change may or may not be detrimental to the long-term viability of the conservation easement as a tool to protect natural and scenic resources. This inquiry requires the exercise of the good judgment of the holder's board after considering the facts and circumstances of the particular proposed change.

Responsibilities for Amendment Decisions

Duty to Manage Charitable Assets Responsibly

Charitable organizations are required to manage their assets so that they are used for charitable purposes and not squandered, wasted or dissipated.²⁷ The Attorney General has the right, and duty, to protect the

²⁷ This topic is more fully discussed in [Nature of the Conservation Easement](#).

interest of the public in the assets of a charity.²⁸ These standards apply to all charitable assets including conservation easements. [Nature of the Conservation Easement](#) provides examples of how an irresponsible amendment decision may violate one or more of the standards and be subject to an enforcement action by the Attorney General.

Board Generally Must Approve

Conservation easements are interests in real property. As such, modifications of grants of conservation easement held by land trusts are real property transactions subject to Title 15 §5546 “Purchase, sale, mortgage and lease of real property” of the Pennsylvania Consolidated Statutes. This law provides that real estate transactions are governed by the bylaws of the corporation just like any other transaction. As a general rule, any transaction outside the ordinary course of business of the organization must be brought before the board for approval. An amendment would fall into this category in most circumstances.²⁹

²⁸ It is the well-settled law of the Commonwealth that the Attorney General is responsible for the public supervision of charities through his *parens patriae* powers. *In re Milton Hershey School Trust*, 807 A.2d 324 (Pa.Cmwlth.2002); *In re Estate of Coleman*, 456 Pa. 163, 317 A.2d 631 (1974). The Commonwealth has *parens patriae* standing whenever it asserts quasi-sovereign interests, which are interests that the Commonwealth has in the well-being of its populace. *Commonwealth v. TAP Pharmaceutical Products, Inc.*, 885 A.2d 1127 (Pa.Cmwlth.2005). “In every proceeding which affects a charitable trust, whether the action concerns invalidation, administration, termination or enforcement, the Attorney General must be made a party of record because the public as the real party in interest in the trust is otherwise not properly represented.” *In re Pruner’s Estate*, 390 Pa. 529, 532-33, 136 A.2d 107, 110 (1957). It is the duty of the Attorney General to ensure that the purpose of the charity remains charitable. Consequently, the Attorney General always has standing in any case involving a charity. See *In re Milton Hershey School*, 867 A.2d 674, 685 (Pa. Cmwlth. 2005) (reversed on other grounds. For more information, see [Who Has Standing?](#)

²⁹ See the guide [Authorization of Real Estate Transactions](#), published by the Pennsylvania Land Trust Association at

Fiduciary Duty of Directors to Make a Business Judgment in Good Faith

When a proposed amendment is submitted to the board as an action item, the directors have the duty to consider and respond to it in compliance with the standard of care required of all corporate directors³⁰. The standard of care required of directors is the fiduciary obligation to the holder to make a business judgment in good faith.³¹

Duty of individual directors

The board, acting as a whole, governs the organization but this rule applies to each director individually. Those who serve as directors are personally bound to exercise their own good faith business judgment in casting their vote to approve or reject a proposed amendment.

Highest standard of faithfulness to the holder

The duty of a director is as a fiduciary — someone who must always put the interests of the holder above any other concern. Policies directed at preventing conflicts of interest help to define situations that may be warning signs of the possibility that a director may, purposely or inadvertently, breach this duty. Several legal rules discussed later in the guide are targeted at preventing directors from benefiting themselves or other private interests rather than the public interest that the holder was created to serve. The overarching principle is that directors may consider a number of views but, in the last analysis, they must act for the good of the holder and no one else.

Example. In the course of debating an amendment, a director observes that it does not conform with voluntary standards established by a third party (for example, *Standards for Excellence* managed by the Pennsylvania Association for Nonprofit Organizations, *Land Trust Standards and Practices*

<http://conservationtools.org/guides/show/103>, for an in-depth discussion of nonprofit rules and processes.

³⁰ Hazen, Thomas Lee, *Punctilios and Nonprofit Corporate Governance*, U. of Pennsylvania Journal of Business Law, Vol. 14, No. 2 at p.375 (2012) (hereafter referred to as “Hazen”).

³¹ ALI’s Principles of Nonprofit Law §365 quoted in Hazen, p. 379.

published by the Land Trust Alliance or rules established by the Land Trust Accreditation Commission). The directors *can and should consider this information* (and possible repercussions) in their deliberations about what action the holder should take but, if their judgment is that the amendment is in the best interests of the holder given the entirety of the facts and circumstances, *their fiduciary duty to the holder must prevail over the voluntary third party standard*. Again, this is not to say that a third party standard can't be taken into account in the analysis and deliberation, only that it must not supersede the judgment of a director and, collectively, the decision of a board.

Duty to be informed

The law requires that the director be informed with respect to the subject of the business judgment to the extent he or she reasonably believes to be appropriate under the circumstances. The [Model Conservation Easement Amendment Policy](#) furnishes guidance as to the scope of inquiry and information gathering needed to inform the directors of the facts and circumstances underlying each proposed amendment brought to the board for action.

Duty to act in best interest of charity in furtherance of its charitable mission

The requirement to act not only in the best interest of the organization but in furtherance of its mission is what distinguishes the business judgment required of a director of a charitable organization from that of a for-profit corporation. In the case of the easement holder deciding an amendment issue, the directors must act to advance the land trust's charitable mission to conserve natural and scenic resources.

Example. Developer offers, in exchange for eased property, a substitute conservation easement on another property, which has far more significant natural and scenic resources than the eased property. The offer furnishes the holder with the opportunity to do other, more significant projects, as well as conserve natural and scenic resources of greater value. Using the director's business judgment, the proposal is reasonable and even advantageous. But the director of a charitable or-

ganization must go one step further: is the proposal in the best interests of the holder in light of its charitable purposes to protect natural and scenic resources? Is the proposal consistent with the charitable purpose of the holder if it denies protection to an eased property? This is a difficult question but one thing is clear—a proposal meeting the business judgment standard may not be consistent with the charitable organization standard.

Directors are in best position to make amendment decisions

Both law and custom in Pennsylvania support the principle that the directors are in the best position to make decisions for the holder—including amendment decisions. Directors are individually held to a high standard of faithfulness to make responsible, well-informed, reasonable decisions on all matters affecting the holder, including amendment decisions.

Risks to Holder's Status as a Qualified Organization under IRC Charitable Gift Rules

Donations of conservation easements only qualify as charitable donations under the IRC charitable gift rules if they are donated to a qualified organization. A qualified organization is a tax-exempt charity or governmental entity that: first, has the commitment to protect the conservation purposes of the donation; and, second, has the resources to enforce the conservation restrictions.³²

Commitment to Protect

Holder's commitment to protect the conservation purposes of the donation is demonstrated in any number of ways, some of which may have bearing on holder's easement amendment decisions. There is no particular formula required under the IRC charitable gift rules. Listed below are items that may support a finding that the holder meets the first prong of the qualified organization test.

³² IRC § 170(h)(3) and Treas. Reg. § 1.170A-14(c).

- The statement of corporate purposes set forth in the Articles of Incorporation forming the holder.
- The mission statement adopted by the holder.
- Policies adopted by the holder setting standards for its practices and procedures for acquiring and managing its easement assets, including suggesting changes to, or responding to requests for change to, existing grants so as to maintain the easement’s long-term viability safeguarding the resources described in the conservation purposes of the easement.³³
- Past practices of holder indicating its commitment to use, as and when necessary, its power to block land uses inconsistent with the conservation purposes of the easement.
- Inclusion of meaningful holder covenants in its grant (i) requiring holder to enforce the easement in furtherance of its conservation purposes in perpetuity and (ii) providing for perpetual enforceability by beneficiaries qualified to be successive holders and, if none is available or willing, the Attorney General.

Resources to Enforce

There is no guidance furnished under the IRC charitable gift rules to answer the question “how much is enough?” regarding resources to enforce the conservation restrictions. As applied to easement amendment decisions, the following inquiries may be relevant to the issue:

- Has easement stewardship been adequately funded in the past? If not, a request for amendment may be an opportunity to correct the shortfall.

³³ The fact that a grant is amended means nothing by itself. A change to the text of the grant may strengthen the power of the holder to protect natural and scenic resources of the eased property and enhance the long-term viability of the easement. The change to the text may gut the enforceability of the easement or render it impossible to protect those conservation values. Or it may not affect the easement at all. Holder’s policy and practices pertaining to amendments over time have some evidentiary value indicating its commitment to manage all of its easements, whether donated or not, responsibly with a goal of long-term viability.

- Will the change to the grant necessitate additional spending or monitoring or added risk of incurring enforcement expenses?
- Are easement beneficiaries having rights of approval over the change willing to fund easement enforcement if needed?³⁴
- One of the considerations for the board in evaluating a change to the grant is the benefit of settling a dispute versus the cost of litigating the matter and the likelihood of an outcome adverse to conservation purposes. One of the purposes of this cost-benefit analysis is to assure that, after the dispute is settled by an amendment to the grant, adequate resources will be available when needed to enforce other easements.

Risks to Holder’s Status as a Tax Exempt Charity under IRC Charitable Exemption Rules

Provisions in the laws and regulations applicable to qualification of organizations for exemption from federal income tax require the organization not only to state in its application the public interest it is committed to serving but to see that it *continues to operate to serve that charitable purpose*. Thus, to remain qualified for tax-exempt status for federal income tax purposes, an organization recognized as a charitable organization under IRC§501(c)(3) (hereafter referred to as a “charitable organization”) must use its charitable assets (which includes the conservation easement) to serve the public interest—not for the interests of private persons.

Two rules have been derived from the text of IRC§501(c)(3) that, if violated, may result in revocation of the tax-exempt status of a charity.³⁵ These are the

³⁴ See [Holders, Beneficiaries and Backup Grantees](#) for an in-depth discussion of agreements among holders, beneficiaries and back-up grantees.

³⁵ Would the Service revoke the tax-exempt status of a land trust that the record shows made a good faith effort to act responsibly, albeit not as the Service would prefer, in making an amendment decision? The level of risk is unknown. The published revocation examples demonstrate that revo-

*private inurement rule*³⁶ and the *private benefit rule*,³⁷ which are discussed in the following two sections. This discussion is not intended to be a comprehensive or detailed explanation of these rules or how the rules apply to amendment issues. That is impossible because application of the rules is highly fact-sensitive and each amendment is based on a unique set of facts and circumstances. The Service's website has comprehensive guides³⁸ that explain the application of the

cation may occur with the most egregious compliance failures but they fail to instruct beyond that. For example, IRS Written Determination 201405018, released 1/31/2014, (http://conservationtools.org/libraries/1/library_items/1353) found an organization disqualified because it failed to show that it engaged in any qualified exempt activities. A single individual was the sole founder, sole chief executive, operated the organization at his own discretion and prepared tax returns for donors. The letter ruling found that the organization's acceptance of donations of conservation easements failed to provide any public benefit.

³⁶ *Example (Private Inurement)*: A director urges support for an amendment that will permit additional residential development of the property. The director is an investor in a company that will benefit from the increase in development potential. The tax-exempt status of the holder may be jeopardized by the board's action in accommodating a change benefitting an insider. A tax-exempt charitable organization is described as one which "no part of the net income of which inures to the benefit of any private shareholder or individual" (called the "private inurement rule").

³⁷ *Example (Private Benefit)*: Landowners (whether or not insiders) request a change that may, or will, result in economic benefit to them. Further inquiry is needed to determine whether the tax-exempt status of the holder may be jeopardized by implementation of such an amendment. A charitable organization must not only be "organized and operated exclusively for religious, educational, or charitable purposes" but must continue to operate only for charitable purposes (and not private interests). This is referred to as the "private benefit rule."

³⁸ See 1990 Exempt Organization – Continuing Professional Education article published by the Service entitled "Part C. Overview of Inurement/Private Benefit Issues in IRC 501(c)(3)" (the "[1990 Guide](http://conservationtools.org/libraries/1/library_items/1354)") (http://conservationtools.org/libraries/1/library_items/1354) and 2001 Exempt Organization – Continuing Professional Education article published by the Service entitled "H. Private Benefit Under IRC 501(c)(3)" (the "[2001 Guide](http://conservationtools.org/libraries/1/library_items/1355)") (http://conservationtools.org/libraries/1/library_items/1355).

regulations³⁹ under IRC§501(c)(3) and the body of judicial decisions that apply the rules to specific fact situations.⁴⁰

Private Inurement

Charitable organizations may not provide economic benefits to insiders

The IRC charitable exemption rules describe a tax-exempt charitable organization as one which "no part of the net income of which inures to the benefit of any private shareholder or individual. In other words, nonprofit, charitable organizations are not operated to distribute net earnings to shareholders or to individuals who, by course of conduct, are the functional equivalent of shareholders. The lack of a profit motive and the inability to distribute earnings sets charities apart from for-profit organizations. Taxpayers ought not to be supporting organizations that distribute earnings to those who are the functional equivalent of shareholders. Organizations that are found to have violated the private inurement rule risk revocation of their tax-exempt status under the IRC charitable exemption rules.⁴¹

Any amount is fatal to revocation of tax-exempt status

With respect to the private inurement standard, the amount of benefit is irrelevant. It does not matter how much benefit was received by the insider or whether that benefit was incidental to the primary activities of

³⁹ Reg. 1.501(c)(3)-1(c)(2).

⁴⁰ As discussed below, published guidance by the Service on the IRC charitable exemption rules sheds little light on how to apply it to amendment issues. Tests developed to evaluate whether or not exchanges of goods and services for cash constitute private benefit may not apply to amendments of grants without an exchange of consideration or, if they do, it is difficult, if not impossible, to apply the test consistent with the purpose of the rule.

⁴¹ The IRC also authorizes the Service to impose excise taxes on managers who allowed an improper benefit and the persons who received the benefit. These sanctions, located in §4958 of the IRC (rather than the tax exemption standards contained in §501(c)(3)), may be imposed instead of or in addition to revocation of tax-exempt status.

the organization.⁴² The purpose of the rule is to be sure that charitable assets of the organization are not distributed to insiders. Cash and other financial benefits, whatever the amount, may not be distributed to those in a position to influence the decisions of the holder.

Standard of reasonableness

The private inurement doctrine requires that transactions with insiders be tested against a standard of reasonableness. The reasonableness standard focuses essentially on comparisons—how do similar organizations, acting prudently, transact their affairs in comparable circumstances?

*No departure from ordinary practice*⁴³

The general rule is that if arrangements are indistinguishable from ordinary prudent business practices in comparable circumstances, a fair exchange of benefits is presumed and inurement will not be found.⁴⁴

*Unusual economic benefit conferred*⁴⁵

There is no prohibition against an exempt charity dealing with its founders, members or others in seeing to the conduct of its economic affairs. However, any transaction between an organization and a private individual in which the individual appears to receive a disproportionate share of the benefits of the exchange relative to the charity served presents an inurement issue.⁴⁶

Who is an insider or other influential person?

Whenever courts have held that a certain transaction, or course of conduct, constitutes private inurement, the underlying fact pattern is that the benefitted individual stands in a relationship with the organization which offers him the opportunity to make use of the organization’s income or assets for personal gain.⁴⁷

Legal Control

Directors and officers of the holder must be considered insiders as well as anyone else considered to be a person having a conflict of interest in the decision as described in holder’s policy on that topic.

Influence Over Operations

The class of insiders is not limited to those who are able to exercise legal control over the organization such as officers, directors or trustees. Any individuals who have significant influence over the organization’s operations may be treated as insiders in an economic sense.⁴⁸

Example: A landowner requesting a change to a grant who is a major donor to the holder may be classed as an insider for purposes of application

⁴² §3.D. of the 1990 Guide.

⁴³ Example of non-inurement: An elderly director requests a change to the grant recorded in 1984 against his property. The problem is that the grant does not clearly define the conservation objectives and contains numerous inconsistencies between what is prohibited and what is not permitted. Before the property is transferred, either in his lifetime or upon his death, he wants to have the grant amended and restated using the Model Grant (the current form used by the holder for its easements) to assure that the conservation easement on his property will be strengthened and remain viable far into the future. An inquiry of the facts and circumstances surrounding the proposed amendment does not indicate any economic benefit accruing to the director by implementation of the proposed amendment although it is possible that, under some set of hypothetical circumstances, the covenants in the amended grant may offer greater economic opportunity than covenants in the original grant.

⁴⁴ §3.A.1. of 1990 Guide.

⁴⁵ Example: A director requests a change that would release an acre of his property from the conservation easement to facilitate the development of his adjoining non-eased property. The change would result in economic benefit to the director. There is little or no evidence of any compelling justification for the amendment. An amendment such as this does not follow the policies and practices generally accepted by reputable conservation organizations; thus, it is likely that it will be denied the presumption that it is a fair exchange in the ordinary course.

⁴⁶ §3.A.1. of the 1990 Guide.

⁴⁷ §3.B. of the 1990 Guide.

⁴⁸ §3.C. of the 1990 Guide.

of the private inurement rule. Likewise, a holder who receives substantial support from governmental or foundation grants must consider the possibility that a landowner who is a Board member or official of such entity may be an insider for these purposes.

Private Benefit

Most charitable activities necessarily involve some benefit to non-charitable interests. Charities purchase goods and services from vendors. Vendors make a profit from sales to charities just like any other transaction. The IRC charitable exemption rules cannot rule out *all* transactions in which a private interest derives an economic benefit from a charity. The question then is: how can charitable organizations, as they enter into transactions and arrangements with private entities, ensure that they will be viewed as serving the public interest when it is at least possible, and often probable, that private interests will economically benefit from these activities?

Purpose of Rule

The private benefit rule, which addresses the above question, arises from a provision in IRC charitable exemption rules that conditions the charitable organization's tax-exempt status on its *continuing to engage primarily in activities which accomplish one or more exempt purposes*.⁴⁹

⁴⁹ The charitable exemption rules explicitly prohibit inurement, but do not mention "private benefit." However, the statute does provide that an entity be "organized and operated exclusively for religious, charitable, scientific" and other specified purposes. Reg. 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as operated exclusively for exempt purposes only if it engages primarily in activities that accomplish one or more exempt purposes. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. Reg. 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest. Thus, even if an organization has many activities which further exempt purposes, exemption may be precluded if it serves a private interest. Applying the Supreme Court rationale in *Better Business Bureau of Washington, D. C., Inc. v. United States*, 326 U.S. 279 (1945), the

The purpose of the private benefit rule is to assure that organizations that have obtained tax-exempt status continue to operate primarily for the exempt purposes identified in their application for such status.⁵⁰

Differentiating primary purpose from incidental benefit

The Internal Revenue Service's approach to analyzing private benefit issues is as follows: The amount of private benefit that will be permitted depends on (a) whether the private benefit is necessary in order to effectuate the organization's exempt purpose; and (b) the magnitude of the private benefit in relation to the public benefit derived from the organization's activities.⁵¹

Application to Easement Amendments

Amendment may benefit both landowner and public

Requests for changes to a conservation easement are typically initiated by the landowners. In many if not most cases the landowners see some personal advantage in doing so. The holder may be able to identify amendments to the grant that would both satisfy the wishes of the landowner and provide new and substantial public benefits. The arrangement is mutually beneficial but, unlike an exchange of goods and services for cash, there is no *exchange* of value from one party to the other. The conservation value of the easement may be increased concurrently with an increase in the value of the eased property. An increase in one does not signify a decrease in the other.⁵²

presence of private benefit, if substantial in nature, will destroy the exemption regardless of an organization's other charitable purposes or activities.

⁵⁰ As applied to amendment issues, a holder who enters into an amendment to strengthen the conservation easement and further achievement of conservation objectives is, by definition, operating to advance its exempt purposes.

⁵¹ §4.A. of the 1990 Guide.

⁵² The IRC charitable gift rules use the diminution in value of land as a measure of the value of the easement for purposes of quantifying the charitable deduction allowed for the gift. That measure is also used to measure the minimum amount the holder is entitled to receive were the easement to be extinguished by eminent domain or a court order. In

Nevertheless, the holder must take care to see that the proposed amendment not only advances the public benefit of conserving natural and scenic resources but that it is viewed in that light and not as conferring a private benefit on the landowner. The IRC charitable exemption rules (including guidance available online) do not address easement amendments but do provide a framework for analysis.

Analyzing private benefit - incidental versus impermissible

- **Primary purpose (operational) test.** The first inquiry in determining if and how much of a private benefit is permissible, as applied to an amendment, is focused on whether the amendment advances the mission of the holder. An amendment that can be demonstrated to strengthen the conservation easement and advance achievement of conservation objectives is likely to pass the operational test.
- **Incidental benefit test (qualitative and quantitative).** Weighing the incidental benefit of an amendment is more difficult. Two general lines of inquiry have developed, and each is briefly summarized in the following two sections.

Qualitative Test

A private benefit is incidental in a qualitative sense if “the benefit to the public cannot be achieved without necessarily benefiting certain private individuals.”⁵³ No specific guidance exists as to how this line of inquiry applies to an amendment; however, the holder may, and typically does, have a factual basis on which to conclude that, first, the proposed amendment would strengthen the easement and/or afford enhanced protection for natural and scenic resources within or beyond the property; and, second, but for

those instances, monetizing the value of a conservation easement is necessary. In the case of application of the private benefit rule, monetization of the value of a conservation easement is not only unnecessary but erroneously excludes the key component of the value of a conservation easement—its power to block land uses inconsistent with conservation objectives. This topic is addressed in more detail below.

⁵³ §4.A. of the 1990 Guide.

provisions in the amendment benefiting the landowner, the holder will not obtain these conservation gains benefiting the public interest.

Quantitative Test

In addition to the qualitative test described above, a private benefit will not be considered incidental if it provides a substantial benefit to private interests, albeit indirectly.⁵⁴ This line of inquiry is, from the holder’s perspective, very difficult to apply to the particular set of facts and circumstances underlying a requested change. While it seems odd for the holder’s tax exempt status to be dependent upon factual matters beyond its ability to establish with any degree of certainty, so long as that remains the rule applied by the Service, the holder may want to require assurances from the requesting landowners⁵⁵.

Illustration of Application of Qualitative and Quantitative Tests

The following scenario illustrates a frequently encountered fact pattern encountered as a result of proposed amendments:

Scenario. An easement covenant allows selective thinning of a forested property. The grant does not define the meaning of “selective” or “thinning,” nor does it indicate what considerations, if any, need to be observed to minimize harmful impacts to wildlife, the soils, the streams, or the scenic character of the property. Other records do not provide holder with meaningful guidance as to how the holder should monitor, enforce or interpret this covenant. A second covenant restricts timber cutting on one portion of the property to “personal use only.” Holder recognizes the impracticality of enforcing this restriction—having no ability to monitor who is using trees cut on the property. (Holder suspects but can’t confirm that trees are sometimes harvested for non-personal use.) Thus, in practice, these covenants do little to further the easement’s conservation objectives or

⁵⁴ §4.A. of the 1990 Guide.

⁵⁵ See the section “Strategies to Minimize Risk of Adverse Consequences to Holder of Amendment Decisions” later in this guide.

guide responsible management of the conservation easement.

A proposed amendment desired by landowners (who are not insiders of the holder) and holder changes these covenants to allow forestry in accordance with a forest management plan that must be prepared in accordance with strict standards on harvesting and replanting to further the conservation objective of maintaining healthy forest while minimizing intrusion on habitats and preserving the scenic character of the property. The proposed amendment also affords the holder the opportunity to update the grant to use the holder's present grant boilerplate, which would greatly enhance the holder's ability to manage the easement in furtherance of the conservation objectives.

Application of operational test

The amendment furthers the mission of the holder to protect natural and scenic resources and, specifically, furthers attainment of the conservation objectives of the easement. Thus, it conforms to the requirement that the amendment must primarily further the tax-exempt purposes of the holder.

Application of Qualitative Test

The next inquiry is whether any benefit to the landowner is qualitatively incidental. There is no question that, in the reasonable judgment of the board, this change is highly beneficial both to achievement of conservation objectives and responsible management of its charitable asset, the conservation easement. From the holder's perspective, the request for change is a welcome opportunity to strengthen the conservation easement and modernize the grant. The improvements could not be achieved without allowing landowners to change the method of regulating acceptable forestry from a *selective thinning* standard to a *forest management plan* standard. The forest management plan is the standard used by the holder anyway; thus, any benefit to the landowner is qualitatively incidental.

Application of Quantitative Test Results in No Clear Answers

How does the holder evaluate the profitability to landowner of (a) harvesting timber for sale in accordance with a forest management plan as compared to (b) harvesting trees based on landowner's own selection criteria (whether or not disputed by holder)? What weight may be given to the cost to landowner of paying a forester to prepare (and update on a regular basis) the forest management plan? What weight may be given to the probability that the landowner is surreptitiously harvesting trees for sale anyway? The quantitative test is of little or no assistance applied to transactions that do not involve an exchange of goods and services in exchange for monetary consideration. Regulations⁵⁶ and other guidance issued by the Service⁵⁷ are of little assistance in clarifying these issues.

Quantitative Test Invalid as Applied to Easement Amendments?

If the Service were to seek revocation of the tax-exempt status of a holder on account of an amendment that passed the operational test and the qualitative test but failed the quantitative test because some benefit (actual or hypothetical and significant or not) may accrue to landowner as a result of the amendment, there are a number of issues that may be raised to counter such claim.

Administrative Rule Must Be Consistent with Statute and Regulations

The rationale for the private benefit rule (never explicitly mentioned in the text of IRC§501(c)(3)) is to assure that tax-exempt charitable organizations continue to serve the public interest. The purpose of the discussion in this section is not to question the authority of the Service to revoke tax-exemption from organizations who make grants available to individuals for non-charitable purposes or who engage in sweetheart deals purchasing goods and services from friends and affiliates for greater than fair value. However, an ad-

⁵⁶ See [IRC §1.501\(c\)\(3\)-1\(F\)\(2\)](#).

⁵⁷ See Section 4 of the 1990 Guide and Section 1 of the 2001 Guide.

ministrative rule that, as applied, *prevents* a charity from serving the interest of the public contradicts the Internal Revenue Code section from which it is derived. A rule that prevents consideration of the public benefit of a transaction (strengthening a conservation easement and assuring its long-term viability) because the other party to the transaction may economically benefit in any way, real or hypothetical, and in any amount (large or small) is invalid because it is not consistent with the IRC provision from which the rule is derived.

Quantitative Test Disregards Public Benefit

The prohibition on private benefit is to assure that tax-exempt charitable organizations serve the public benefit. The IRC charitable exemption rules recognize that sometimes activities that serve the public benefit may also benefit private interests as well. The proper relationship between public and private benefit is phrased as “primarily” serving the public benefit. Another description is that the benefit to private interests must be “incidental.” Application of the quantitative test using a valuation method that disregards (rather than weighs) the public benefit of a transaction contradicts the intent of the IRC charitable exemption rules.

Public benefit is key factor

The Service has published guidance on whether a tax-exempt organization is serving the public benefit when it invests charitable assets in recreational facilities within a private club or community if, as a result, the facilities are inaccessible to the general public. The key (and only) factor targeted by the Service in this example was whether the recreational facilities will or will not be open to the public.⁵⁸ Lack of public access ended the inquiry as to whether the tax-exempt organization served private rather than public interests. One lesson that may be learned from the recreational facili-

ties guidance is that the main focus of the private benefit inquiry must be an examination of the public benefit of the tax-exempt organization’s activities. A test that, as applied, disregards public benefit (in the case of an amendment, conservation benefit) must be rejected as contrary to the IRC charitable exemption rules.

Intent to benefit public or private interest

The guidance provided by the Service⁵⁹ suggests that the intent of the organization to advance public or private interests is a factor for consideration. Application of a mechanical test that rules out any consideration of the intent of the organization is also contrary to the IRC charitable rules. Intent to benefit the public is a factor worthy of consideration if only to determine whether private benefits were incidental or not.⁶⁰

Before-and-After Valuation Inappropriate for Purposes of Weighing Public vs. Private Benefit

There is no support whatever in the IRC charitable exemption rules for disregarding the public benefit of an amendment in favor of an analysis that looks solely to private benefit. The crux of the problem, as applied to amendments, may be the notion that conservation easements have no value but for the monetary value established by the “before and after” test required in certain instances under the IRC charitable gift rules. Monetary valuation is needed in the IRC charitable gift rules for the practical purpose of putting a figure on the allowable deduction for the donation of a conservation easement. Monetary valuation also comes into play under the IRC charitable gift rules to put a figure on holder’s allocable share of proceeds of a condemnation or other easement extinguishment. In these cases, monetary valuation of a conservation easement is necessary to establish the value of the easement on the date it comes into existence or goes

⁵⁸ See Revenue Ruling 67-325, C.B. 1967-2, 113, which relates to an organization exempt under section 501(c)(3) of the IRC providing recreational facilities to the residents of a township. See Revenue Ruling 66-358, C.B. 1966-2, 218, which relates to an organization exempt under section 501(c)(3) of the IRC operating and maintaining a public park with incidental private benefits. See *Benedict Ginsberg and Adele W. Ginsberg v. Commissioner*, 46 T.C. 47 (1966).

⁵⁹ See Private Benefit, Inurement and Community Deterioration (1981 E.O. CPE text) available online <http://www.irs.gov/pub/irs-tege/eotopicf81.pdf>.

⁶⁰ The Merriam-Webster dictionary defines the word *incidental* as “occurring merely by chance or without intention or calculation.”

out of existence. The before-and-after test is sufficient in those cases because the measurement is a snapshot of value on a particular day. Analogizing to a commercial setting, book value may be a reasonable way to create a snapshot of the value of a company on the day it starts business or goes out of business but is not the only way (or the best way) to measure the value of a going concern with prospects for the future. That principle may be applied to valuation of conservation easements. The before-and-after valuation is not the only way (or the best way) to consider the worth of a viable, ongoing conservation easement with prospects for the future. Future conservation benefits anticipated from an amendment are an important element of value and cannot be disregarded.

Monetization of conservation easement unnecessary

Research for this guide has found no guidance requiring use of the before-and-after method of valuation for purpose of weighing public vs. private benefit. Unlike the instances in the IRC charitable gifts (where a specific numeric value is needed) there is no need to monetize the value of a conservation easement to determine whether or not an amendment is serving the public interest rather than a private interest. If there were a need to monetize value, there is no mandate in the IRC charitable gift rules requiring use of the before-and-after test, particularly as it produces a false, and unbalanced, result as explained below.

Before-and-after valuation from IRC charitable gift rules is misapplied to IRC charitable exemption rules

The “before and after” method of valuing a conservation easement puts a monetary value on the easement based upon the economic benefit or detriment to the landowners caused by the establishment of the easement on their land. Application of the “before and after” valuation to amendments is inappropriate for several reasons.

Disregards non-monetary public benefit (conservation value)

The before-and-after valuation focuses only on the economic benefit to landowner’s interest in the eased property due to the existence of the amended ease-

ment. It ignores the benefit to holder’s easement interest due to the existence of the amended easement. That omission directly conflicts with the purpose of the public benefit test – to assure that the tax-exempt organization continues to serve the public in accordance with the purposes for which tax exempt status was given.

Purpose of determining monetary value of easement under IRC charitable gift rules is different from determining conservation value of easement under IRC charitable exemption rules

The value of a conservation easement for purposes of the IRC charitable exemption rules is the easement’s strength and viability as a tool to protect natural and scenic resources within the eased property. The public benefit derived from those conservation values may increase whether the value of landowner’s interest increases, decreases or stays the same.

Application of before-and-after valuation produces false, and unbalanced, result

Application of the before-and-after valuation for purposes of the quantitative test will always result in a gross miscalculation. The only amendments that pass the quantitative test using the before and after valuation are amendments that decrease the value of the eased property. The unfounded assumptions and illogical reasoning that underlies the application of the before-and-after valuation to easement amendments are as follows:

- The validity of the before-and-after test for purposes of determining public benefit rests on the unsupported (and untrue) assumption that the only value worth considering is the monetary value of the land encumbered by the easement. Public benefit value is given no weight in the evaluation and, as discussed above, that contradicts the IRC charitable exemption rules.
- The before-and-after valuation method is founded on the assumption that land value plus easement value always equals 100% of value. That is not true. The value of an easement (a separate property interest) may increase at the same time the value of the land increases. They are not linked in an inverse proportionality relationship.

Consideration of Non-monetary Public Benefit is Required by IRC Charitable Exemption Rules

Comparison of the public benefit in relationship to possible private benefit is the foundation of the IRC charitable exemption rules applicable to private benefit. If no weight is given to the non-monetary conservation value of the amendment, then any opportunity to weigh the public benefit vs. private benefit is precluded. Such an approach is invalid because it is in direct opposition to the private benefit rules, which require weighing the conservation value to the holder (and to the public) of an amended easement.

Harmonize Quantitative Test with Other Avenues of Inquiry to Evaluate Permissible (or Impermissible) Private Benefit

The Service, or a court considering the issue, may adopt another avenue of inquiry to substitute for the quantitative test as applied to transactions, such as easement amendments, that generate benefits that are not quantifiable by monetary valuation. A number of these avenues for inquiry have been adopted in the IRC charitable gift rules and may serve as models to apply to inquiries pertaining to public (or private) benefit of easement amendments.

Apply Standard Applicable to Excess Benefit Transactions

One possibility that the Service, or a court considering the issue, may adopt as a substitute for the quantitative test is to incorporate the rebuttable presumption of reasonableness as is contained in regulations issued with respect to excess benefit transactions.⁶¹

⁶¹ See IRC §4958 and accompanying Regulation 53.4958-6 for a suggested application of this standard to adoption of a Proposed Amendment, see discussion of minutes in Part III.

Factors qualifying for rebuttable presumption of reasonableness

The excess benefit test provides that payments under a compensation arrangement are entitled to a *rebuttable presumption of reasonableness* if the following three elements are met: (a) a disinterested body of the organization, (b) relies on comparable data and (3) properly documents the basis for the decision.

Example based on amendment scenario

The example below illustrates how this test might be adapted to determine whether an economic benefit was or was not incidental:

Example: The requested change is to eliminate uncertainty in the grant about whether or not subsurface (horizontal) drilling for natural gas is permitted within the Property. The existing grant does not address the issue with any clarity. The proposed amendment will incorporate into the existing grant exactly the same rules as are applied to other landowners under the Model Grant used by holder. The incorporation of Model Grant provisions will eliminate the possibility of an interpretation of the existing grant permitting surface disturbance of the property (which would be highly detrimental to natural and scenic resources) and would empower the holder to monitor plans and implementation of the drilling so as to minimize adverse effects on water quality and other resources protected by the easement. On the other hand, the immediate effect of the amendment will be that the landowners will enter into a lucrative lease of the natural gas deposits within their property.

Application of rebuttable presumption of reasonableness to amendment scenario

If a variation of the excess benefits test were applied to the above example, the economic benefit to landowners following the amendment would be entitled to a rebuttable presumption that it was incidental if a) the directors considering the proposed amendment were all disinterested; b) the proposed amendment does not treat the requesting landowners any differently from other landowners (holder's policy, consistent with other reputable land trusts, is to allow underground, but not surface, drilling); and c) the information on which the board's decision was based and the minutes

of the meeting in which the amendment was adopted contain a reasonable basis on which to conclude that the directors acted in good faith and for the purpose of serving the public interest in preserving the conservation values of the property. On the other hand, if factors a) and c) remain the same but the holder's policy, consistent with other reputable land trusts, is to disallow all drilling (whether underground or surface) then approval of the amendment allowing subsurface drilling will create a presumption of economic benefit (which may be overcome by other compelling justifications).

Apply Standard Applicable to Private Inurement Inquiry

The inquiry to determine whether an insider is benefitting unfairly due to its relationship with holder is to question whether the insider is being treated the same as any other landowner. In the above example, the directors have weighed the deficiencies and vulnerabilities of the existing grant and proposed to treat the requesting landowner the same as any other landowner subject to the Model Grant. Nevertheless, strict application of the quantitative test would rule out such an amendment. Why should the test applicable to a transaction with a non-insider be more stringent than a transaction with an insider? Applying the standard applicable to insider benefits, the inquiry to determine the existence of impermissible private benefit would be: Does the amendment result in any economic benefit to landowner different from the standards applied by holder to evaluate easements proposed for acceptance as of the amendment date?

Apply the Private Benefit Test so as to be Consistent with Governance Responsibilities of Directors

The directors in the above example are caught in a predicament.

If they reject the proposed amendment, they not only lose the certainty that the natural resources identified in the conservation objectives will be protected in perpetuity but they may be forced into investing staff-time and charitable assets enforcing an interpretation of a covenant that prohibits a use that, in all of its

more recent easements, is considered consistent with conservation objectives. The directors have a fiduciary duty to act in the best interests of the holder. Rejection of the proposed amendment has little benefit to holder's conservation mission and a high degree of risk to result in a far worse situation.

On the other hand, if the directors approve the proposed amendment, they risk the possibility that the Service may threaten revocation of holder's tax-exempt status by strict application of the quantitative test.

Directors should not be compelled to act contrary to the best interests of the holder due to the possibility that the landowners may, or will, economically benefit from the change.

Strategies to Minimize Risk of Adverse Consequences to Holder

The discussion of legal considerations in this guide must, of necessity, leave to future development exactly how general rules apply to specific amendment issues. Application of the IRC Charitable Gift Rules and the IRC Charitable Exemption Rules may result in uncertainty. A proposed amendment, or its implementation, may inadvertently fall afoul of a private benefit or private inurement rule notwithstanding the land trust's reasonable, good faith belief that it is acting in furtherance of its mission and, as to the property, in furtherance of the conservation objectives. An easement amendment decision, made in good faith in furtherance of the holder's mission, may be found to be non-compliant with applicable state law or may be alleged to jeopardize holder's status as a qualified organization. In cases of uncertainty, or the potential for litigation initiated by persons alleging to be easement beneficiaries, the holder may want to condition its willingness to move forward with the proposed amendment on one of the following suggestions:

Indemnity

When landowner requests an amendment, it is good practice for holder to request, as a condition of moving forward, an understanding that the landowners will pay the costs and expenses incurred by holder in

considering and, if approved, implementing the amendment. Easement holders may want to consider broadening the scope of the agreement to cover costs and expenses incurred after the amendment becomes effective; for example, those incurred as a result of an inquiry by the Service or the Attorney General or commencement of a civil action by a person alleging to be an easement beneficiary. Even if the amendment is ultimately found to be valid and consistent with applicable law, holder will invest time and money responding to the inquiry or civil action. Holder and landowners need to sort out between themselves who is responsible for payment of these expenses before the amendment is implemented.

Agreement to Unwind

An indemnity from a creditworthy source affords some comfort that, if a problem arises with respect to the amendment and the problem is not the fault of the holder, adverse economic consequences to the holder will be borne by the landowners. What if the problem cannot be solved by the payment of money? If the problem is that the Service has revoked the holder's tax-exempt status due to an economic benefit not disclosed by landowners to holder, no amount of cash is going to compensate the holder for loss of its tax-exempt status. In such case, the equitable remedy is to put the landowners and the holder back to their positions before the amendment by setting aside all, or the problematic portion, of the transaction. An agreement to achieve this result (called an "unwinding clause") may be incorporated into the amendment document.

Opinion of Tax Counsel

The holder may require, as a condition of finalizing the amendment, production of the opinion of competent tax counsel, satisfactory to the holder, which opinion is addressed to the holder and which states that it may be relied upon by the holder, that in the opinion of such counsel, after reviewing all of the facts and circumstances, neither the proposed amendment nor its implementation, constitutes a private benefit or private inurement in violation of the IRC. The opinion may be expanded to include other areas of concern, if appropriate; for example, issues arising under state law.

Letter Ruling

For total assurance, the holder may require, as a condition of finalizing the amendment, production of a letter ruling issued by the Service confirming that neither the proposed amendment nor its implementation, as explained in the request for letter ruling, will adversely affect the tax-exempt status of the holder.

Attorney General No-action Letter

The holder may want to consider notifying the Attorney General of any occurrence (including a proposed amendment) that may be viewed by others (if not by holder) as a breach of a holder covenant or a possible violation of holder's duties as a charitable, nonprofit organization under state law. The notice may include additional information which holder has relied upon in its determination that the action does not violate any holder covenant and is otherwise consistent with applicable law. The holder may request a "no action" letter evidencing the Attorney General's lack of objection to the proposed occurrence.

Resources at ConservationTools.org

To find experts on the topics covered by this guide, see the right hand column of the on-line edition at <http://conservationtools.org/guides/show/139>. The on-line edition also contains the most up-to-date listing of related library items and guides.

Library Categories

[Conservation Easement Amendment, Modification and Termination](#)

[Conservation Easements](#)

[Internal Revenue Service Guidance](#)

Featured Library Items

[Conservation and Preservation Easements Act](#)

[Model Conservation Easement Amendment Policy](#)

[Model Grant of Conservation Easement](#)

Related Guides

[The Nature of the Conservation Easement and the Document Granting It](#)

[Authorization of Real Estate Transactions](#)

[Conservation Easement](#)[Conservation and Preservation Easements Act](#)[Holder, Beneficiaries and Backup Grantees](#)[Who Has Standing?](#)[Not a Public Trust: The Land Trust-Held Conservation Easement in Pennsylvania](#)[Not a Charitable Trust: The Conservation Easement in Pennsylvania](#)

Submit Comments

Help improve the next edition of this guide. Email your suggestions to the Pennsylvania Land Trust Association at aloza@conserveland.org. Thank you.

Acknowledgements

[Patricia L. Pregmon](#), attorney at law, is the primary author, and [Andrew M. Loza](#), the contributing author and editor.

The Pennsylvania Land Trust Association published this guide with support from the William Penn Foundation, the Colcom Foundation and the Community Conservation Partnerships Program, Environmental Stewardship Fund, under the administration of the Pennsylvania Department of Conservation and Natural Resources, Bureau of Recreation and Conservation.



Colcom Foundation

Nothing contained in this or any other document available at ConservationTools.org is intended to be relied upon as legal advice. The authors disclaim any attorney-client relationship with anyone to whom this document is furnished. Nothing contained in this document is intended to be used, and cannot be used, for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing or recommending to any person any transaction or matter addressed in this document.

© 2015, 2014 Pennsylvania Land Trust Association

Text may be excerpted and reproduced with acknowledgement of ConservationTools.org and the Pennsylvania Land Trust Association.