Increasing the Tax Incentives for Conservation Easement Donations – A Responsible Approach

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—A Responsible Approach

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The use of tax incentives to encourage private landowners to donate conservation easements has become increasingly popular as policy makers search for ways to combat the growing problem of urban sprawl. The tax incentives have worked remarkably well to encourage private landowners who have both the will and the means to shoulder a significant percentage of the economic cost of protecting their land through the donation of conservation easements. However, the success of the tax incentive program should not blind its proponents to its inevitable inefficiencies and limitations. Continually increasing the tax incentives in an effort to make them attractive to a broader class of landowners – including, in particular, so-called "land rich, cash, poor" landowners – could have unintended consequences. Thus far, the land trust community has been able to recognize and respond to the challenges presented by the acquisition and long-term stewardship of conservation easements. However, the capacity of land trusts (and the often less well-equipped government agencies) to respond to such challenges is not unlimited. Some easement holders could be overwhelmed if Congress and the states adopt policies that result in a sudden surge in easement donations. Moreover, exploitation and abuse of the tax incentives by profit motivated "donors" could imperil the very existence of the tax incentive program and call into question both the credibility of the land trust community and the use of conservation easements as a private land protection tool. This article undertakes a much-

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needed critical analysis of the tax incentives designed to encourage conservation easement donations and proposals to increase those incentives. The article ultimately concludes that a responsible approach to increasing the tax incentives is called for: Congress should increase the incentives only if some assurance can be had that the increase will be efficient, that land trusts and government agencies have the expertise and resources to appropriately screen and steward the anticipated additional easements, and that the increase will not encourage exploitation and abuse.

INTRODUCTION

Private land in the United States is being developed at an increasingly prodigious rate.[1] Every day we convert thousands of acres of forest, farmland, and open space into residential subdivisions, strip malls, and other commercial and industrial uses. At the same time, there is a general consensus across the political spectrum that the pattern (if not also the pace) of such development is socially undesirable, and that some

1. *See, e.g.,* United States Department of Agriculture, *1997 National Resources Inventory: Highlights, Revised December 2000*, *at* http://www.nrcs.usda.gov/technical/land/pubs/97highlights.html [hereinafter 1997 NRI Highlights] (noting that the pace of development of nonfederal lands in the U.S. during the five year period from 1992 to 1997 was more than one and one-half times that of the previous ten year period, and that between 1992 and 1997 more than 3.2 million acres of prime farmland were converted to developed land, on average more than half a million acres (645,00) of prime farmland per year overall); U.S. GEN. ACCT. OFF. REP. (2000) at 11-12 (noting that the nation will face a growing demand for residential, commercial, and industrial development in the years ahead because the population of the United States is expected to increase by almost 50 percent in the next fifty years and, historically, land consumption has increased faster than population growth).

form of government intervention is necessary to combat the growing problem of urban sprawl.

In a political climate that is hostile to government regulation, the use of financial incentives to encourage private landowners to voluntarily engage in conservation practices has emerged as a favored approach to private land protection. One set of such incentives—federal tax incentives intended to encourage private landowners to voluntarily restrict the development and use of their land through the donation of conservation easements—has enjoyed particular success and, as a result, has garnered significant bipartisan support.

A conservation easement is a legally binding agreement between the owner of the land encumbered by the easement and the holder of the easement that restricts the development and use of the land to achieve certain conservation goals, such as the preservation of wildlife habitat, a scenic view, or agricultural land.[2] The restrictions on development and use contained in an easement become part of the land records and operate to prevent the landowner and successor owners from developing or otherwise using the land in manners prohibited by the easement.[3] Some conservation easements terminate after a specified number of years and are referred to as "term easements."[4] However, the vast majority of conservation easements are granted in perpetuity because most recipient conservation organizations accept only perpetual easements, and donated easements are eligible for the various federal tax incentives only if they are perpetual.[5]

The acquisition of conservation easements by nonprofit conservation organizations, typically referred to as land trusts, increased dramatically over the last two decades. According to the census data collected by the Land Trust Alliance (the "LTA"), which is the umbrella organization for the nation's local, state, and regional land trusts, in 1980 there were only 431 local, state, and regional land trusts extant, and by the end of 2000, that number had grown to 1,263.[6] In addition, in 1980 there were only

2. *See, e.g.*, Janet Diehl, *Part One: Managing an Easement Program, in* JANET DIEHL & THOMAS S. BARRETT, THE CONSERVATION EASEMENT HANDBOOK: MANAGING LAND CONSERVATION AND HISTORIC PRESERVATION EASEMENT PROGRAMS 5 (1988) [hereinafter CONSERVATION EASEMENT HANDBOOK]. The terms "conservation easement" and "easement" will be used interchangeably throughout this article.

3. *Id*. at 7.

4. *Id.*

5. *Id.*

6. LAND TRUST ALLIANCE, NATIONAL LAND TRUST CENSUS (2000) (on file with author); *see also* Land Trust Alliance, *National Land Trust Census*, *at* http://www.lta.org/aboutlta/census.shtml (last updated Sept. 19, 2001) (providing details about the census). The LTA collects census data with respect to the local, state, and regional land trusts operating in the United States (including governmental and quasi-governmental agencies that operate in a manner similar to land trusts, such as the Virginia Outdoors Foundation). Telephone conversation with Martha Nudel, Director of Communications for the LTA (Feb. 12,

128,001 acres protected by conservation easements held by local, state, and regional land trusts, and by 2000, that number had grown to almost 2.6 million.[7] Moreover, the census data collected by the LTA does not include statistics from the few land trusts that operate on a national scale, such as The Nature Conservancy,[8] or from governmental units that do not operate as land trusts, such as the United States Forest Service and state, city, and county governments, which also have been active in acquiring conservation easements over the last two decades.[9]

As a result of the tremendous growth in the number of land trusts operating in the United States and in the number of acres protected by conservation easements held by such land trusts, land trusts and the conservation easements they acquire now play an important role in the

2002) [hereinafter NUDEL CONVERSATION]. The LTA describes itself as the national leader of the private land conservation movement, and notes that it promotes voluntary land conservation across the country, provides resources, leadership, and training to the nation's 1,200-plus nonprofit, grassroots land trusts and helps them to protect important open spaces. *See* Land Trust Alliance, *About LTA*, *at* http://www.lta.org/aboutlta/index.html (last visited Jan. 29, 2003).

7. Land Trust Alliance, *National Land Trust Census*, *at* http://www.lta.org/aboutlta/census.html (last updated Sept. 19, 2001). Each local, state, and regional land trust has a conservation objective specific to its particular location. For example, the Land Trust of Napa County, a local land trust, focuses its efforts on protecting "the natural diversity, scenic open space and agricultural vitality of Napa County." Land Trust of Napa County, *Mission Statement*, *at* http://www.napalandtrust.org/framewho.html (last visited Dec. 29, 2003). Utah Open Lands, a state land trust, focuses its efforts on "protecting the scenic, wildlife, historic, agricultural, and recreational values of open land in the state of Utah." Utah Open Lands, *Fact Sheet: Organization Mission*, *at* http://www.utahopenlands.org/faq.html (last visited Dec. 29, 2003). And the Teton Regional Land Trust, a regional land trust, works "to conserve the agricultural and natural resources of the Upper Snake River Valley" in Montana, Idaho, and Wyoming. Teton Regional Land Trust, *Land, Community, and Conservation*, *at* http://www.tetonlandtrust.org/index.html (last visited Dec. 30, 2003).

8. Other land trusts that operate on a national scale include the American Farmland Trust and the Trust for Public Lands. The Nature Conservancy focuses primarily on biodiversity conservation, the American Farmland Trust works to protect the nation's farmland, and the Trust for Public Lands works broadly to "conserve land for recreation and spiritual nourishment and to improve the health and quality of life of American communities." The Nature Conservancy, *Our Mission*, *at* http://nature.org/aboutus/howwework/ (last visited Dec. 29, 2003); American Farmland Trust Board of Directors, *Mission Statement*, *at* http://www.farmland.org/what/mission_pop.htm (last visited Dec. 29, 2003); The Trust for Public Land, *About TPL*, *at* http://www.tpl.org/tier2_sa.cfm?folder_id=170 (last visited Dec. 29, 2003).

9. *See* NUDEL CONVERSATION *supra* note 6. *See also, e.g., Conservancy Update* 53 NATURE CONSERVANCY 19, 20 (FALL 2003) (noting that The Nature Conservancy has protected 1.8 million acres by means of 1,682 conservation easements); U.S.D.A. Forest Service, *Forest Legacy Program National Report for 2001* (Jan. 2002) (describing the Forest Legacy Program, through which the United States Forest Service protects privately-owned forest land from development by, *inter alia*, acquiring conservation easements encumbering such land and facilitating the acquisition of conservation easements encumbering such land by state governments and land trusts).

protection of private land in the United States.[10] In fact, collaboration between government agencies and land trusts on private land protection projects has become commonplace as government agencies recognize that land trusts often have unique "kitchen table" access to and credibility with private landowners, superior knowledge of local landscapes and the needs of the communities in which they operate, and the ability to respond quickly and creatively to land protection challenges.[11]

Spurred by the successes of the land trust community[12] and the assertions of representatives of that community that additional tax incentives are needed to stimulate easement donations from "land rich, cash poor" landowners,[13] Congress increased the federal tax incentives in 1997, and appears inclined to continue to do so.[14] Congress has, however, become more cautious regarding the incentives following a series of

10. *See, e.g.,* Barton H. Thompson, Jr., *Conservation Options: Toward a Greater Private Role,* 21 VA. ENVTL. L.J. 245, 309-310 (2002) (discussing the "important supplemental role" land trusts play in private land conservation efforts in this country).

11. *See, e.g., id.* at 306, 308 (noting that, as a reflection of the need for more flexible organizations, the federal government has begun to create ad-hoc assemblies of governmental agencies and stakeholders to address specific conservation needs; that land trusts, which are not burdened by the wide variety of procedural safeguards designed to protect the public from abuse of governmental power, frequently are key players in these special assemblies; and that land trusts, because they often are locally based and staffed by local activists, frequently have important contextualized knowledge of local environments and needs, both biological and social, that the central government may lack); Nancy A. McLaughlin, *The Role of Land Trusts in Biodiversity Conservation on Private Lands*, 38 IDAHO L. REV. 453, 462 n. 37, 464 n. 44 (2002) (citing, respectively, to sources describing (i) land trusts' unique access to and credibility with private landowners and (ii) collaboration of government agencies and land trusts on land protection projects); SALLY K. FAIRFAX & DARLA GUENZLER, CONSERVATION TRUSTS 6 (2001) (noting that "[f]amiliar land and resource conservation organizations are being supplemented, if not supplanted, by . . . local cooperatives, government–private partnerships, corporate-private projects, local consensus groups, watershed associations, and land trusts of all stripes and configurations," and that "these new conservation organizations are working in partnership with, or in place of government agencies").

12. The "land trust community" comprises the LTA and the local, state, regional, and national land trusts operating in the United States, and encompasses the volunteer and paid staff members and members of the governing board or other governing bodies of such organizations.

13. "Land rich, cash poor" landowners are landowners who do not have significant annual income and for whom their land represents their most valuable asset. *See, e.g., infra* note 56 and accompanying text.

14. Congress held hearings on land conservation issues in 1996, 1999, 2000, 2001, and 2002, and in each case the land trust community lobbied for increases in the federal tax incentives available with respect to conservation easement donations to make those incentives compelling to land rich, cash poor landowners. *See infra* notes 56, 173, 174, and accompanying text. *See also* Warren Rojas, *Taxwriters Keep Hope Alive for More Tax Bills,* 2001 TAX NOTES 114-1 (2001) (quoting Senate Finance Committee ranking Republican Charles E. Grassley of Iowa as stating that land conservation tax provisions are likely to move without major opposition because "They are relatively noncontroversial and very bipartisan. . .")]

articles published in the Washington Post criticizing land trusts and alleging widespread abuse of the incentives.[15]

Despite the negative publicity engendered by the Washington Post articles, the LTA announced in its Strategic Plan for the years 2004 through 2008 that its "top policy priority" is the passage of federal legislation to provide new tax incentives for land conservation.[16] In addition, a growing number of states are enacting a variety of state tax incentives intended to further stimulate the donation of easements protecting land within their borders.[17] The popularity of conservation easements and the tax incentives intended to stimulate their donation appears to be fairly resilient, and so far they remain the darlings of the private land conservation movement.

Other than the Washington Post's recent criticism, there has been surprisingly little critical analysis of the federal tax incentives available with respect to easement donations.[18] Congress and a growing number of

15. In May of 2003, the Washington Post published a three part series criticizing The Nature Conservancy on a variety of grounds, including The Nature Conservancy's involvement in conservation easement transactions that allegedly resulted in abuse of the federal tax incentives. *See* David B. Ottaway and Joe Stephens, *Nonprofit Land Bank Amasses Billions*, Wash. Post, May 4, 2003 A1; Joe Stephens and David B. Ottaway, *How a Bid to Save a Species Came to Grief*, Wash. Post, May 5, 2003 A1; Joe Stephens and David B. Ottaway, *Nonprofit Sells Scenic Acreage to Allies at a Loss*, Wash. Post, May 6, 2003 A1. The Senate Finance Committee responded by launching an investigation of The Nature Conservancy's practices. *See* Joe Stephens, *Charity's Land Deals to be Scrutinized*, Wash. Post, May 10, 2003 A2. In November of 2003, the Washington Post reported that the Chairman of the Senate Finance Committee and sponsor of a bill that would increase the tax incentives available with respect to easement donations is reserving judgment until the investigation of The Nature Conservancy is concluded, but expects "it will become even more clear that reforms to existing law should accompany any new incentives for taxpayers to donate land for conservation." *See* Joe Stephens and David B. Ottaway, *Senate Panel Intensifies its Conservancy Probe,* Wash. Post, November 10, 2003 A1. *See also* Joe Stephens and David B. Ottaway, *Developers Find Payoff in Preservation*, Wash. Post, December 21, 2003 A1 (describing a myriad of allegedly abusive conservation easement donation transactions involving "wildly exaggerated" easement appraisals and developers who reaped "shocking" tax deductions for donating conservation easements on golf course fairways or otherwise undevelopable land). *But see* Rand Wentworth, President, LTA, *The Uses and Abuses of Conservation Easements (Editorial),* Wash. Post, Jan. 3, 2004 A20 (noting that, in their December 2003 article, the Washington Post reporters did not clearly distinguish the con artists from the land trusts doing legitimate conservation work, and that most landowners who donate easements are not wealthy developers or golf course owners but farmers, ranchers, and other ordinary Americans who love their land and are willing to forego the profits of development to preserve it forever).

16. *See infra* notes 237 and 246.

17. *See infra* Part II.A.3.c.

18. In the early 1980s, at the request of Congress, the United States Department of the Treasury (the "Treasury") conducted the only study to date of the use of tax incentives to stimulate the donation of conservation easements. *See* S. REP. NO. 96-1007, at 606 (1980) [hereinafter SENATE REPORT] (requesting the study). The Treasury delivered its final report on the tax incentives to Congress in 1987. *See* A REPORT TO THE CONGRESS ON THE USE OF TAX DEDUCTIONS FOR DONATIONS OF CONSERVATION EASEMENTS, OFFICE OF TAX ANALYSIS, U.S. DEPARTMENT OF THE TREASURY (December 1987) [hereinafter 1987 REPORT]. The 1987

states have been proposing and enacting new tax incentives with little consideration of the efficiency of the incentives, the ability of the government agencies and land trusts accepting donated easements to appropriately select, monitor, and enforce such easements, or the potential for exploitation and abuse. In fact, until the Washington Post articles, neither policy makers nor members of the land trust community appeared to recognize that if the federal government and state governments increase the tax incentives to a point where they encourage significant exploitation and abuse, a public opinion backlash could result, culminating in the restriction or elimination of the federal and state tax incentive programs, and calling into question both the credibility of the land trust community and the use of conservation easements as a private land protection tool.

The goal of this Article is to provide policy makers and the land trust community with the information necessary to judge whether and how the federal tax incentives available with respect to easement donations should be increased. The Article examines the operational aspects of the current federal tax incentive program, the weaknesses and limitations of that program, the interaction of that program with state sponsored tax incentive programs, and the possible ramifications of proposed increases in the federal tax incentives. The Article concludes with a recommendation for increasing the federal tax incentives in a manner that addresses some of the weaknesses and limitations of the federal tax incentive program. The Article also recommends the adoption of several strategies that would improve the existing federal tax incentive program and thereby reinforce an increasingly important component of private land conservation efforts in this country.[19]

To provide the reader with the necessary background, Part I of this Article sets forth a brief history of the development of the federal tax

Report suggests that direct government spending or government grant programs might be preferable to the use of tax incentives to acquire easements. *See id. at* 2. However, because the data necessary for a complete analysis of the tax incentives was lacking at the time of the preparation of the 1987 Report, the Treasury acknowledged that the findings in the report were not conclusive. *Id. at* 3; *see also* Ellin Rosenthal, *Treasury Suggests Replacing Deduction for Conservation Easements with Direct Outlays,* 38 TAX NOTES 8, 9 (1988) (noting that because of the paucity of hard facts in the "fact-finding" 1987 Report, neither the Treasury nor the conservation community was willing to assign great significance to the findings in the report). For the lone commentator critical of the tax incentives, *see* John A. Bogdanski, *Enough Already with the Breaks for Conservation Easements,* 78 TAX NOTES 1569 (1998).

19. For purposes of this article, it is assumed that Congress is correct in its determination that conservation easements are an important private land protection tool, and that the federal tax incentive program provides a valuable adjunct to other private land protection policies, such as regulation and direct spending programs, over which the federal government exercises greater control. A comparison of the various types of governmental policies that are implemented to accomplish private land protection goals (including regulation, direct spending programs, and tax incentives) is beyond the scope of this article.

incentives available with respect to easement donations. Part II then discusses the important operational aspects of the federal tax incentive program.

First examined in Part II is the issue of responsiveness, or the extent to which tax incentives actually stimulate the donation of easements. The available information suggests that tax incentives do play a role in stimulating easement donations, and that they are most effective in stimulating donations from relatively affluent landowners who do not intend to develop or otherwise use their land in ways inimical to its conservation values.

Next examined in Part II is the extent to which we can rely on easement donors and the government agencies and land trusts accepting donated easements to ensure that such easements accomplish the type of land protection envisioned by Congress when it enacted the federal tax incentives. Although easement donors have an incentive to comply with the requirements for the federal tax incentives, much of the responsibility for ensuring that donated easements accomplish the type of land protection envisioned by Congress rests with the government agencies and land trusts accepting such easements. While a variety of forces motivate government agencies and land trusts to accept only those easements that provide significant benefits to the public, Congress and the public could have far greater confidence in their easement selection and stewardship capabilities if they were required to meet certain basic expertise, practice, and resource standards through an accreditation program. Accordingly, it is recommended that the land trust community, perhaps through the LTA, begin developing a formal accreditation program for its members.

Last examined in Part II is the issue of conservation easement valuation. While it seems clear that some valuation abuse is occurring, to accurately assess and eventually quell such abuse the United States Department of the Treasury (the "Treasury") first must develop clear and comprehensive conservation easement appraisal standards. Due to the complexity involved in conservation easement appraisals, it is recommended that the Treasury call upon sources and experts outside of the department in developing such standards.

Part III then discusses three issues that Congress should consider when contemplating any proposed increase in the federal tax incentives. The issue of efficiency is discussed first, and in that context it is recommended that Congress consider the effect of any proposed increase in the incentives on the tax savings accruing to landowners of varying income and wealth levels. If Congress determines that a proposed increase in the incentives is likely to provide significant additional tax savings to a class of landowners that would have donated easements in the absence of such additional savings, Congress should design the increase to minimize those "windfall" benefits. Next discussed is the impact of proposed increases in the incentives on land rich, cash poor landowners, who are presented by the land trust community as the poster children for the proposed increases. Part III illustrates that land rich, cash poor landowners are not the appropriate targets of the federal tax incentive program, and that portraying them as the beneficiaries of proposed increases in the incentives is a red herring. Part III concludes with a discussion of the potential exploitation of the federal tax incentives, and warns that as the tax savings accruing to a landowner for the donation of a conservation easement approach the value of the development and use rights relinquished in the easement, the potential for exploitation and abuse of the tax incentives increases dramatically.

Part IV outlines a recommendation for increasing the federal tax incentives that addresses the efficiency, exploitation, and easement selection and stewardship concerns—in other words, a responsible approach.

I. HISTORY OF THE FEDERAL TAX INCENTIVES[20]

1964 Revenue Ruling

The Internal Revenue Service (the "IRS") first officially sanctioned a charitable income tax deduction for the donation of a conservation easement in a 1964 Revenue Ruling.[21] The taxpayer involved in the ruling

20. The history of the development of the federal tax incentives available with respect to conservation easement donations set forth in this Part is based upon and updates the history contained in the 1987 Report. *See* 1987 REPORT, *supra* note 18, at 4-7. However, the history set forth in this Part is intentionally brief and, in some respects, incomplete. For a more complete discussion of the history of the tax incentives *see, e.g.,* Kingsbury Browne, Jr. & Walter G. Van Dorn, *Charitable Gifts of Partial Interests in Real Property for Conservation Purposes,* 29 TAX LAWYER 69 (1975); Stephen J. Small, *The Tax Benefits of Donating Easements on Scenic and Historic Property,* 7 REAL ESTATE LAW JOURNAL 304 (1979) [hereinafter Small, *The Tax Benefits*]; Janet L. Madden, *Tax Incentives for Land Conservation: The Charitable Contribution Deduction for Gifts of Conservation Easements,* 11 B.C. ENVTL. AFF. L. REV. 105 (1983); STEPHEN J. SMALL, FEDERAL TAX LAW OF CONSERVATION EASEMENTS (1997) [hereinafter FEDERAL TAX LAW OF CONSERVATION EASEMENTS]; Stephen J. Small, *An Obscure Tax Code Provision Takes Private Land Protection into the Twenty-First Century*, *in* PROTECTING THE LAND: CONSERVATION EASEMENTS PAST, PRESENT, AND FUTURE 57-58 (Julie Ann Gustanski & Roderick H. Squires eds., 2000) [hereinafter Small, *An Obscure Tax Code Provision*]. Stephen J. Small, who worked as an attorney-advisor in the Office of Chief Counsel of the Internal Revenue Service (the "IRS") from 1978 to 1982, was involved in the drafting of the current Internal Revenue Code provision authorizing a charitable income tax deduction for the donation of a conservation easement, and was the principal author of the Treasury regulations interpreting that provision. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS at 1-2 to 1-3. Small now practices law in Boston and is a nationally recognized expert and consultant with respect to conservation easement transactions.

21. Rev. Rul. 64-205, 1964-2 CB 62.

was a private individual who owned land adjacent to a federal highway.[22] The United States wished to preserve the wooded appearance of the taxpayer's land (as well as the wooded appearance of other land adjacent to the highway) to maintain the scenic view afforded to travelers from the highway.[23] The ruling provides that the taxpayer, who gratuitously conveyed a perpetual conservation easement to the United States to preserve the scenic view from the highway, was entitled to a charitable income tax deduction equal to the fair market value of the easement.[24]

1965 Internal Revenue Service News Release

In a 1965 news release, the IRS advertised that landowners donating scenic easements to federal, state, and local governments are eligible for a charitable income tax deduction.[25]

Tax Reform Act of 1969

In the Tax Reform Act of 1969 (the "1969 Act"), Congress revised the Internal Revenue Code (the "Code")[26] to deny income, gift, and estate tax deductions for charitable contributions of most partial interests in property.[27] One type of partial interest in property that remained deductible was a fractional or percentage "undivided interest in property," such as an interest owned by a tenant in common.[28] However, because a conservation easement does not constitute an "undivided interest in property,"[29] the 1969 Act technically (and, apparently, inadvertently) eliminated the deductions for easement donations.[30]

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22. *Id.*

23. *Id.*

24. *Id.* The easement restricted the type and height of buildings that could be constructed on the taxpayer's land, the type of activities that could be conducted in the buildings, the removal of trees, the erection of utility lines, the dumping of trash, the use of signs, the erection of sales booths, and the size of parcels that could be sold. *Id.*

25. I.R.S. News Release No. 784 (Nov. 15, 1965).

26. Unless otherwise indicated, references to the Code or I.R.C. in this article are to the Internal Revenue Code of 1986, as amended.

27. *See* Pub. L. No. 91-172 (1969), § 201. *See also* BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS 35-28 to 35-29 (1990) (explaining that the 1969 revisions were intended, in large part, to curtail abuses associated with charitable lead trusts and charitable remainder trusts).

28. *See* Browne & Van Dorn, *supra* note 20, at 72 (citing to Treas. Reg. §1.170A-7(b)(1)(i), which provides that an undivided interest in property "must consist of a fraction or percentage of each and every substantial interest or right owned by the donor in such property and must extend over the entire term of the donor's interest in such property. . .").

29. A conservation easement generally represents the right to prevent or restrict the development and certain other uses of a parcel of land and, thus, does not represent a fraction or percentage of each and every substantial interest or right owned by the owner of the property encumbered by the easement. *See* supra note 28; Madden, *supra* note 20, at 127 n. 130, 131.

30. Browne & Van Dorn, *supra* note 20, at 74; Madden, *supra* note 20, at 127.

Aware of this problem, the committee preparing the Conference Report on the 1969 Act (the "1969 Conference Report") salvaged the deductions for easement donations by inserting the following statement in the report:

> The conferees on the part of both Houses intend that a gift of an open space easement in gross is to be considered a gift of an undivided interest in property where the easement is in perpetuity.[31]

Despite the inclusion of the foregoing statement in the 1969 Conference Report, the lack of explicit statutory authority for the deductibility of easement donations led to some uncertainty and caution on the part of potential donors.[32]

Tax Reform Act of 1976

Congress enacted explicit statutory authority for the charitable income, gift, and estate tax deductions for conservation easement donations as part of the Tax Reform Act of 1976 (the "1976 Act").[33] The 1976 Act added a provision to the Code authorizing such deductions for the donation of a conservation easement having a term of at least thirty years, provided the easement was donated to a governmental unit or qualifying charitable organization exclusively for one or more of the following three conservation purposes:

> (i) the preservation of land areas for public outdoor recreation or education, or scenic enjoyment,
>
> (ii) the preservation of historically important land areas or structures, or
>
> (iii) the protection of natural environmental systems.[34]

Congress did not indicate whether it intended the new deduction provision, with its conservation purposes requirement, to supersede the deductibility of "open space" easements based on the statement in the 1969 Conference Report discussed above.[35] However, the land

31. CONF. REP. 91-782, 1969-3 C.B. 644, 654; *see* Browne & Van Dorn, *supra* note 20, at 74 (noting that Congress evidently overshot the mark with a broad exclusionary rule for partial interest gifts, then employed the fiction that a conservation easement is an "undivided interest in property" not to merely fill a gap or resolve an ambiguity in the statute, but, rather, to make an exception for a partial interest otherwise squarely within the statutory prohibition).

32. *See* Browne & Van Dorn, *supra* note 20, at 75 (noting that "the cautious practitioner might well counsel that so fragile an exception may be narrowly and strictly construed and if relied upon should be closely adhered to"); Small, *The Tax Benefits, supra* note 20, at 310 (noting that "'the precarious non-Code authority for the deduction for *any* easements' had created considerable uncertainty. . .and had thrown a cloud over the growing use of easements for conservation and historic preservation purposes") (emphasis in original).

33. *See* Pub. L. No. 94-455 (1976).

34. I.R.C. §170(f)(3)(B)(iii) (1976).

35. *See* SENATE REPORT, *supra* note 18, at 603. By this time, the IRS had interpreted the statement in the 1969 Conference Report broadly to allow taxpayers to claim charitable

conservation community generally assumed that perpetual open space easements remained deductible pursuant to the statement in the 1969 Conference Report, and that the new deduction provision applied only to term easements.[36]

Tax Reduction and Simplification Act of 1977

In 1977, a Senator introduced legislation to extend the expiration date of the easement deduction provision enacted in 1976.[37] Although the Treasury had strongly endorsed the enactment of the easement deduction provision in 1976, in 1977 it had a change of heart and urged eliminating the deduction with respect to term easements.[38] Representatives from land conservation organizations apparently had convinced the Treasury that term easements would not result in the long-term protection of land for conservation purposes because land subject to a term easement was likely to be developed at the expiration of the term.[39] The Treasury ultimately was successful in pressing its position and, thus, while the Tax Reduction and Simplification Act of 1977 (the "1977 Act") extended the expiration date of the easement deduction provision until 1981, it also limited charitable income, gift, and estate tax deductions to the donation of perpetual easements.[40] Accordingly, the easement deduction provision as modified by the 1977 Act permitted deductions only with respect to perpetual easements donated to governmental units or qualifying charitable organizations exclusively for one or more of the three conservation purposes specified in the 1976 legislation.[41]

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deductions for the donation of perpetual open space, historical, and recreational easements. *See id.*

36. *See* Kingsbury Browne, Jr., *Taxes as a Form of Public Financing: Treasury's Open Space Protection Program*, *in* LAND SAVING ACTION 147, 152 (Russell L. Brenneman & Sarah M. Bates eds., 1984) (noting that "the land conservation community correctly took the position that the new criteria applied only to term easements" because "the notion that the 1976 legislation somehow narrowed or supplanted the 1969 undivided interest" exception "did not square with the obvious intent of Congress to liberalize the conservation easement tax rules" in the 1976 Act).

37. *See* Small, *The Tax Benefits, supra* note 20, at 315 (explaining that, as a result of a drafting error, the easement deduction provision enacted in 1976 was due to expire in June of 1977 instead of June of 1981 as originally intended).

38. *See id.* at 314-315.

39. *See id.* at 316 (noting the different views of land conservation and historic preservation organizations regarding term easements, and that the Treasury was influenced by the views of the land conservation organizations, particularly The Nature Conservancy, which believed that term easements were undesirable because they merely allowed development pressures to build up over thirty years, at which time the pressure to develop would be irresistible, and that the availability of the deduction for the donation of term easements inhibited the giving of perpetual easements on the same property).

40. *See* Pub. L. No. 95-30 (1977).

41. I.R.C. §170(f)(3)(B)(iii) (1977).

Congress again did not indicate whether it intended the deduction provision enacted in 1976, as modified by the 1977 Act, to supersede the deductibility of "open space" easements based on the statement in the 1969 Conference Report.[42] In addition, the Treasury never issued regulations interpreting the new deduction provision.[43] However, with the temporary blessing of the IRS, the land conservation community generally continued to assume that perpetual open space easements remained deductible pursuant to the statement in the 1969 Conference Report.[44]

Tax Treatment Extension Act of 1980

As part of the Tax Treatment Extension Act of 1980, Congress made the conservation easement deduction provision a permanent part of the Code, but imposed substantial new limitations on the deduction.[45] Under §170(h) of the Code as enacted in 1980 ("§170(h)"), an easement is eligible for the charitable income tax deduction only if it is donated: (i) in perpetuity, (ii) to a governmental unit or publicly-supported charity (or satellite of such charity), and (iii) for one or more of the following conservation purposes (the "conservation purposes test"):

(a) the preservation of land areas for outdoor recreation by, or the education of, the general public,

(b) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,

(c) the preservation of an historically important land area or a certified historic structure, or

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

42. *See* Senate Report, *supra* note 18, at 603.

43. *See* Federal Tax Law Of Conservation Easements, *supra* note 20, at 6-2 (noting that, although the Treasury Department had begun drafting regulations interpreting the deduction provision, "by 1979 it had become apparent that the statute would be reconsidered by Congress in 1980 because of the 1981 expiration date, and the Treasury Department decided that no further work would be done on the easement regulations pending the outcome of the congressional review of the statute.")

44. *See* Browne, *supra* note 36, at 147, 152 (noting that there was no suggestion that the 1977 amendment was intended to supplant the deductibility of easement donations based on the statement in the 1969 Conference Report, that the IRS issued a private letter ruling to that effect in 1979, but that the IRS reversed its position after a statement appeared in the Senate Report accompanying the 1980 legislation "to the effect that 'doubt' existed whether the 1976/1977 legislation supplanted the 1969 version.").

45. *See* Pub. L. No. 96-541 (1980), §6.

The Senate Finance Committee published a report providing guidance on the operation of §170(h) and the meaning of many of the unprecedented terms used therein, such as "clearly delineated governmental conservation policy" and "significant public benefit" (the "Senate Report").[46] The Senate Report also made it clear that §170(h) superseded the deductibility of easements based on the statement in the 1969 Conference Report and, thus, that to be deductible for income, gift, or estate tax purposes, all easements, including open space easements, must satisfy the requirements set forth in §170(h).[47]

Treasury Regulations

The Treasury published proposed regulations interpreting §170(h) in May of 1983, and held a public hearing on those regulations in September of 1983.[48] In November of 1983, representatives from several land conservation groups and a small number of attorneys met at the Feathered Pipe Ranch in Helena, Montana, to draft comments on the proposed regulations, which they then submitted to the Treasury for consideration.[49]

The Treasury published final regulations interpreting §170(h) on January 14, 1986 (the "Regulations").[50] The Regulations incorporate the explanations and examples of the operation of §170(h) contained in the Senate Report, and provide substantial additional guidance with regard to the meaning of many of the new concepts introduced into the Code by §170(h). The Regulations also reflect an acceptance by the Treasury of many of the major suggestions made by the participants in conference at the Feathered Pipe Ranch.[51] In fact, in crafting §170(h) and the Regulations, both Congress and the Treasury relied heavily on the experience and expertise of the conservation organizations acquiring easements. [52]

46. SENATE REPORT, *supra* note 18. The House Committee on Ways and Means published a substantially identical report. *See* H.R. REP. NO. 96-1278, at 14 (1980).

47. SENATE REPORT, *supra* note 18, at 604.

48. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 1-4; 48 Fed. Reg. 22,940 (May 23, 1983).

49. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 1-5. The "Feathered Pipe Comments" are included as Appendix D to FEDERAL TAX LAW OF CONSERVATION EASEMENTS.

50. Treasury Decision 8069, 51 Fed. Reg. 1496 (Jan. 14, 1986).

51. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 1-5.

52. *See, e.g., Minor Tax Bills: Hearings Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means,* 96th Cong. 212-221, 224-248 (1980) (in hearings on proposed revisions to §170(h), Congress heard testimony and received written statements from Thomas A. Coughlin, Chief Counsel, Real Estate, National Trust for Historic Preservation; William J. Chandler, Legislative Rep., The Nature Conservancy; Jennie Gerard, Dir., Land Trust Program of the Trust For Public Land; Benjamin R. Emory, Executive Dir., Maine Coast Heritage Trust; David P. Miller, Executive Dir., Maryland Environmental Trust; Tyson B. Van

Tax Reform Act of 1986

As part of the Tax Reform Act of 1986 (the "1986 Act"), Congress enacted provisions that permit a taxpayer to claim a charitable gift or estate tax deduction for the donation of a conservation easement without regard to whether the easement satisfies the conservation purposes test of §170(h).[53] Congress enacted those provisions because it was concerned that: (i) if a taxpayer donated an easement during her life to a qualified recipient and the IRS later established that the conservation purposes test of §170(h) was not satisfied, the taxpayer might be deemed to have made a taxable transfer equal to the value of the easement for purposes of the gift tax, and (ii) if a taxpayer donated an easement at death to a qualified recipient and the IRS later established that the conservation purposes test of §170(h) was not satisfied, the taxpayer's estate could be denied a charitable estate tax deduction for the value of the transferred easement.[54] Congress considered it unfair to subject easement donors or their estates to gift or estate tax under such circumstances because the donation of an easement is irreversible and the donor or the donor's estate might not have other property or funds with which to pay the gift or estate tax.[55]

Taxpayer Relief Act of 1997

As a result of the lobbying efforts of representatives of the land trust community, who argued that the existing tax incentives were not sufficient to stimulate the donation of easements from land rich, cash

Auken, Dir., Virginia Outdoors Foundation; Samuel W. Morris, Dir., French and Pickering Creeks Conservation Trusts, Inc.; and William Sellers, Dir., Brandywine Conservancy); *supra* note 39 and accompanying text (describing how the Treasury was influenced by the fact that land conservation organizations were not in favor of term easements); Janet Diehl, *Part One: Managing an Easement Program, in* CONSERVATION EASEMENT HANDBOOK, *supra* note 2, at 12, 23 (noting that "both the IRS and easement program administrators invested many months of effort to develop" the Regulations under §170(h)).

53. *See* Pub. L. No. 99-514 (1986), §1422.

54. *See* General Explanation of the Tax Reform Act of 1986, JCS-10-87, Title XIV, C. 2, at 1257. In general, a gratuitous transfer of property during life is treated as a gift subject to the federal gift tax unless a deduction or exclusion applies. Similarly, a gratuitous transfer of property at death is treated as a transfer of wealth subject to the federal estate tax unless a deduction or exclusion applies. After the enactment of §170(h) in 1980, and before the uncoupling of the §170(h) conservation purposes test from the charitable gift and estate tax deductions available with respect to easement donations in the 1986 Act, a landowner gratuitously transferring an easement during life or at death was entitled to a charitable gift or estate tax deduction equal to the value of the easement only if the donation transaction satisfied all of the requirements under §170(h), including the conservation purposes test. Thus, during that period, a landowner gratuitously transferring an easement during life or at death that did not satisfy one or more of the requirements under §170(h) could be treated as having made a gift subject to the gift tax or a transfer of wealth subject to the estate tax.

55. *Id*.

poor landowners,[56] Congress enacted a new federal estate tax incentive for the donation of a conservation easement as part of the Taxpayer Relief Act of 1997.[57] Under §2031(c) of the Code ("§2031(c)"), up to 40 percent of the value of land encumbered by a conservation easement can be excluded from a decedent's estate for estate tax purposes, provided, *inter alia,* that the easement was donated (rather than sold) and the donation met the requirements for the charitable income tax deduction under §170(h).[58] As originally enacted, the estate tax exclusion under §2031(c) was available only with respect to land located in or within twenty-five miles of a metropolitan statistical area, national park, or wilderness area, or in or within ten miles of an urban national forest.[59]

The Economic Growth and Tax Relief Reconciliation Act of 2001

As part of the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act"), Congress amended §2031(c) to provide that the estate tax exclusion is available with respect to all land located in the United States or its possessions.[60]

56. *See, e.g., Impact of Tax Law on Land Use: Hearing Before the Subcomm. on Oversight of the House Comm. on Ways and Means,* 104th Cong. 40-43 (1996) (statement of Jean Hocker, President, Land Trust Alliance) (testifying in favor of the adoption of a variety of measures to increase the tax incentives available with respect to easement donations, and noting that property owners whose land or extinguished development rights are worth a great deal, but whose incomes are modest, are unable to claim much of the charitable income tax deduction generated by an easement donation, and, in areas of rapidly escalating land values, the long term estate tax benefit of the reduction in the value of land resulting from an easement donation may not be substantial enough to serve as a strong incentive for conservation.); *id.* (statement of C. Timothy Lindstrom, attorney, Piedmont Environmental Council) (testifying in favor of the enactment of an estate tax exclusion for land subject to a conservation easement, and noting that the existing tax incentives provide landowners with very valuable land but small incomes, many of whom are farmers and ranchers, with "little or no incentive" to donate easements).

57. Pub. L. No. 105-34 (1997), §508.

58. Due to an apparent drafting error, the estate tax exclusion is not available with respect to an easement donated for the conservation purpose of protecting an historic land area or structure. *See* I.R.C. §2031(c)(8)(B). For a detailed description of the additional eligibility requirements and limitations of §2031(c), *see, e.g.,* C. Timothy Lindstrom & Stephen J. Small, *New Estate Tax Relief for Land Under Conservation Easement,* 78 TAX NOTES 1171 (1998); Nancy A. McLaughlin, *Tax Benefits of Conservation Easements,* 23 TAX MGMT. EST., GIFTS & TR. J. 253 (1998); Stephen J. Small, *Understanding the Conservation Easement Estate Tax Provisions,* 87 TAX NOTES 435 (2000).

59. § 2031(c)(8)(A)(i) (1997).

60. *See* Pub. L. No. 107-16 (2001), § 551.

II. OPERATIONAL ASPECTS OF THE TAX INCENTIVE PROGRAM

A. *Responsiveness: The Extent to Which Tax Incentives Stimulate Conservation Easement Donations*

In the early 1980s, the Treasury prepared a report for Congress on the use of charitable deductions to stimulate the donation of conservation easements (the "1987 Report").[61] In the 1987 Report, the Treasury noted that the desirability of providing tax incentives to stimulate the donation of easements depends, in part, on the effectiveness of those incentives in actually stimulating donations.[62] The Treasury explained that if the tax incentives do not stimulate the donation of any easements, and all of the donations that are made would be made even in the absence of the incentives, the only impact of providing the incentives would be foregone tax revenue.[63] On the other hand, the Treasury noted that it is possible that a large number of easement donations are made in response to the tax incentives, and that the incentives stimulate the donation of easements with an aggregate value far in excess of the revenue lost as a result of the incentives.[64] In the latter case, the tax incentive program would be "efficient" in the sense that the value of the easements obtained as a result of the program would far exceed the cost of the program. The Treasury acknowledged, however, that at the time of the preparation of the 1987 Report, very little was known about the extent to which tax incentives stimulate the donation of easements and, thus, the efficiency of the incentives as a policy tool.[65]

Unfortunately, we still know very little about the extent to which tax incentives stimulate the donation of easements. To the author's knowledge, no one has yet conducted any empirical research on that topic. In addition, although economists have extensively researched the extent to which federal tax incentives stimulate charitable giving in general, they have not reached a consensus on the efficiency of such incentives.[66] Moreover, even if such research provided more definitive

61. *See* 1987 REPORT, *supra* note 18.

62. *Id.* at 8.

63. *Id.* at 8-9.

64. *Id.* at 9. The term "value" used in this section refers to the appraised value of donated easements. Various issues associated with the valuation of easements are discussed in Part II.C, *infra*.

65. *See* 1987 REPORT, *supra* note 18, at 9.

66. *See, e.g.,* JOINT COMMITTEE ON TAXATION, DESCRIPTION AND ANALYSIS OF PRESENT LAW AND PROPOSALS TO EXPAND FEDERAL TAX INCENTIVES FOR CHARITABLE GIVING 14 (2001) (citing to the economic literature and noting that while the preponderance of the evidence indicates that the charitable income tax deduction acts as a stimulant to charitable giving, at least for high-income taxpayers, less consensus exists on exactly how responsive charitable contributions are to changes in the incentives); Edward J. McCaffery & Don R. Weigandt, *Lobbying for Life: Protecting Charitable Giving Without a Death Tax*, 98 TAX NOTES

conclusions on the question of efficiency, it arguably would be inappropriate to extrapolate from studies of charitable giving in general to easement donations.[67]

In the absence of empirical evidence, other sources must be consulted to determine whether and the extent to which tax incentives stimulate the donation of easements. Considered below are several diverse sources of information that, collectively, give a general sense of the responsiveness of easement donors to the tax incentives. That information, and the tentative conclusions drawn therefrom, inform the discussion of the efficiency of the tax incentives in Part III.A.

1. Growth in the Use of Conservation Easements and Number of Land Trusts Acquiring Conservation Easements

From the first official recognition of the availability of a charitable income tax deduction for the donation of a conservation easement in 1964 to the enactment of §170(h) in 1980, the federal income, gift, and estate tax deductions available with respect to easement donations remained relatively obscure and somewhat uncertain in their application.[68] In addition, although the enactment of §170(h) in 1980 resolved some of the uncertainties surrounding the deductions available with respect to easement donations, that section also imposed substantial new requirements on such deductions, many of which were without precedent in the Code.[69] In fact, one commentator noted that the uncertainty surrounding the new deductibility requirements set forth in §170(h) caused the temporary suspension of various land protection programs involving easement donations.[70]

It was not until the mid-1980s that landowners, practitioners, and the land trust community began to feel confident that the new deductibility requirements under §170(h) could be satisfied.[71] By that time, the IRS

97 (2003) (noting that the empirical effects of estate tax repeal on charitable giving are uncertain and have been the subject of lively debate).

67. The donation of a conservation easement differs significantly from the typical donation of cash or appreciated property to a charity because an easement represents a partial interest in property, and the easement donor retains the ownership and use of the land subject to the easement.

68. *See supra* Part I, discussing the history of the development of the federal tax incentives available with respect to easement donations.

69. *See supra* Part I, *Tax Treatment Extension Act of 1980.*

70. *See* Browne, *supra* note 36, at 147, 149 (noting also that such suspensions support "the perception that tax incentives can be a major factor" in stimulating easement donations).

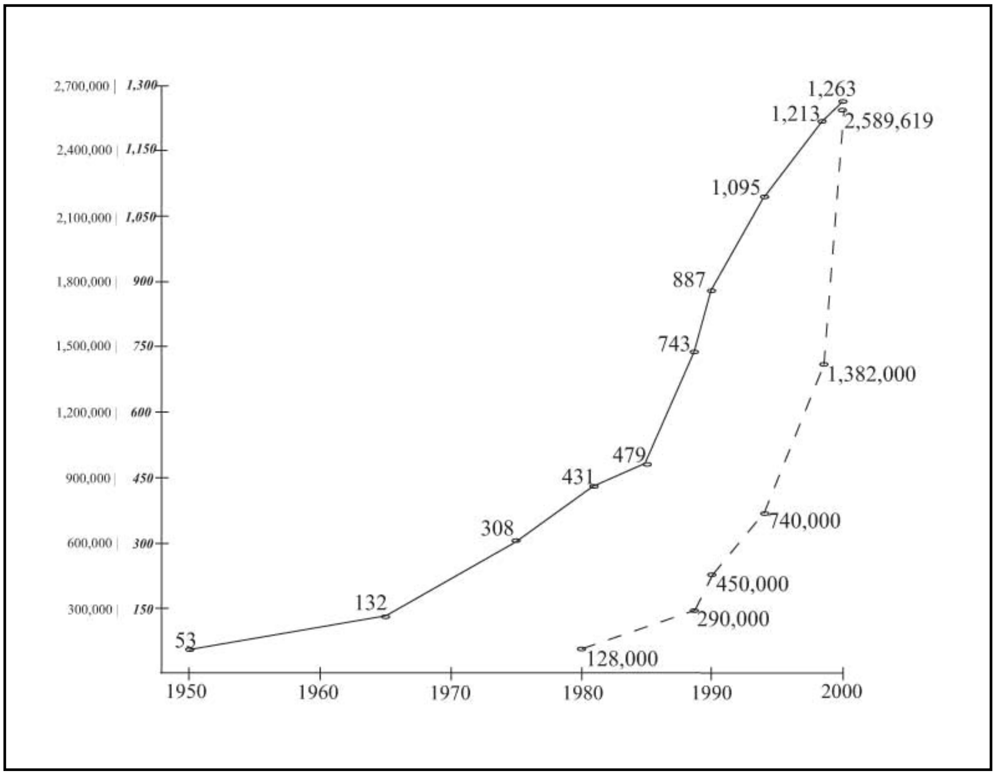
71. *See* Small, *An Obscure Tax Code Provision, supra* note 20, at 57 (noting that the land trust community initially was concerned that §170(h) might be unworkable because landowners would have no assurance that they were satisfying the tests for deductibility under §170(h), and that through the early 1980s many people did not believe they eventually would become comfortable with the new tax language in that section).

had issued a series of taxpayer-friendly private letter rulings addressing the deductibility requirements under §170(h), the Tax Court had decided a number of cases addressing the issue of easement valuation, and the Treasury had issued final regulations interpreting §170(h).[72] Moreover, the uncoupling in 1986 of the conservation purposes test of §170(h) from the charitable gift tax deduction available with respect to easement donations assured potential easement donors that they would not find themselves subject to gift tax as a result of having donated a non-qualifying easement.[73] Accordingly, it is not surprising that, as illustrated in *Figure 1* below, there was a dramatic increase beginning in the mid-1980s in the number of local, state, and regional land trusts operating in the United States, and in the number of acres protected by conservation easements held by such land trusts.

72. *See id.,* at 55, 57-60 (noting that the growth of the land trust movement accelerated through the 1980s as land trusts became increasingly familiar with §170(h) and its possible uses, that a series of favorable IRS letter rulings increased landowner and advisor confidence in the workability of the tax code rules, that a series of generally positive tax court cases assured practitioners that §170(h) works and that a sound and professional appraisal would result in the anticipate income tax benefits, and that the Regulations provided a sound framework for the answers to the questions raised by §170(h)).

73. *See supra* Part I, *Tax Reform Act of 1986*.

Figure 1[74]*—Growth in Land Trusts and Acres Protected by Conservation Easements*



——— Number of local, state, and regional land trusts operating in the United States

------- Number of acres protected by conservation easements held by local, state, and regional land trusts operating in the United States

74. The information contained in *Figure 1* was derived from the periodic census data gathered by the LTA. *See supra* note 6. 1980 is the first year for which data with respect to the number of acres protected by conservation easements held by local, state, and regional land trusts is readily available. *Id.* The LTA does not collect data on the number of acres protected by conservation easements that were purchased by, as opposed to donated to, local, state, and regional land trusts. *See* NUDEL CONVERSATION *supra* note 6. However, there is some evidence indicating that most of the acreage protected by conservation easements held by local, state, and regional land trusts is protected by easements that were donated to such land trusts. *See, e.g.,* Martha Nudel, *Conservation Easements Emerge as the Decade's Top Land Protection Tool*, in Vol. 18, No. 1 EXCHANGE, THE JOURNAL OF THE LAND TRUST ALLIANCE 5 (1999) (noting that, according to the LTA's census data, in 1998 approximately 1.4 million acres were protected by conservation easements held by local, state, and regional land trusts, the "vast majority" of those easements were donated, and only 18 percent of the land trusts had purchased any easements).

As *Figure 1* indicates, over 60 percent of the 1,263 local, state, and regional land trusts in existence as of December 31, 2000, were created after 1985, and approximately 88 percent of the acreage protected by conservation easements held by such land trusts as of December 31, 2000, was protected after 1988.

Of course, the dramatic growth in the use of conservation easements and the number of land trusts that acquire easements since the mid-1980s may be attributable to a variety of factors including: (i) approval of the Uniform Conservation Easement Act in 1981,[75] (ii) increasing development pressures,[76] and (iii) a growing disillusionment with the government's ability to adequately protect private land from development.[77] However, the fact that the growth in the use of easements and the number of land trusts has so closely paralleled the evolution of the federal tax incentives strongly suggests that such growth is attributable, at least in part, to such incentives.[78]

The recent experience of the State of Virginia also indicates that tax incentives play a role in stimulating easement donations. Since 2000, Virginia has allowed a landowner who donates a perpetual easement encumbering land located in Virginia to claim a credit against Virginia income tax equal to 50 percent of the value of such easement.[79] Pursuant

75. *See* John L. Hollingshead, *Conservation Easements: A Flexible Tool for Land Preservation*, 3 ENVTL. LAW. 319, 335-36 (1997) (noting that the Uniform Conservation Easement Act (the "UCEA") made conservation easements more useful for modern land protection purposes by eliminating several common law impediments to the validity and enforcement of such easements and that, as of 1997, sixteen states and the District of Columbia had adopted the UCEA). As of 2003, twenty-one states and the District of Columbia had adopted the UCEA. *See* Uniform Law Commissioners, *A Few Facts About the Uniform Conservation Easement Act*, *at* http://www.nccusl.org/nccusl/uniformact_factsheets/uniformacts-fs-ucea.asp (last visited Dec. 29, 2003).

76. *See, e.g.,* 1997 NRI Highlights, *supra* note 1.

77. *See, e.g.,* Julie Ann Gustanski, *Protecting the Land: Conservation Easements, Voluntary Actions, and Private Lands*, *in* PROTECTING THE LAND: CONSERVATION EASEMENTS PAST, PRESENT, AND FUTURE 17 (Julie Ann Gustanski & Roderick H. Squires eds., 2000) (noting that "despite the efforts of countless planning commissions and local and regional government agencies, many people across the country have become frustrated and disillusioned by the failings of various government programs to adequately protect cherished lands from sprawling development," and that "this 'disappointment factor' has played a significant role in the phenomenal growth of land trusts"); FAIRFAX & GUENZLER, *supra* note 11, at 7-8 (discussing the devolution and dispersal of governmental authority in the areas of land and resource conservation).

78. *See* Small, *An Obscure Tax Code Provision, supra* note 20, at 55 (noting that "passage of section 170(h) in 1980 was not the only reason for the land trust boom, but conditions were certainly ripe for capitalizing on tax incentives. . . . [A]cross the country, land values were on the rise and there was an increasing demand for land. . . . [T]hese factors, coupled with continued and growing estate tax problems, made the perfect setting for section 170(h).").

79. *See* VA. CODE ANN. §§ 58.1-510—513 (2000).

to the original credit legislation, in 2002 and thereafter, the amount of the credit that can be claimed by an easement donor in any year is limited to $100,000, and unused credit can be carried forward for five years following the year of the donation (for a maximum aggregate credit over the six year period of $600,000).[80] In April of 2002, the Virginia Legislature amended the credit provision to allow easement donors to sell or otherwise transfer unused credits to other Virginia taxpayers, thus extending the benefit of the credit to landowners who do not have sufficient Virginia income tax liability to fully absorb the credit.[81] The following chart indicates the annual growth since 1993 in the number of easement projects undertaken by the Virginia Outdoors Foundation, the state agency that accepts the vast majority of easements donated in Virginia, and in the number of acres protected by such projects.[82]

80. *Id.* A tax credit is much more valuable than a deduction because a credit reduces a taxpayer's tax liability dollar-for-dollar, while the tax savings from a deduction are limited to the amount of the deduction multiplied by the taxpayer's marginal tax rate. For example, a $600,000 Virginia income tax credit could save a taxpayer with $600,000 of Virginia income tax liability $600,000, while a deduction for the same amount, assuming a Virginia income tax rate of 5 percent, could save the taxpayer a maximum of only $30,000 ($30,000 is the amount of Virginia income tax the taxpayer would pay at a rate of 5 percent on an additional $600,000 of income absent the deduction).

81. *Id.* at §58.1-513 (2002). In November of 2002, the Virginia Attorney General issued an advisory opinion indicating that, although the donor of an easement can claim no more than $600,000 of credit over a period of six years, the amount of credit that may be sold or otherwise transferred is equal to 50 percent of the value of the easement. Thus, a landowner donating an easement valued at $2 million would be allowed a state income tax credit of $1 million that the landowner could use or transfer as he pleases, subject to the restriction that any one taxpayer may use only $600,000 of the credit at a rate of $100,000 per year. *See* Letter from Jerry W. Kilgore, Attorney General of Virginia, to The Honorable William J. Howell, Member, House of Delegates (Nov. 19, 2002) (on file with author). Easement donors who have sold their state income tax credits through credit "brokers" have received up to eighty cents per dollar of credit transferred. Telephone conversation with Taylor M. Cole, President of Conservation Partners, LLC (Feb. 7, 2004).

82. Virginia Outdoors Foundation, *VOF Easements by Year*, *at* http://www.virginiaoutdoorsfoundation.org/VOF/Statistics.htm (last visited Dec. 29, 2003). The term "easement project" includes any legal instrument to which the Virginia Outdoors Foundation is party, including new easements, amendments to existing easements, boundary line adjustments, and corrections. *Id.*

Year	Easement Projects	Yearly Acreage
1993	30	4,884
1994	43	5,392
1995	37	5,453
1996	34	5,712
1997	45	7,673
1998	75	13,532
1999	60	11,419
2000	188	28,725
2001	155	22,702
2002	207	37,000

The dramatic jump in the number of easement projects undertaken by the Virginia Outdoors Foundation and the yearly amount of acreage protected by such projects since 1999 may be attributable to a variety of factors, including increasing development pressures and a growing perception in the region of the need to protect rural and historic lands from suburban development.[83] However, the fact that the number of easement projects and the yearly amount of acreage protected by such projects more than doubled in 2000, which was the first year the generous state income tax credit was available, and rose significantly again in 2002, when the credit provision was amended to allow donors to sell or otherwise transfer unused credits, strongly suggests that the state income tax credit has played a significant role in stimulating easement donations in Virginia.

2. The Costs of a Conservation Easement Donation

There are two types of costs associated with the donation of a conservation easement: (i) the reduction in the fair market value of the land that results from placing permanent restrictions on its development and use (the "market cost" of the donation), and (ii) the legal, appraisal, and other out-of-pocket costs associated with the donation (the "transaction costs").

The market cost of a conservation easement donation can be measured by comparing: (i) the fair market value of the land immediately before the donation (unencumbered by the easement restrictions) and (ii) the fair market value of the land immediately after the donation (encumbered by the easement restrictions). The difference between those

83. *See, e.g.*, Larry Van Dyne, *As Far as the Eye Can See*, 35 WASHINGTONIAN 58 (describing the negative impacts associated with the dramatic increases in population and suburban sprawl in the counties located in northern Virginia and southern Maryland near Washington, D.C.).

two values represents the cost incurred by the landowner in foregoing, permanently, the opportunity to develop and use the land in ways prohibited by the easement. The difference between those two values also represents the value of the landowner's charitable contribution for purposes of the deduction under §170(h).[84]

Anecdotal evidence of the market cost of conservation easement donations is readily available. For example, the IRS has challenged the taxpayer's asserted value for a donated conservation easement encumbering land for purposes of the deduction under §170(h) in seventeen reported cases, and those cases reveal court-approved easement values with a low of $20,800 and a high of $4,970,000.[85] Those cases also reveal that easements have reduced the value of the land they encumber by as little as 2 percent and as much as 91 percent, with an average diminution of approximately 43 percent.[86] The seventeen reported cases in which the IRS has challenged the taxpayer's asserted value for a donated conservation easement clearly do not represent a valid sample of easement donations. However, the values reported in those cases do support the common sense notion that, due to rising land values,[87] increasing development pressures,[88] and the type of permanent restrictions that must be placed on the development and use of land in an easement to be eligible for the federal tax incentives,[89] the donation of an easement generally will reduce the value of the land it encumbers by at least multiple thousands, if not hundreds of thousands, or even millions of

84. *See infra* Part II.C (discussing the "before and after" method of easement valuation sanctioned by the Regulations for purposes of determining an easement donor's charitable income tax deduction).

85. *See infra* Appendix A. Appendix A does not include cases in which the IRS challenged the taxpayer's asserted value for a conservation easement encumbering an historic structure (typically referred to as an "historic preservation easement").

86. *Id*. The information needed to calculate a diminution percentage is available in only fourteen of the seventeen cases, and the average diminution percentage is based on those fourteen cases.

87. For example, the national average farm real estate value (land and buildings) per acre held steady at under $100 from 1910 through the late 1950s, then jumped from slightly over $100 per acre in 1960 to over $800 per acre in 1996. *See* Keith Wiebe, Abebayehu Tegene, & Betsey Kuhn, *Partial Interests in Land, Policy Tools for Resource Use and Conservation,* U.S.D.A. REP. NO. 744, 3 (Nov. 1996) [hereinafter PARTIAL INTERESTS IN LAND]. By January 1, 2001, the average farm real estate value (land and buildings) per acre had risen to $1,130. U.S.D.A. National Agricultural Statistics Service, *Agricultural Land Values* 1 (Aug. 2001) (noting that during the 1990s, the average farm real estate value (land and buildings) per acre increased 65 percent for an average of 6.5 percent a year).

88. *See* 1997 NRI Highlights, *supra* note 1.

89. For a detailed discussion of the type of permanent restrictions that must be placed on the development and use of land in an easement to be eligible for the charitable income tax deduction under §170(h), the charitable gift tax deduction under §2522(d), and the estate tax exclusion under §2031(c), see FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, and the articles cited in note 58 *supra*.

dollars.[90] Accordingly, the market cost of an easement donation typically will be quite high.[91]

The typical easement donor also will incur costs associated with obtaining legal and tax advice, making any necessary surveys of the property, and obtaining a qualified appraisal to substantiate the value of the donation for purposes of the deduction under §170(h).[92] In addition, many land trusts either request or require that a landowner donating an easement make a cash donation to the land trust to help defray the costs associated with the land trust's acceptance, monitoring, and enforcement of the easement.[93] Thus, the transaction costs associated with an easement donation also can be significant.[94]

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90. In fact, there is some anecdotal evidence that easements valued in the millions of dollars are becoming more common. *See* Stephen J. Small, *Third Supplement (1996-2000),* Federal Tax Law Of Conservation Easements, *supra* note 20, at 2 (noting that "Whereas million dollar income tax deductions for conservation easement donations were unusual, if not quite rare, a decade ago, they seem to happen more often as development values increase."); Small, *An Obscure Tax Code Provision, supra* note 20, at 56 (noting that at least one easement donated in 1998 had a value of more than ten million dollars).

91. Landowners have limited ability to reduce the market cost of their easement donations. Although the reduction in the value of land resulting from an easement donation can be minimized by encumbering only a small or less valuable portion of a landowner's acreage with the easement, or by reserving substantial development and use rights in the easement, such easements are likely to be less attractive to easement holders and to run afoul of the eligibility requirements for the federal tax incentives.

92. *See, e.g.*, Janet Diehl, *Part One: Managing an Easement Program, in* Conservation Easement Handbook, *supra* note 2, at 61-68 (describing the steps involved in the easement donation process).

93. *See id.* at 101-10 (noting that many donee organizations solicit cash contributions from easement donors to cover the costs associated with accepting, monitoring, and enforcing the donated easements, and describing formulas used by various organizations in determining how much money to solicit from donors); William T. Hutton, *The Munificent Conservation Easement, in* Tax Strategies in Land Conservation Transactions 9 (2002) (on file with author) [hereinafter Hutton, *The Munificent Conservation Easement*] (noting that the donation of an easement is nearly always conditioned upon a simultaneous cash gift sufficient to cover the generally predictable costs of the land trust's monitoring responsibilities and the contingent and unpredictable costs of future enforcement proceedings). The costs incurred by a land trust in accepting a donated easement include the staff time and resources spent in negotiating the terms of the easement with the donor and documenting the condition of the land at the time of the donation.

94. *See* Lynn Asinof, *Your Money Matters: Conservation Easements Lighten Taxes,* Wall St. J., Aug. 9, 1999, at C15 (noting that the easement donation process "typically takes many months, can cost $5,000 to $10,000 or more, and may require creation of an endowment for the parcel"); Paul Elconin & Valerie A. Luzadis, *Evaluating Landowner Satisfaction with Conservation Restrictions,* A Research Project and Publication of the State University of New York, College of Environmental Science and Forestry and Vermont Land Trust 11 (1997) [hereinafter The SUNY Survey] (on file with author) (noting that landowners are chagrined at the costs of granting easements, that several respondents to the survey expressed dismay with the costs of the property appraisals and surveys necessary before granting an easement, that some respondents wondered why they had to pay to give something away and felt that those costs deter potential grantors, and that one respondent commented *". . .I have friends who would be more than willing to donate conservation easements but have told me they will not spend thousands of dollars to give something away. I don't blame them."*) (emphasis in original).

The Treasury has argued that a landowner who has no desire to sell or develop his land gives up little or nothing by donating an easement.[95] However, that argument ignores both the economic and practical realities of an easement donation. As noted above, the market and transaction costs associated with an easement donation typically will be quite high. In addition, the significant reduction in the value of land that results from an easement donation is not reversible should the landowner have a change in fortunes, will have an adverse impact on the landowner's ability to borrow against the value of the land, and will reduce either the proceeds the landowner will receive on a subsequent sale of the land or the value of the assets the landowner is able to transfer at death.[96] Moreover, every

95. *See Miscellaneous Tax Bills: Hearing on H.R. 4611 Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means,* 96th Cong. 12 (1979) (statement of Daniel I. Halperin, Deputy Assistant Sec'y, Treasury Dep't) (noting that "for a taxpayer who does not have the present intention to sell or develop the property, the gift of. . .a conservation easement, while perhaps diminishing the value of the property, does not do so until a later date; in particular, it may have no material impact on the continuing enjoyment of the property by the donor of the easement").

96. Perpetual easements theoretically may be terminated through a variety of means. *See* RICHARD R. POWELL, POWELL ON REAL PROPERTY §34A.07[1] (Michael Allan Wolf ed., 2003) [hereinafter POWELL ON REAL PROPERTY] (noting that conservation easements may be modified or terminated by condemnation, by the foreclosure of pre-existing liens, by foreclosure for unpaid taxes, under a Marketable Title Act, by merger or abandonment, under the doctrine of changed conditions, or by release of the holder). However, the Regulations contain a number of requirements intended to protect the public's investment (in the form of foregone tax revenue) in easements eligible for the various federal tax incentives. For example, any mortgage encumbering the land subject to an easement must be subordinated to the rights of the agency or organization accepting the easement (thus precluding extinguishment by foreclosure of pre-existing liens); the easement deed must provide that the easement may be transferred only to another government agency or publicly-supported charity (or satellite thereof), and only if the transferee agrees that the conservation purposes of the easement will continue to be carried out (thus arguably precluding release by the holder); and the easement deed must provide that, if changed conditions make impossible or impractical the continued use of the land for conservation purposes, the easement may be extinguished only in the context of a judicial proceeding and, if the easement is so extinguished and the land is sold or exchanged, proceeds attributable to the value of the easement must be paid to the agency or organization holding the easement (thus protecting the interest of the holder of the easement in the event of extinguishment due to changed conditions). *See* Treas. Reg. §§1.170A-14(c)(2), (g)(2), (g)(6). In addition, under the law of most states, compensation will be paid to the holder of an easement in the event of condemnation, and encumbrances such as easements are not extinguished by tax sales. *See* POWELL ON REAL PROPERTY at §34A.07[2], [3]. Finally, while a perpetual easement could be extinguished by abandonment, the application of a Marketable Title Act, or merger, the incidence of such extinguishments is likely to be low. *See, e.g., id.* at §34A.07[5][b] (noting that abandonment is not likely to occur in the conservation easement context); Janet Diehl, *Part One: Managing an Easement Program, in* CONSERVATION EASEMENT HANDBOOK, *supra* note 2, at 67 (discussing the use of "back-up" grantees to prevent abandonment); William R. Ginsberg, *Term and Termination: When Easements Aren't Forever, in* CONSERVATION EASEMENT HANDBOOK, *supra* note 2, at 134 (noting that merger will not occur often and is of little importance since the holder-owner's interest is to protect the property); Bill Silberstein & Bridget McNeil, *Protecting Conservation Easements from Marketable Record Title Act Extinguishment*, vol. 21, n.1 EXCHANGE: THE JOURNAL OF THE LAND TRUST ALLIANCE 19-20 (Winter 2002) (noting that, while twenty-two states have a Marketable Title Act, five of those

easement donation involves a permanent loss of some autonomy with respect to the use and management of the encumbered land.[97]

On the other hand, it is reasonable to assume that landowners who do not intend to develop or otherwise use their land in ways inimical to its conservation values will tend to discount at least the market cost of an easement donation.[98] Such discounting is likely to be modest among less affluent landowners, who often are forced to rely upon the development value of their land as collateral for loans, as a source of cash from the sale of lots in the event of economic exigency, or as a source of retirement savings. However, such discounting is likely to be aggressive among more affluent landowners, who generally do not need or rely upon the development value of their land. In fact, more affluent landowners who do not intend to develop or otherwise use their land in ways inimical to its conservation values may view an easement donation as an enticing opportunity to liquidate some of the equity in their land without interfering with their current use and enjoyment of that land, albeit at generally disadvantageous terms.[99] Moreover, because of the declining marginal utility of the dollar, both the market and transaction costs associated with an easement donation are likely to seem less significant to more affluent landowners. Indeed, the transaction costs alone may present an insurmountable barrier to easement donations by less affluent landowners, who simply may not have the cash to defray such costs.[100]

3. *The Design of the Tax Incentives*

A landowner who donates a conservation easement during his lifetime may be eligible for three federal tax benefits: a charitable income tax deduction under §170(h), a charitable gift tax deduction under §2522(d) of the Code ("§2522(d)"), and an exclusion of up to 40 percent

states exempt conservation easements from the act, and in the other seventeen states easement holders can take proactive steps to prevent their easements from being extinguished under the act). Thus, while it is theoretically possible that an easement could be extinguished and the value attributable to the easement would inure to the benefit of the donor (or the donor's successor in interest), for all practical purposes the donor of a tax-deductible perpetual easement irrevocably parts with the value attributable to the easement.

97. The restrictions on development and use contained in a perpetual easement become a part of the land records and operate to prevent the landowner and all successor owners from developing or otherwise using the land in manners prohibited by the easement. In addition, the donor of an easement that qualifies for the federal tax incentives generally must grant the agency or organization accepting the easement the right to enter the property at reasonable times to ensure that the easement terms are not being violated. *See* Treas. Reg. §1.170A-14(g)(5)(ii).

98. That is, landowners will discount the market cost of an easement if they feel that what they are giving up in the easement is something they did not want or need anyway.

99. *See infra* Part II.A.3, explaining that, in most cases, the federal tax savings generated by an easement donation, when computed on a present value basis, will be substantially less than the market cost of the donation.

100. *See supra* note 94.

of the value of the land subject to the easement from the landowner's estate for estate tax purposes under §2031(c). The landowner also may be eligible for state and local tax benefits.

The analysis set forth below of the design of the various federal and state tax incentives provides important information regarding the extent to which those incentives can be expected to stimulate easement donations. In particular, such analysis reveals that: (i) in most cases, the combined federal income and estate tax savings generated by an easement donation, when computed on a present value basis, will reimburse the donor for substantially less than the market cost of the easement, (ii) the federal income and estate tax savings generated by an easement donation decline precipitously as the donor moves down the income and wealth scale, and (iii) the addition of generous state income tax credits like those available in Virginia will increase significantly the aggregate tax savings accruing to more affluent landowners as a result of an easement donation, and may make easement donations attractive to landowners at the low end of the income and wealth scale who benefit little from the existing federal incentives.

a. The Federal Charitable Income Tax Deduction

The charitable income tax deduction has been criticized for being an "upside-down" incentive in that it provides high-income taxpayers with disproportionately greater tax savings than middle and low-income taxpayers.[101] The upside-down incentive effect of the charitable income tax deduction results from the fact that the tax savings generated by a deduction depend upon the taxpayer's marginal income tax rate and, under our progressive rate structure, marginal income tax rates increase as one moves up the income scale. For example, if a high-income taxpayer subject to a marginal income tax rate of 35 percent, a middle-income taxpayer subject to a marginal income tax rate of 27 percent, and a low-income taxpayer subject to a marginal income tax rate of 15 percent each make a deductible charitable contribution of $100, the $100 deduction will generate an income tax savings of $35 for the high-income taxpayer, $27 for the middle-income taxpayer, and only $15 for the low-income taxpayer.[102]

101. *See, e.g.*, CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING 285 (1985) (noting that the charitable deduction has come in for sustained and vigorous criticism for its alleged favoritism toward high-income taxpayers).

102. The $100 deduction generates income tax savings for each taxpayer equal to the amount of income tax the taxpayer would have paid at the taxpayer's marginal income tax rate on an additional $100 of income absent the deduction. The $100 deduction would generate no tax savings for a taxpayer who does not have sufficient income to incur tax liability, or whose aggregate itemized deductions fall below the amount of the standard deduction. *See* MUSGRAVE & MUSGRAVE, PUBLIC FINANCE IN THEORY AND PRACTICE 362 (3rd ed. 1980) (noting that "[a]

The upside-down incentive effect of the charitable income tax deduction is exacerbated in the context of an easement donation for two reasons. First, the charitable income tax deduction generated by an easement donation generally is equal to the amount by which the easement reduces the fair market value of the land it encumbers, and easements typically reduce the fair market value of the land they encumber by multiple thousands, if not hundreds of thousands, or even millions of dollars.[103] Second, low and middle-income landowners find it difficult to benefit from the typically sizable charitable income tax deduction generated by an easement donation because of the limitations imposed on the claiming of the deduction. A landowner who donates a conservation easement can generally claim the resulting charitable income tax deduction only to the extent of 30 or 50 percent of the landowner's adjusted gross income ("AGI") in any year, and only in the year of the donation and the following five years.[104] If the full deduction cannot be claimed within the six-year period, the unclaimed portion of the deduction is simply lost.

The following example illustrates the upside-down incentive effect of the charitable income tax deduction in the context of an easement donation. Assume that an identical easement valued at $500,000 is donated by each of three landowners, one who has annual AGI of $250,000 and is subject to a marginal income tax rate of 35 percent (the "High-Income Landowner"), one who has annual AGI of $75,000 and is subject to a marginal income tax rate of 27 percent (the "Middle-Income

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philosopher-economist might observe that the opportunity cost of virtue falls as one moves up the income scale").

103. *See infra* Part II.C. for a discussion of the "before and after" method of easement valuation sanctioned in the Regulations for purpose of determining an easement donor's charitable income tax deduction and *supra* Part II.A.2 for a discussion of the extent to which conservation easements typically reduce the value of the land they encumber.

104. The limitations imposed on the claiming of the deduction generated by an easement donation are as follows: (i) if the land encumbered by the easement is long-term capital gain property in the hands of the donor (e.g., the donor owned the land for more than one year before the donation), absent the special election described in clause (iii), the donor can claim the deduction only to the extent of 30 percent of the donor's adjusted gross income ("AGI") in the year of the donation and each of the following five years; (ii) if the land encumbered by the easement is short-term capital gain property in the hands of the donor (e.g., the donor owned the land for one year or less before the donation), the donor can claim the deduction to the extent of 50 percent of the donor's AGI in the year of the donation and each of the following five years, but the aggregate deduction is limited to the donor's income tax basis in the easement; and (iii) if the land encumbered by the easement is long-term capital gain property in the hands of the donor, the donor may make a special election to raise the annual deduction limit to 50 percent of the donor's AGI, but if that special election is made, the aggregate deduction is limited to the donor's income tax basis in the easement. *See generally* BORIS I. BITTKER & LAWRENCE LOKKEN, FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS 35-34 to 35-35 (1990). Upon the donation of an easement, a proportionate amount of the donor's income tax basis in the land encumbered by the easement is allocated to the easement. *Treas. Reg.* §1.170A-14(h)(3)(iii).

Landowner"), and one who has annual AGI of $35,000 and is subject to a marginal income tax rate of 15 percent (the "Low-Income Landowner"). Assume also that each landowner is able to claim the $500,000 deduction generated by the donation only to the extent of 30 percent of his AGI in the year of the donation and each of the following five years.[105]

The tax savings enjoyed by each landowner as a result of the donation would be as follows:

105. This assumes that, in each case, the land encumbered by the easement is long-term capital gain property in the hands of the landowner, and the landowner had a relatively low income tax basis in the land (and, thus, the easement), making the special election to increase the annual deduction limitation to 50 percent of AGI but limit the aggregate deduction to the income tax basis in the easement undesirable. *See supra* note 104. However, even if each landowner had a high income tax basis in the land and claimed the deduction generated by the easement donation to the extent of 50 percent of AGI each year for the six-year period, with the aggregate deduction limited to the landowner's income tax basis in the easement, the upside-down incentive effect of the deduction would be only slightly less pronounced. The lower annual AGIs and lower marginal income tax rates of the Middle and Low-Income Landowners still would have a significant depressive effect on the tax savings accruing to them as a result of the donation.

	High-Income Landowner	Middle-Income Landowner	Low-Income Landowner
Adjusted Gross Income	$ 250,000	$ 75,000	$ 35,000
Marginal Income Tax Rate	35%	27%	15%
Charitable Contribution[106]	$ 500,000	$500,000	$500,000
Annual Deduction[107]	$ 75,000	$ 22,500	$ 10,500
Aggregate Deduction over 6 years[108]	$ 450,000	$ 135,000	$ 63,000
Annual Tax Savings[109]	$ 26,250	$ 6,075	$ 1,575
Aggregate Tax Savings[110]	$ 157,500	$ 36,450	$ 9,450
Present Value of Aggregate Tax Savings[111]	$ 133,237	$ 30,835	$ 7,994

In this example, the annual 30 percent of AGI limitation and the six year window imposed on the claiming of the $500,000 deduction drastically reduce the amount of the deduction that can be claimed by the Middle and Low-Income Landowners, while only slightly reducing the amount of the deduction that can be claimed by the High-Income Landowner. The limitations on the claiming of the deduction, coupled with the effect of the landowners' differing marginal income tax rates, result in the High-Income Landowner receiving aggregate tax savings over the six year period with a present value equal to approximately 27

106. *See supra* note 103 and accompanying text.

107. The annual deduction is equal to 30 percent of the landowner's AGI. *See supra* notes 104, 105, and accompanying text. The High-Income Landowner's annual deduction actually would be slightly less than $75,000 due to the application of §68 of the Code ("§68"), which reduces the amount of certain itemized deductions (including the charitable income tax deduction) that can be claimed in any year by a taxpayer with AGI above a certain threshold. However, the §68 limitation on itemized deductions is ignored in all examples in this Article because its continued existence is uncertain. The §68 limitation is scheduled to gradually phase out beginning in 2006, to be eliminated in 2010, and then to be reinstated in 2011 and thereafter. *See* JOINT COMMITTEE ON TAXATION, SUMMARY OF PROVISIONS CONTAINED IN THE CONFERENCE AGREEMENT FOR H.R. 1836, THE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 3,13 (2001).

108. The aggregate deduction is the landowner's annual deduction multiplied by six. The portion of the $500,000 deduction that cannot be claimed by a landowner within the six-year period is simply lost. *See supra* note 104 and surrounding text.

109. The annual tax savings is the amount of additional income tax that would have been paid by the landowner in the absence of the annual deduction, assuming the additional income would have been taxed at the landowner's marginal income tax rate.

110. The aggregate tax savings is the landowner's annual tax savings multiplied by six.

111. The present values were calculated assuming a discount rate of 5 percent.

percent of the value of the donated easement, while the Middle and Low-Income Landowners receive aggregate tax savings over the six year period with a present value equal to only approximately 6 percent and 2 percent, respectively, of the value of the donated easement. Thus, although each landowner donates an identical easement and suffers an identical $500,000 reduction in the value of his or her land as a result of the donation, the Middle and Low-Income Landowners receive far less annual and aggregate income tax savings as a result of the donation than the High-Income Landowner.[112]

The landowners in this example might be able to increase their income tax savings by donating their easements in phases and thereby increasing the number of years in which they can claim the annual deductions.[113] However, for mathematical and practical reasons that "phase-in technique," like the charitable income tax deduction itself, would provide a far greater benefit to the High-Income Landowner than it would to the Middle or Low-Income Landowners. To illustrate, the following chart compares the tax savings that would be enjoyed by each of the High, Middle, and Low-Income Landowners if each was able to employ the phase-in technique to claim the full $500,000 deduction generated by the easement donation.

112. A taxpayer considering donating property to charity often will compare: (i) the tax savings that would be generated by the donation to (ii) the proceeds that would be obtained if the property were sold, net of capital gains tax and sales commissions. A landowner considering donating an easement generally cannot make the same comparison because easement purchase programs are relatively uncommon. Moreover, many prospective easement donors have no intention of selling their land. However, some landowners considering the donation of an easement also may be considering the sale of all or a portion of their land, and those landowners are likely to compare the tax savings that would be generated by an easement donation to the net proceeds attributable to the development value of their land that would be obtained from a sale of the land. For those landowners, the tax savings that would be generated by an easement donation will look slightly more attractive because rather than being compared to the full market cost of the donation (in our example, $500,000), they will be compared to the net proceeds attributable to the development value of the land that would be obtained on the sale of the land (in our example, $500,000 *net of* capital gains tax and real estate sales commissions). *See infra* note 404, for a numerical example of this type of comparison.

113. For example, a landowner could donate one easement encumbering half of his land, and seven years later donate a second easement encumbering the remaining half of his land, thereby enabling the landowner to claim the resulting deductions over as many as twelve years.

	High-Income Landowner	Middle- Income Landowner	Low-Income Landowner
Adjusted Gross Income	$ 250,000	$ 75,000	$ 35,000
Marginal Income Tax Rate	35%	27%	15%
Annual Deduction[114]	$ 75,000	$ 22,500	$ 10,500
Years Deductible[115]	7	23	48
Number of Easements[116]	2	4	8
Aggregate Deduction	$ 500,000	$ 500,000	$ 500,000
Annual Tax Savings[117]	$ 26,250	$ 6,075	$ 1,575
Aggregate Tax Savings[118]	$ 175,000	$ 135,000	$ 75,000
Present Value of Aggregate Tax Savings[119]	$ 145,674	$ 84,405	$ 28,414

As the chart indicates, it would take the High-Income Landowner only seven years and two easements to claim the full $500,000 deduction, generating an aggregate tax savings with a present value of $145,674. Alternatively, it would take the Middle-Income Landowner twenty-three years and four easements to claim the full $500,000 deduction, generating an aggregate tax savings with a present value of only $84,405, and it would take the Low-Income Landowner an astonishing forty-eight years and eight easements to claim the full $500,000 deduction, generating an

114. The annual deduction is equal to 30 percent of the landowner's AGI. *See supra* notes 104, 105, and accompanying text.

115. It would take the High-Income Landowner seven years to claim the full $500,000 deduction at a rate of $75,000 a year (with only $50,000 being deducted in the seventh year). It would take the Middle-Income Landowner twenty-three years to claim the full $500,000 deduction at a rate of $22,500 a year (with only $5,000 being deducted in the twenty-third year). It would take the Low-Income Landowner forty-eight years to claim the full $500,000 deduction at a rate of $10,500 a year (with only $6,500 being deducted in the forty-eighth year).

116. The deduction generated by any single easement donation can be claimed only over a period of six years (the year of the donation and the following five years). *See supra* note 104 and accompanying text. Accordingly, the High-Income Landowner would have to donate two easements to spread the deduction over seven years, the Middle-Income Landowner would have to donate four easements to spread the deduction over twenty-three years, and the Low-Income Landowner would have to donate eight easements to spread the deduction over forty-eight years.

117. The annual tax savings is the amount of additional income tax that would have been paid by the landowner in the absence of the annual deduction, assuming the additional income would have been taxed at the landowner's marginal income tax rate.

118. The maximum tax savings that each landowner could receive as a result of the phased easement donations is limited to the aggregate amount of the deduction ($500,000) multiplied by the landowner's marginal income tax rate. Thus, the $500,000 deduction could never generate tax savings greater than $75,000 for the Low-Income Landowner, $135,000 for the Middle-Income Landowner, or $175,000 for the High-Income Landowner.

119. The present values were calculated assuming a discount rate of 5 percent.

aggregate tax savings with a present value of only $28,414. Thus, even if each landowner were able to employ the phase-in technique to claim the full $500,000 deduction generated by the easement donations, the Middle and Low-Income Landowners still would receive far less annual and aggregate income tax savings as a result of the donations than the High-Income Landowner.

Moreover, the Middle and Low-Income Landowners would find it exceedingly difficult to employ the phase-in technique in the manner described above. First, each of the multiple easements would have to satisfy all of the requirements under §170(h) (including the conservation purposes test) and be appealing to a government agency or land trust, which could prove difficult if each easement encumbers only a small amount of acreage. Second, any plan involving the phasing in of an easement would have to take into account the possibility that donating an easement encumbering only a portion of the donor's land would enhance the value of other land that is owned by the donor, a member of the donor's family, or certain other related persons. The Regulations require that the charitable income tax deduction generated by an easement donation be reduced to the extent of the value of any such "enhancement,"[120] and as the number of easements donated with respect to a parcel of land increases, the difficulties associated with minimizing enhancement can be expected to increase. Finally, the transaction costs associated with donating multiple easements likely would be prohibitive, particularly in the case of the Low-Income Landowner, who would be required to donate eight easements. Accordingly, the phase-in technique, like the charitable income tax deduction itself, provides far greater tax savings to high-income landowners who, because of their high annual AGIs, can take advantage of a large charitable income tax deduction over a small number of years using only a few easements.

The foregoing discussion illustrates the following points regarding the charitable income tax deduction available with respect to an easement donation: (i) the maximum federal income tax savings that any landowner can receive as a result of the deduction are limited to the value of the easement multiplied by the landowner's marginal income tax

120. *See* Treas. Reg. §1.170A-14(h)(3)(i) (setting forth the valuation rules relating to "enhancement") and Treas. Reg. §1.170A-14(h)(4), *Example (10)* (involving a landowner who owned ten one-acre lots consisting of woods and parkland, donated a perpetual conservation easement encumbering eight of the lots to the county for use as a public park, and was required to reduce the value of the charitable income tax deduction generated by the easement donation to the extent the donation enhanced the value of the remaining two lots because, by perpetually restricting development on the eight lots, the landowner "ensured that the two remaining acres will always be bordered by parkland, thus increasing their fair market value. . .").

rate,[121] (ii) because of the size of the typical easement donation and the various limitations placed on claiming the resulting deduction, landowners generally spread the deduction over a number of years and often cannot claim the entire deduction within the statutorily imposed six year period (although high-income landowners are able to more effectively employ the phase-in technique to maximize their use of the deduction), (iii) because of their lower marginal income tax rates and lower annual AGIs, middle and low-income landowners receive far less tax savings than their high-income counterparts for the donation of equivalently valued easements, and (iv) at some point on the low end of the income scale, the charitable income tax deduction generated by an easement donation provides no incentive at all.[122]

b. The Federal Gift and Estate Tax Incentives

A landowner who donates a conservation easement during his lifetime may be eligible for a charitable gift tax deduction equal to the value of the easement under §2522(d) and, upon his death, his executor may be able to exclude up to 40 percent of the value of the land encumbered by the easement from his estate for estate tax purposes under §2031(c). To illustrate the operation of those incentives, assume that the land owned by each of the High, Middle, and Low-Income Landowners discussed in the previous section originally was valued at $1,500,000, and that the donation of the easement reduced the value of the land to $1,000,000. Assume also that the donation transactions satisfied the various eligibility requirements for the federal income, gift, and estate tax incentives.[123] In addition to the charitable income tax deduction under §170(h) (discussed in the previous section), each landowner would be eligible for a charitable gift tax deduction equal to

121. Pursuant to the Jobs and Growth Tax Relief Reconciliation Act of 2003, from 2003 through 2010 the top marginal income tax rate will be 35 percent. *See* JOINT COMMITTEE ON TAXATION, SUMMARY OF CONFERENCE AGREEMENT ON H.R. 2, THE "JOBS AND GROWTH TAX RELIEF RECONCILIATION ACT OF 2003" 2 (2003). Thus, during that period, the maximum tax savings that any easement donor could receive as a result of the charitable income tax deduction will be limited to 35 percent of the value of the easement. In 2011, the top marginal income tax rate is scheduled to return to 39.6 percent, the top marginal income tax rate in effect before the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001 (the "2001 Act"). *See id.;* JOINT COMMITTEE ON TAXATION, SUMMARY OF PROVISIONS CONTAINED IN THE CONFERENCE AGREEMENT FOR H.R. 1836, THE ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001 2, 13 (2001).

122. A charitable income tax deduction is of no use to a landowner who does not have sufficient income to incur tax liability, or whose aggregate itemized deductions fall below the amount of the standard deduction.

123. For a discussion of the eligibility requirements for the charitable income tax deduction under §170(h) and the charitable gift tax deduction under §2522(d), see FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20. For a discussion of the eligibility requirements for the estate tax exclusion under §2031(c), see the articles cited in *supra* note 58.

$500,000, which would remove $500,000 of value from each landowner's estate free of gift and estate tax.[124] Moreover, assuming each landowner dies still owning the land encumbered by the easement, each landowner's executor could elect to exclude an additional 40 percent of the value of that land from the landowner's estate for estate tax purposes.[125] In summary, as a result of the donation of a conservation easement that reduces the value of land from $1,500,000 to $1,000,000, each landowner would be entitled to a $500,000 charitable income tax deduction (although each landowner's ability to claim that deduction would be constrained by the limitations discussed in the previous section), and $900,000 of the original $1,500,000 value of the land could be removed from each landowner's estate for estate tax purposes ($500,000 through the deductible charitable gift of the easement, and an additional $400,000 through the operation of the estate tax exclusion).

Under current law, a decedent's estate may be liable for estate tax only if the value of the estate exceeds the amount that can be transferred free of estate tax at death (the "Exclusion Amount"). The 2001 Act gradually increases the Exclusion Amount from $1,000,000 in 2002 to $3,500,000 in 2009,[126] gradually reduces the top marginal estate tax rate from 55 percent in 2001 to 45 percent in 2009,[127] repeals the estate tax for decedent's dying in 2010,[128] and then "sunsets" at the end of 2010, at which time the estate tax with an Exclusion Amount of $1,000,000 and a top marginal rate of 55 percent will be reinstated for decedent's dying in 2011 and thereafter.[129] Although the 2001 Act temporarily reduces and,

124. The landowners would not be subject to gift tax on the donation of their easements because the transfers would be eligible for the charitable gift tax deduction under §2522(d). *See supra* Part I, *Tax Reform Act of 1986* (discussing the charitable gift tax deduction available with respect to an easement donation). In addition, assuming each landowner dies still owning the land encumbered by the easement, and the land still is valued at $1,000,000, only the $1,000,000 value of the land would be included in the landowner's estate for estate tax purposes. *See* Treas. Reg. §20.2031-1(a) and (b). Although the charitable gift tax deduction under §2522(d) technically is a *gift tax* incentive (in that it prevents an easement donor from being subject to gift tax on the donation of a qualifying easement), the typical easement donor perceives it as an estate tax incentive in that it removes the value of the easement from the donor's estate for estate tax purposes. In fact, the typical easement donor likely would be shocked to find that, absent §2522(d), he or she could be subject to gift tax on the donation of an easement.

125. If each landowner dies still owning the land encumbered by the easement, and the land still is valued at $1,000,000, each landowner's executor could elect to exclude $400,000 of that value from the landowner's estate for estate tax purposes under §2031(c). The maximum amount that can be excluded from a decedent's estate under §2301(c) is $500,000. §2031(c)(3).

126. Pub. L. No. 107-16 (2001), § 521.

127. *Id.* § 511.

128. *Id.* § 501.

129. *Id.* § 901 (which provides that all provisions of the 2001 Act will cease to apply after December 31 2010, at which time the law in effect before the enactment of the 2001 Act again will be effective). *See* Michael W. Evans, *The Budget Process and the "Sunset" Provision of the 2001 Tax* Law, 99 TAX NOTES 405 (2003) (explaining the federal budget process and the inclusion of the "sunset" provision in the 2001 Act).

for one year, eliminates the impact of the estate tax, the long-term status of the estate tax is uncertain. Congress almost certainly will revisit the estate tax before its scheduled one-year repeal in 2010, and it is impossible to predict whether Congress will vote to repeal the estate tax permanently or retain the estate tax in some modified form.[130]

In addition, there is very little empirical evidence of the extent to which taxpayers are motivated to make lifetime charitable gifts by the fact that the resulting decrease in the value of their assets may reduce the estate tax paid at their deaths. Although economists have extensively studied the degree to which the charitable *income* tax deduction stimulates charitable giving, they have spent far less energy studying the relationship between gift and estate taxes and charitable giving, and one commentator notes that the few recent econometric studies on that subject are "beset with uncertainty."[131]

Given the uncertain status of the estate tax, and the uncertainty with regard to whether taxpayers are motivated to make lifetime charitable gifts by the prospect of estate tax savings at their deaths, it is difficult to draw many conclusions regarding the extent to which the charitable gift tax deduction under §2522(d) and the estate tax exclusion under §2031(c) stimulate landowners to donate easements.[132] However, it is clear that the charitable gift tax deduction and the estate tax exclusion do not operate to stimulate easement donations from landowners who do not expect to be subject to the estate tax at their deaths, either because they do not expect to own assets with a value in excess of the Exclusion Amount at their deaths, or because they believe Congress will repeal the estate tax permanently. In addition, given the significant scheduled increases in the Exclusion Amount through 2009, it is likely that, at least over the short-term, a growing percentage of less affluent landowners will not find the charitable gift tax deduction or the estate tax exclusion to be compelling incentives.[133]

130. *See, e.g.,* Martin A. Sullivan, *Economic Analysis: AMT, Estate Tax Time Bombs Set Stage for Some High-Class Warfare*, 96 TAX NOTES 1443, 1443-45 (2002) (noting that the "on-off-and-on-again" status of the federal estate tax is a disaster, that everybody agrees there must be some change, but that there is bitter partisan disagreement about the direction of estate tax change).

131. *See, e.g.,* Eric Rakowski, *Estate Tax Reform and Charitable Giving*, 77 TAX NOTES 463, 468, 470-471 (1997) (noting that economists have spent little energy studying the relationship between wealth transfer taxes and charitable giving because wealth transfer taxes have less economic importance than income taxes and the available data is limited).

132. Although the extent to which the charitable gift tax deduction under §2522(d) stimulates easement donations is not clear, it is reasonable to assume that repealing §2522(d), which could render the donation of an easement a taxable event for gift tax purposes, would have a significant chilling effect on the donation of easements.

133. *See, e.g., Policy Report Tax Update: 2001 Changes Add Complexity to Farm Estate Planning,* V LANDWORKS CONNECTION: NEWSLETTER OF THE AMERICAN FARMLAND TRUST 3-4 (2002) (quoting Jerry Cosgrove, Northeast Director of the American Farmland Trust, as

c. The State and Local Tax Incentives

Numerous states have enacted state income tax incentives designed to encourage the donation of easements encumbering land within their borders. As a general rule, those incentives (primarily in the form of income tax credits) are relatively modest and, like their federal counterparts, provide greater benefits to high-income landowners who have significant state income tax liability.[134] However, both Virginia and Colorado recently enacted very generous and egalitarian state income tax credits designed to encourage the donation of easements encumbering land within their borders.[135] Those credits are generous in that they are significant in amount, and egalitarian in that low-income easement donors who lack sufficient state income tax liability to absorb the credits may sell their excess credits to other taxpayers (and, in Colorado, possibly obtain a refund of such credits of up to $50,000 per year).[136]

If an easement reduces the assessed value of the land it encumbers, a landowner also may receive local property tax savings. However, reductions in property taxes are unpopular with local government

stating that, as a result of the scheduled increases in the estate tax Exclusion Amount in the 2001 Act, "for most farm and ranch families, avoiding estate tax liability likely will be less of an immediate concern over the next decade. . ."); STEPHEN J. SMALL, PRESERVING FAMILY LANDS: BOOK III 18-21 (2002) [hereinafter SMALL, BOOK III] (noting that, if a donor is wondering whether to consider a conservation easement as an important part of estate planning, the 2001 Act may cause the donor "to think twice, hesitate, delay, or simply reject the idea.")

134. For example, Maryland allows a landowner to claim a credit against Maryland income tax equal to the fair market value of a perpetual easement donated to the Maryland Environmental Trust or the Maryland Agricultural Land Preservation Foundation. *See* MD. CODE ANN., §10-723 (2003). However, the amount of the credit that may be claimed in any year is limited to $5,000, and any unused credit may be carried forward for a period of only fifteen years (for a maximum of $80,000 of credit). *Id.* Assuming a landowner pays Maryland income tax at a rate of 5 percent, such landowner would have to have annual income, after all applicable deductions, exclusions, and exemptions, of at least $100,000 to generate sufficient Maryland income tax liability to take advantage of the full annual $5,000 credit. *See also* Philip Tabas, *Making the Case for State Tax Incentives for Private Land Conservation,* Vol. 18, No. 2 EXCHANGE, THE JOURNAL OF THE LAND TRUST ALLIANCE 5 (1999) (describing the state tax incentives available for the donation of easements in various states); National Conference of State Legislatures, *State Incentive-Based Growth Management Laws*, *available at* http://www.ncsl.org/programs/esnr/growthdata.htm (last visited September 29, 2003) (containing a database of state legislation designed to provide financial and other incentives to manage growth and preserve open space).

135. *See supra* notes 79-81 and accompanying text for a description of the Virginia income tax credit. Colorado allows a landowner to claim a credit against Colorado income tax equal to 100 percent of the first $100,000 of the value of a perpetual easement donated with respect to land located in Colorado, and 40 percent of the value of such easement in excess of $100,000, subject to a cap of $260,000. COLO. REV. STAT. § 39-22-522 (2001). Unused credit may be carried forward by the donor for up to twenty years, sold or otherwise transferred to another Colorado taxpayer who can use the credit, or, if there are sufficient state revenues, refunded in an amount not exceeding $50,000 per year. *Id.*

136. *See supra* note 81, noting that easement donors who have sold their state income tax credits through credit "brokers" have received up to eighty cents per dollar of credit transferred.

officials and, in some jurisdictions, such officials may refuse to consider easements when making assessments.[137] In addition, some landowners decline to seek a property tax reduction after granting an easement for fear the assessor will reassess the property in its entirety, which, in areas with rapidly escalating land values, could result in a higher assessment even if the easement is taken into account.[138] Moreover, because many jurisdictions already assess specified types of land (such as agricultural or forested land) at a value lower than the land's fair market value, a landowner may not receive any additional property tax benefit as a result of donating an easement.[139] Accordingly, the potential for property tax savings does not provide a strong incentive to most prospective easement donors.[140]

d. The Combined Federal, State, and Local Tax Incentives

Due to the design of the charitable income tax deduction, the delay in the accrual of estate tax savings until the death of an easement donor, and the reduction in the impact of the estate tax under the 2001 Act, in most cases the combined federal income and estate tax savings generated by an easement donation, when computed on a present value basis, will be substantially less than the market cost of the easement.[141] In addition, the federal income and estate tax incentives available with respect to an easement donation offer the greatest tax savings to high-income donors with sufficient wealth to be concerned about the estate tax, and progressively less tax savings as the donor moves down the income and wealth scale.

In most cases, the addition of state and local tax incentives will not materially change the amount of tax savings received by an easement donor. However, the generous and egalitarian state income tax credits recently enacted in Virginia and Colorado can be expected to have two effects on easement donations in those states. First, such credits, because

137. *See* Janet Diehl, *Part One: Managing an Easement Program, in* CONSERVATION EASEMENT HANDBOOK, *supra* note 2, at 56.

138. *Id*. at 57.

139. *See id*. at 25.

140. *Id*. at 57.

141. Although one can posit cases in which the present value of the combined federal income and estate tax savings generated by the donation of an easement would approach the value of the easement, such cases are likely to be quite rare because they generally must involve a donor with: (i) very high annual AGI (and, thus, the ability to claim a large charitable income tax deduction over a period of six or fewer years despite the annual percentage limitations on the deduction) and (ii) significant wealth (and, thus, the ability to benefit from the removal of value from his estate through an easement donation). In addition, any income tax savings generated by the donation of an easement will increase the size of the landowner's estate for estate tax purposes, and that increase must be taken into account in assessing the aggregate tax savings generated by a donation.

they can be sold (and, in Colorado, possibly refunded up to $50,000 a year), may provide a compelling incentive to landowners who benefit little from the existing federal tax incentives – that is, low-income landowners who do not expect to be subject to estate tax at their deaths. Second, because the credits in both Virginia and Colorado are available to landowners who donate easements regardless of the level of their income or wealth, such credits will increase significantly the tax savings accruing to more affluent landowners as a result of an easement donation. In fact, a high-income landowner with a sizable estate who donates an easement in Virginia may be reimbursed by the public for close to or even more than the full market cost of the easement through a combination of the federal and state tax incentives.[142]

4. *Surveys of Easement Donor Motivation*

The factors that motivate landowners to donate conservation easements have been explored in the following three surveys.

a. *The LTE Survey*

In 1985, the Land Trust Exchange (the "LTE"), now known as the LTA,[143] conducted a survey of easement holders to determine, *inter alia*, the most important factors that motivate landowners to donate conservation easements and the types of landowners who can be persuaded to donate such easements (the "LTE Survey").[144] The LTE mailed the survey questionnaire to all known conservation easement programs, governmental and private, as well as other entities it had reason to believe might hold or promote easements.[145]

With regard to the factors that motivate landowners to donate conservation easements, the LTE Survey results were as follows: (i) 67 percent of the easement program administrators who responded to the survey (the "Administrators") regarded "love for the land" as the

142. At least one land trust operating in Virginia has advertised this potential. *See* "Virginia Conservation Tax Credit Information Packet," Piedmont Environmental Council, (August 19, 2002) (on file with author) (noting that "*the combined tax savings* [associated with an easement donation] *could be well over the reduction in land value due to the easement*.") (emphasis in original). Thus far, the Treasury has declined to furnish definitive guidance on whether a landowner's use, refund, or transfer of state income tax credits generated by an easement donation would reduce the federal tax benefits accruing to the landowner as a result of the donation. *See* IRS Chief Counsel Advisory 200238041 (September 20, 2002) (discussing the possible federal tax treatment of an easement donor's use, refund, or transfer of Colorado conservation easement income tax credits, but concluding that such issues would be best addressed in official published guidance).

143. *See supra* note 6 and accompanying text for a discussion of the LTA.

144. *See The Donors of Conservation Easements—And Their Motivations,* LAND TRUSTS' EXCHANGE 10 (December 1985) (on file with author).

145. *Id.*

primary factor that motivates landowners to donate easements, (ii) 22 percent of the Administrators regarded the charitable income tax deduction as the primary factor that motivates landowners to donate easements, (iii) 54 percent of the Administrators who regarded "love for the land" as the primary factor that motivates landowners to donate easements ranked the charitable income tax deduction as the second most important factor, and (iv) no other factor suggested in the survey came close to being ranked as high as "love for the land" or the charitable income tax deduction as a motivating factor.[146]

With regard to the type of landowner who can be persuaded to donate an easement, the LTE Survey results indicated that the most common easement donor is an individual (or couple) over the age of fifty with a relatively high income derived from sources unrelated to the land being placed under easement.[147]

b. The Michigan Survey

In 1995, James A. Ochterski, a graduate student at the University of Michigan, School of Natural Resources and Environment, conducted a survey of individuals who had donated land or a conservation easement to one of seven land trusts located in Michigan (the "Michigan Survey").[148] The primary goal of the Michigan Survey was to determine the incentives and motivations underlying the donation of land and conservation easements to land trusts.[149] The Michigan Survey is of limited use in assessing whether, and the extent to which, tax incentives stimulate the donation of easements because the results from donors of land and donors of easements were combined, and the factors that motivate the donation of land can be expected to be somewhat different from the factors that motivate the donation of an easement.[150]

146. *Id.* The other factors suggested were: estate or gift tax savings, neighbors also granting easements, property tax reductions, and prevention of conflicts among heirs. *Id.*

147. *Id.* 62 percent of the Administrators who accepted donated easements reported that they dealt mostly with donors over the age of fifty, and 84 percent of such Administrators reported that they dealt mostly with individuals earning high incomes or who are retired. *Id.* Only 4 percent of the Administrators reported dealing mostly with individuals actually working the land under easement and relying on that land for income. *Id.*

148. *See* James A. Ochterski, Why is Land Protected? Motivations Underlying Real Estate Donations to Land Conservancies (Summary Report of the 1995-96 Michigan Land Conservancy Research Project, University of Michigan School of Natural Resources and Environment) (on file with the author) [hereinafter The Michigan Survey].

149. *Id.* at v.

150. The donation of fee title to land is fundamentally different from the donation of a conservation easement. The donor of fee title to land relinquishes all incidents of ownership in the land, while the donor of a conservation easement retains the use and enjoyment of the land subject to the easement restrictions. *See supra* Part II.A.2 discussing the fact that landowners who do not intend to develop or otherwise use their land in ways inimical to its conservation

Nevertheless, some general conclusions can be drawn from the Michigan Survey.

The results of the Michigan Survey indicated that three primary factors motivated the landowners who responded to the survey (the "Donors") to donate land or a conservation easement to a Michigan land trust: (i) a deep and personal commitment to the future of the land, (ii) a concern about ecological stewardship, and (iii) economic concerns, including the ability to claim a tax deduction as a result of the donation.[151] A deep and personal commitment to the future of the land was the strongest overall motivation, followed by a concern about ecological stewardship and then economic concerns.[152]

Ochterski noted that the results of the survey "strongly suggest that money is not as influential as existing literature suggests," and recommended that land trusts consider emphasizing a landowner's personal commitment to his or her land and concern for ecological stewardship in their promotional literature.[153] He also went as far as to suggest that eliminating the charitable income tax deduction might have little effect on land and easement donations given the relative weakness of economic concerns as a motivating factor.[154] That suggestion may be somewhat reckless in light of the finding that economic concerns, including the ability to claim a tax deduction, were one of the three primary factors motivating land and easement donations, albeit the weakest of the three. A more conservative interpretation of the data would suggest that eliminating a significant component of one of the three primary factors reported as motivating easement donations might have some demonstrable adverse impact on donation behavior.

values may view an easement donation as an enticing opportunity to liquidate some of the equity in their land without interfering with their current use and enjoyment of that land.

151. *See* The Michigan Survey, *supra* note 148, at 7. The personal commitment factor measured whether the donor had a desire to leave behind a significant legacy, a desire to provide natural places for future generations, a concern about the actions of future inheritors or owners, respect for what the land had given the donor, and a strong personal attachment to the land. *Id.* The ecological stewardship factor assessed whether concern for plants and wildlife was a motivating factor for the donation by measuring whether the property had high ecological value, whether the donor believed that rare species or habitats existing on the property should be protected, and whether the donor had a desire to provide a haven for wildlife. *Id.* The economic concerns factor assessed whether the ability to claim a tax deduction, the ability to reduce property taxes, and a concern about being financially unable to maintain the property motivated the donation. *Id*

152. *Id.* at 8. Social influences from family and friends had an impact on the decision to donate, but were far less significant than the three primary factors. *Id.* at 14.

153. *Id.* at 14, 18.

154. *Id.* at 15.

c. *The SUNY Survey*

In 1997, the State University of New York, College of Environmental Science and Forestry, and the Vermont Land Trust collaborated on a research project to evaluate landowners' motivations for granting conservation easements and their satisfaction with such easements (the "SUNY Survey").[155] The authors of the SUNY Survey mailed questionnaires to landowners who had either sold or donated an easement encumbering property located in the Northeast (the "Original Grantors").[156] The SUNY Survey is of limited use in assessing whether, and the extent to which, tax incentives stimulate the donation of easements because: (i) the data for sellers and donors was combined, and it can be expected that sellers are far less motivated by tax incentives than donors[157] and (ii) even if the data for sellers and donors was examined separately, the survey assessed only whether "[a] tax break was the *most important reason* for granting the easement," rather than whether, or the extent to which, a tax break was a motivating factor at all.[158] Nevertheless, some of the findings of the SUNY Survey are illuminating.

Similar to the LTE and Michigan Surveys, the SUNY Survey found that the Original Grantors were motivated to sell or donate their easements primarily by their personal attachment to their land, a sense of altruism, and a commitment to the stewardship of their land, and that the "more externalized concerns of tax breaks and pressure from family or friends are not primary motivations to restrict a piece of land."[159] However, slightly more than 15 percent of the Original Grantors strongly or very strongly agreed with the statement: "A tax break was the most important reason for granting the conservation easement."[160] Given that sellers of easements are far less likely to be motivated by tax incentives than donors, a majority of those respondents likely were easement donors. In addition, slightly more than 30 percent of the Original Grantors strongly or very strongly agreed with the statement "I wanted to

155. *See* The SUNY Survey, *supra* note 94, at 5-6.

156. *Id*. Landowners who acquired property subject to an easement through purchase or inheritance also were surveyed, but the findings with regard to those landowners are not addressed in this article. *Id.*

157. The charitable income tax deduction is not available to the extent a landowner receives sale proceeds in exchange for conveying an easement. In addition, although the seller of an easement reduces the value of the land subject to the easement for federal estate tax purposes, the proceeds from the sale become a part of the seller's assets and, to the extent they are not consumed during life, they will be included in the seller's estate for estate tax purposes. Sellers as well as donors of easements might receive local property tax savings, *but see supra* Part II.A.3.c, discussing why many easement grantors do not receive property tax savings.

158. The SUNY Survey, *supra* note 94, at 18 (emphasis added).

159. *Id.* at 9, 15.

160. *Id.* at 10, 18.

reduce the estate taxes."[161] It is less clear that a majority of those respondents were easement donors, as easement sellers might perceive that they are reducing estate taxes by replacing land value with cash proceeds that will be consumed. Nevertheless, such finding indicates that, for at least some percentage of easement donors, a reduction in estate taxes played a role in motivating their easement donations.[162]

Alternatively, the fact that more than 55 percent of the Original Grantors reported that they strongly or very strongly disagreed with the statement: "A tax break was the *most important reason* for granting the conservation easement,"[163] tells us little about whether, or the extent to which, tax incentives motivate easement donations. Again, given that sellers of easements are far less likely to be motivated by tax incentives than donors, it is plausible that many of those respondents were easement sellers. Moreover, even to the extent those respondents consisted of easement donors, the statement does not tell us whether, or the extent to which, a tax break played some necessary subsidiary or supplemental role in stimulating their donations.[164]

d. Survey Conclusions

Although there were some differences in the findings, the surveys indicate that for most easement donors, a strong personal attachment to and concern about the long-term stewardship of their land is the primary factor motivating their donations, while tax incentives generally play a subsidiary or supplemental role. Those findings are not surprising given that the federal tax incentives compensate the typical easement donor for only a modest percentage of the reduction in the value of his or her land resulting from an easement donation.[165] Any charitable donation that requires a significant financial sacrifice must be motivated by factors

161. *Id.*

162. At various points in the SUNY Survey, the authors state that the Original Grantors were not motivated by tax benefits. *Id.* at 11, 15. However, given the findings discussed in the text, and the fact that the survey failed to assess whether, or the extent to which, the available tax incentives were subsidiary or supplemental factors motivating the easement grants, those statements are inaccurate and misleading.

163. *Id.* at 10, 18 (emphasis added).

164. A class of easement donors reporting that they strongly or very strongly disagreed with the statement: "A tax break was the most important reason for granting the conservation easement" might consist of both landowners for whom the tax incentives played no role in motivating their donations (that is, landowners who were motivated solely by non-tax factors such as a "love of their land") and landowners for whom the tax incentives played some necessary subsidiary or supplemental role in motivating their donations (that is, landowners who would not have donated their easements but for the tax incentives *and* other non-tax motivating factors).

165. *See supra* Part II.A.3.d. Note that none of the studies involved generous state tax credits like those now available in Virginia or Colorado.

other than, or in addition to, the anticipated tax savings.[166] Moreover, it is difficult to imagine that many landowners would be willing to give away a significant percentage of the development value of their land, permanently part with some autonomy over the use and management of their land, and pay for the privilege of doing so in the form of substantial transaction costs without having some interest in the long term protection of their land.

The surveys do, however, suffer from a variety of shortcomings that make their conclusions of somewhat limited benefit in determining the extent to which tax incentives stimulate easement donations. First, the findings in the surveys are based on donor self reports, which are of questionable reliability.[167] It is quite plausible that landowners reporting on what motivated them to donate their easements (either to the authors of the Michigan or SUNY Surveys, or, in the case of the LTE Survey, to the land trust administrators with whom they worked) were inclined to stress their personal attachments to and concern about the long term stewardship of their land, and to downplay their more mercenary or selfish interests. Thus, the anticipated tax savings and some of the less flattering non-tax factors that may motivate easement donations, such as the desire to exercise "dead hand" control over family decision making, to create a permanent monument to oneself or one's family, or for public recognition of one's charitable largesse, may play more of a role in stimulating easement donations than was indicated in the surveys.[168]

Second, the surveys do not indicate the extent to which the tax incentives were *necessary* to stimulate easement donations, particularly when they were reported to play only a subsidiary or supplemental role as a motivating factor. Thus, we do not know what percentage of the landowners involved in the surveys would have found the various non-tax factors that motivate easement donations to be so compelling that they would have been willing to donate their easements in the absence of tax

166. For example, a landowner who donates an easement that reduces the fair market value of his land by $1,000,000 in exchange for aggregate tax savings with a present value of $350,000—thereby giving away $650,000 of the development value of his land—simply must be motivated by factors other than, or in addition to, the anticipated tax savings.

167. *See* Gerald E. Auten, Charles T. Clotfelter, & Richard L. Schmalbeck, *Taxes and Philanthropy Among the Wealthy, in* DOES ATLAS SHRUG? THE ECONOMIC CONSEQUENCES OF TAXING THE RICH 400-403 (Joel B. Slemrod ed., 2000) (noting that determining the various factors that motivate charitable giving is complex and ultimately resistant to scientific proof because such inquiries generally are reliant on small samples and donor self reports, and that, as a result, economists prefer to limit their attention to the effects of changes in prices and incomes on donation behavior).

168. There are a tremendous number of factors that may motivate landowners to donate easements, some of which may be surprising. For example, one of the easement donors in the Michigan Survey reported that halting developer harassment was a motivating factor. *See* The Michigan Survey, *supra* note 148, at 17. In the words of the donor, "There have been many attempts by developers to obtain this land. This harassment has stopped since our donation." *Id.*

incentives or, perhaps, for smaller incentives.[169] Finally, the surveys assessed the motivations of landowners who already had donated easements, leaving unanswered the question of whether there exists a significant untapped pool of landowners who might be stimulated to donate easements by an increase in the tax incentives.[170]

5. The Position of the Land Trust Community

Based on their statements and lobbying efforts, the members of the land trust community[171] appear to be convinced that the extent to which the available federal tax incentives stimulate the donation of easements depends upon the financial circumstances of the landowners.[172] In advocating for increases in the federal tax incentives, the members of the land trust community have consistently argued that: (i) land rich, cash poor landowners, many of whom apparently are farmers and ranchers, cannot afford to substantially reduce the value of their land through the donation of an easement without receiving substantial tax savings or some other form of monetary compensation in return,[173] and (ii) the existing federal tax incentives are not sufficient to stimulate the donation

169. Some landowners clearly are willing to donate easements in the absence of tax incentives. For example, the author knows of one easement donated in western Virginia where tax incentives played no role in motivating the donation because the family corporation that owned the land had no annual income to be offset by the resulting charitable income tax deduction, and there was minimal benefit to the shareholders from a reduction in the value of the shares for estate tax purposes.

170. Determining whether such an untapped pool of potential easement donors exists would involve gathering annual AGI, wealth, and other data on the landowners who own land with the type of conservation values Congress deems worthy of protection under §170(h). *See infra* Part III.A.2, discussing how such data would help policy makers assess the efficiency of the tax incentives.

171. *See supra* note 12 for the definition of "land trust community."

172. The statements and lobbying efforts of members of the land trust community are, of course, self-serving and cannot be relied upon as purely objective data. However, given that the goal of such members is to obtain more easement donations, we can have some confidence that they truly believe the changes they advocate will trigger more easement donations. Thus, the self-serving statements and efforts of the members of the land trust community are not without some evidentiary weight, especially in light of their unique position—they work on a daily basis with prospective easement donors and arguably have a unique understanding of the factors that motivate easement donations.

173. *See, e.g.*, *Impact of Tax Law on Land Use, Conservation, and Preservation: Hearings Before the Subcomm. on Oversight of the House Comm. on Ways and Means*, 106th Cong. 58-63 (1999) (statement of Michael Dennis, Vice President and General Counsel, The Nature Conservancy) (noting that "for many farmers near metropolitan areas, the fair market value of their land is a primary financial asset that cannot be relinquished."); *Preserving and Protecting our Natural Resources: Hearing Before the Senate Comm. on Finance*, 107th Cong. 11-12 (2001) (statement of William W. McDonald, Co-Executive Director, Malpai Borderlands Group) (stating that "Frankly, some ranchers simply need compensation to sell a conservation easement").

of easements from that class of landowners.[174] Alternatively, the members of the land trust community also have maintained that the available federal tax incentives do play an important role in stimulating easement donations from a different class of landowners—those with the financial wherewithal to make the sizable charitable contribution typically involved in an easement donation, and the income to take advantage of the charitable income tax deduction generated by the donation.[175] However, the members of the land trust community also note that the federal tax incentives do not appear to be sufficient on their own to motivate even more affluent landowners to donate easements, and that

174. *See, e.g., Land Tax Issues: Hearings Before the Subcomm. on Taxation and I.R.S. Oversight of the Senate Comm. on Finance,* 106th Cong. 32-33 (2000) (statement of Austin Cleaves, Dairy Farmer, on behalf of The Nature Conservancy) (noting that there are many landowners with income too low, or land so valuable, that the deduction under §170(h) and the exclusion under §2031(c) simply are not financially beneficial); *Preserving and Protecting our Natural Resources: Hearing Before the Senate Comm. on Finance,* 107th Cong. 15-26 (2001) (statement of Chase T. Hibbard, Co-Founder, Montana Land Reliance) [hereinafter 2001 Testimony of the Montana Land Reliance] ("Put simply, the current limitations on deductions from gross income provide little real incentive for working farm and ranch households to place a conservation easement on their property."); *Tax Incentives for Open Space Preservation: Hearing Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means,* 108th Cong. 44-47 (2002) (statement of Steven J. McCormick, President and CEO, The Nature Conservancy) [hereinafter 2002 Testimony of The Nature Conservancy] (noting that "[a]lthough current federal tax law does provide some financial compensation to landowners for the conservation of their land, these provisions were not designed with the so-called land-rich, cash-poor landowners in mind."). *See also*, Land Trust Alliance, *When Communities Care, So Do Legislators,* Fall/Winter 2001 LANDSCAPE, NEWSLETTER OF THE LAND TRUST ALLIANCE 4, 4 (quoting Russell Shay, the Public Policy Director of the LTA, as saying,

> This doesn't come up in other areas of charity, because schoolteachers don't own Rembrandts that they can give to the National Gallery of Art. But because real estate values have grown incredibly, we do have farmers and ranchers—and many others—who own millions of dollars of development rights. . .What we are telling Congress is this: if we want people to give gifts of their most valuable family assets, we have to give them an incentive that reflects the value of the gift).

175. *See, e.g.,* 2001 Testimony of the Montana Land Reliance, *supra* note 174 (noting that the lack of incentive provided to working farmers and ranchers by the charitable income tax deduction is "not generally a problem for more affluent taxpayers, who are able to fully utilize an equivalent deduction amount within the existing carry-forward period," and that an increase in the tax incentives is now required because "[w]e've already creamed the crop, so to speak, under current law."); *Tax Incentives for Open Space Preservation: Hearings Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means,* 108th Cong. 59-63 (2002) (statement of Rand Wentworth, President, Land Trust Alliance) (noting that "the incentives already in place in our tax code have been a major contributor to the work land trusts have done" and that the charitable income tax deduction with respect to an easement donation "provides a good incentive for high-income individuals"); 2002 Testimony of The Nature Conservancy, *supra* note 174 ("Wealthier landowners who are able to make charitable conservation contributions can realize tax benefits that make it possible for them to achieve both conservation and financial goals").

other factors, such as a significant commitment to the protection of the land, are necessary to trigger such donations.[176]

6. Responsiveness Conclusion

A few conclusions can be drawn from the information discussed above. First, tax incentives clearly play a role in stimulating some easement donations, although the percentage of landowners who require the financial inducement of tax incentives to donate an easement, the precise role played by tax incentives in motivating donations, and the level at which such incentives must be set to trigger donations are all unknown.

Second, the significant costs associated with an easement donation, the limited ability of less affluent landowners to discount those costs, and the rather paltry tax savings accruing to such landowners under the existing federal tax incentives strongly suggest that less affluent landowners do not find the existing federal tax incentives to be compelling. The significant costs associated with an easement donation and the limited ability of less affluent landowners to discount those costs also suggest that such landowners are unlikely to be willing or able to donate easements unless they are offered substantial tax benefits or other monetary compensation for their easements.

Alternatively, more affluent landowners who have no intention of developing or otherwise using their land in ways inimical to its conservation values are likely to aggressively discount the costs associated with an easement donation. For some such landowners, powerful non-tax factors, such as a strong personal attachment to and concern about the long-term stewardship of their land, may be sufficient, on their own, to motivate an easement donation. For others, the modest federal tax incentives currently available appear to be sufficient, in conjunction with non-tax factors, to trigger easement donations. As noted above, the federal tax incentives rarely, if ever, reimburse even the most

176. *See, e.g.,* W. WILLIAM WEEKS, BEYOND THE ARK, TOOLS FOR AN ECOSYSTEM APPROACH TO CONSERVATION 20 (1997) (noting that "the lower federal income tax rates of the late 1980s and 1990s have made the tax benefits of gifts a relatively less important factor in donor motivation. In recent years, simple personal commitment to the cause of conservation and, for some donors, the benefits of public recognition have been more central motivations."); Janet Diehl, *Part One: Managing an Easement Program, in* CONSERVATION EASEMENT HANDBOOK, *supra* note 2, at 37-39 (describing the available tax benefits as only one of the four key selling points of an easement donation program, with the other selling points being: the desire to protect cherished property forever, the fact that property subject to an easement remains in private ownership, and the fact that easements can be tailored to the property in question and the desires of the landowner). *See also* David J. Dietrich, *Conservation Easements*, 12 PROB. AND PROP. 42, at 43 (1998) (noting that "[c]lients usually grant conservation easements for two reasons: a genuine charitable motive to protect environmentally unique land and a desire to obtain a charitable income tax deduction").

affluent landowners for the full costs associated with the donation of an easement. Accordingly, it is not surprising that tax incentives appear to play only a subsidiary or supplemental (rather than primary) role in stimulating most donations, and that non-tax motivating factors also must be present to trigger a donation.

Finally, the enactment of generous and egalitarian state tax credits in Virginia and Colorado can be expected to have a number of impacts on easement donation behavior in those states. First, the credits likely will trigger easement donations from less affluent landowners who do not find the existing federal tax incentives to be compelling. Second, because the credits are available to all landowners regardless of their income or wealth level, they will, in some cases, be paid to more affluent landowners who, for the reasons discussed in the preceding paragraph, would have been willing to donate their easements in the absence of such credits. Finally, given that a more affluent landowner may be reimbursed by the public for close to or even more than the full market cost of his easement through a combination of the federal tax incentives and state tax credits, the credits may stimulate the donation of easements from a new class of landowners who have little personal attachment to their land and are motivated solely, or at least primarily, by the anticipated tax savings.

B. Public Benefit—Oversight and Compliance

Although the Treasury initially was inclined favorably toward the charitable income tax deduction available with respect to easement donations, by 1980 it had become hostile to the deduction, believing that easements were being aggressively overvalued and that the deduction was being permitted with respect to easements that provided little or no benefit to the public.[177] In addition, although Congress was still supportive of the deduction in 1980, it too had become concerned about the potential for abuse and the need to ensure that adequate public benefit is derived from donated easements.[178] Accordingly, in enacting §170(h) in 1980, Congress imposed substantial new limitations on the deduction, the most significant of which are that, to be deductible, a perpetual conservation easement must: (i) be donated to a government

177. *See Minor Tax Bills: Hearing on H.R. 7318 Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means,* 96th Cong. 165-168 (1980) (statement of Daniel I. Halperin, Deputy Assistant Sec'y, Treasury Dep't).

178. *See* SENATE REPORT, *supra* note 18, at 603 (in explaining the new deduction requirements under §170(h), the Senate Finance Committee noted that it found it appropriate to expand the types of easement donations qualifying for the deduction in cases where the donations are likely to further significant conservation goals without presenting significant potential for abuse, and restrict the types of easement donations qualifying for the deduction where there is no assurance that the public benefit, if any, furthered by the donations would be substantial enough to justify allowance of a deduction).

agency or publicly-supported charity (or satellite thereof) and (ii) satisfy the conservation purposes test.[179]

The requirement that an easement be donated to a government agency or a publicly-supported charity was included in §170(h) in response to the Treasury's concern about abuse. Although it had no data to support its position, during the deliberations leading up to the enactment of §170(h), the Treasury repeatedly asserted that landowners were claiming large deductions for "backyard" easements donated to local private foundations, such as a local garden club or a private "neighborhood" foundation formed by ten or twelve neighbors.[180] The Treasury believed that easements donated to private foundations, which are not accountable to the public for their support,[181] were less likely to be enforced and, presumably, less likely to provide benefits to the general public.[182]

The Treasury was successful in pressing its position and, in 1980, the deduction provision was revised to exclude private foundations from the category of permissible donees of tax-deductible easements.[183] Under §170(h), permissible donees of tax-deductible easements are limited to: (1) government agencies, which are accountable to the public for their land preservation activities through the one-person one-vote democratic process; and (2) publicly-supported charities (or satellites of such charities), which are accountable to the public for their land preservation activities through the necessity of having to appeal to the public for their ongoing support. Virtually all land trusts now qualify as publicly-

179. *See supra* Part I, *Tax Treatment Extension Act of 1980,* for a description of the conservation purposes test under §170(h). The Regulations contain a number of additional requirements intended to protect the public's investment (in the form of foregone tax revenue) in tax-deductible easements. *See supra* note 96 (discussing some of those requirements). For a detailed description and analysis of the deductibility requirements in §170(h) and the Regulations, see FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20.

180. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 3-2 and 6-3, note 6.4. The lack of any meaningful data on the donation of easements made it impossible to rebut the Treasury's claims of abuse. *Id.* at 3-2.

181. *See* JOINT COMMITTEE ON TAXATION, *supra* note 66, at 3 (describing the various tax-exempt organizations and noting that, in contrast to public charities, private foundations generally are funded from one or a limited number of sources, such as an individual, family, or corporation).

182. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 3-2; *Minor Tax Bills: Hearing on H.R. 7318 Before the Subcomm. on Select Revenue Measures of the House Comm. on Ways and Means,* 96th Cong. 176 (1980) (testimony of Daniel I. Halperin, Deputy Assistant Sec'y, Treasury Dep't) (noting that

> we had felt that the potential donees ought to be limited to public charities in order to give us somewhat greater assurance that the easement will be enforced. We are concerned about gifts to those organizations without a substantial number of contributors and the feeling that there may be less reason for these organizations to enforce the easement and therefore the donor really has not given up very much.)

183. *See supra* Part I, *Tax Treatment Extension Act of 1980.*

supported charities because they normally receive a substantial portion of their support from one or more governmental units or from direct or indirect contributions from the general public.[184]

Congress carefully crafted the conservation purposes test of §170(h) to limit the types of land and the conservation values that could be protected by tax-deductible easements to those it deemed would provide significant benefits to the public.[185] Although the text of §170(h) is relatively brief, and some of the terms used therein were without precedent in the Code, Congress provided substantial guidance regarding the four types of easements that would satisfy the conservation purposes test in the Senate Report, and the Treasury provided significant additional guidance regarding the parameters of that test when it issued the Regulations. However, because of the breadth of the land protection objectives of §170(h), the tremendous diversity of land in the United States, and the inherently subjective nature of the concept of "public benefit," in crafting and interpreting the conservation purposes test, Congress and the Treasury were forced to delegate some of the easement selection process to the agencies and organizations accepting donated easements. Thus, while the conservation purposes test does contain some objective standards,[186] a significant number of the standards are unavoidably subjective.

For example, one of the subjective standards allows the donor of an easement intended to preserve "open space" to retain rights to develop the land subject to the easement, provided such retained rights will not "interfere" with the essential scenic quality of the land or the clearly delineated governmental conservation policy being furthered by the donation (the "permissible development standard").[187] A more objective

184. *See* William T. Hutton, *Mathematical Prescriptions for Relief of the Public Charity Status Blues, in* THE BACK FORTY ANTHOLOGY 1.17 (William T. Hutton ed., 1995) (noting that if a land trust fails to meet the publicly-supported test it is, for all practical purposes, out of business since it no longer will qualify to receive tax-deductible conservation easement donations). A charitable organization that normally receives substantial support through a combination of gifts, grants, and income for goods sold or services rendered in pursuit of its exempt function, such as the Boy Scouts of America, also can accept a tax-deductible conservation easement donation provided it has a "commitment to protect the conservation purposes of the donation. . ." *See* Treas. Reg. §1.170A-14(c)(1).

185. *See* SENATE REPORT, *supra* note 18, at 603 (noting that "the Committee believes that provisions allowing deductions for conservation easements should be directed at the preservation of unique or otherwise significant land areas. . .").

186. For example, an easement donated to preserve land located within a historic district listed in the National Register automatically falls within the conservation purpose of preserving a "historically important land area." *See* Treas. Reg. §1.170A-14(d)(5)(ii)(B).

187. Treas. Reg. §1.170A-14(d)(4)(v). To be eligible for the deduction under §170(h), the donor of an "open space" easement must demonstrate, *inter alia,* that preservation of the land subject to the easement is either: (i) for the scenic enjoyment of the general public or (ii) pursuant to a "clearly delineated Federal, State, or local governmental conservation policy." I.R.C. §170(h)(4)(A)(iii). To qualify as preserving property pursuant to a "clearly delineated

permissible development standard, such as one that would allow the donor of an open space easement to retain rights to subdivide the land subject to the easement, but not into smaller than one hundred acre lots, obviously would have been easier for the IRS to administer. However, the Treasury presumably recognized that, because of the tremendous diversity of lands in this country that may be deemed worthy of protection as "scenic" or "pursuant to a clearly delineated governmental conservation policy," crafting an objective permissible development standard that reasonably could be applied to open space easements nationwide was impossible.[188] Accordingly, the Treasury instead included the subjective permissible development standard in the Regulations, provided two examples of the application of that standard to a specific set of facts,[189] and implicitly acknowledged in the second of those examples

governmental conservation policy," an easement must further a specific, identified conservation project. *See* Treas. Reg. §1.170A-14(d)(4)(iii)(A). Although a general declaration of conservation goals by a single official or legislative body is not enough, the governmental policy need not rise to the level of a certification program that identifies individually owned parcels as worthy of preservation. *Id.* The Regulations provide a number of helpful examples of easements that would further a "specific, identified conservation project," including an easement that preserves land within a state or local landmark district that is locally recognized as being significant to the district, or an easement that preserves farmland pursuant to a state program for flood prevention and control. *Id*. The Regulations also provide that a donation made pursuant to a formal resolution or certification by a local governmental agency established under state law specifically identifying the subject property as worthy of protection for conservation purposes will satisfy the "clearly delineated governmental conservation policy" requirement, thus establishing a "safe harbor" for satisfying that requirement. *Id*.

188. The development rights that can be retained by the donor of an open space easement without unduly interfering with the conservation purposes of the easement will vary greatly depending upon the location and characteristics of the land subject to the easement, as well as the specific conservation purposes of the easement. For example, an open space easement preserving farmland pursuant to a state program for flood prevention and control could be expected to allow more development than an open space easement preserving a stretch of undeveloped property located between a public highway and the ocean in order to maintain the scenic view of the ocean from the highway. *See also* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 9-6 (describing the possible different standards that might apply in a Western state, where some take the position that open space easements should not permit subdivision of the encumbered property into smaller than one hundred acre parcels, and a New England state, where many parcels smaller than one hundred acres are protected by open space easements).

189. *See* Treas. Reg. §1.170A-14(f), *Example (3)* (denying a deduction for the donation of a scenic easement on a 900-acre parcel located on the crest of a mountain and visible from a national park where the donor wanted to reserve the right to subdivide the parcel into ten ninety-acre parcels with no more than one single-family home on each parcel because such "random" building on the property would "destroy the scenic character of the view"); Treas. Reg. §1.170A-14(f), *Example (4)* (allowing a deduction for the donation of a scenic easement under the same facts as in Example (3), except not all of the parcel is visible from the national park, the easement allows for limited cluster development of no more than five nine-acre clusters (with four houses on each cluster) located in areas generally not visible from the park, and the development is subject to site and building approval by the donee organization); *see also* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 13-3 and 13-4 (noting that Example (3) "provides very little guidance to taxpayers about how much building is too

that it was relying, in large part, on the government agencies and charitable organizations accepting tax-deductible easement donations to ensure that any development rights retained in an easement do not interfere with the conservation purposes of the easement.[190]

The Regulations also contain an equally subjective "inconsistent use standard" that applies to all donated easements regardless of the conservation purpose of the easement.[191] Pursuant to the inconsistent use standard, a deduction for an easement donation will be denied if the donation would accomplish one of the four conservation purposes enumerated in §170(h), but would permit the destruction of "other significant conservation interests."[192] As an example, the Regulations provide that an "open space" easement preserving farmland pursuant to a state program for flood prevention and control would not qualify for the deduction under §170(h) if, under the terms of the easement, a significant naturally occurring ecosystem could be injured or destroyed by the use of pesticides in the operation of the farm.[193] The Regulations defining the inconsistent use standard further provide that "[a] use that is destructive of conservation interests will be permitted only if such use is necessary for the protection of the conservation interests that are the subject of the contribution."[194] As an example, the Regulations state that a deduction for the donation of an easement to preserve an archeological

much" and that, although Example (4) offers clues to working with the permissible development standard and "blesses cluster zoning as one important way to preserve open space," the fact pattern of Example (4) "should not be taken to mean that this is the only level of development the IRS would sanction.")

190. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 13-4 (noting that the Treasury authorized the deduction for the donation of the easement discussed in Treasury Regulation §1.170A-14(f), Example (4), in part because exercise of the retained development rights was subject to site and building plan approval by the donee organization, and that Example (4) indicates that "donee organizations must exercise a significant level of care and responsibility to see to it that the mandate of the statute. . .is carried out."); Stephen J. Small, *Conservation Easements Today: The Good and the Not-So-Good,* Vol. 22, No. 2 EXCHANGE, THE JOURNAL OF THE LAND TRUST ALLIANCE 32, 33 (2003) [hereinafter Small, *The Good and the Not-So-Good*] (noting, with regard to the permissible development standard, that "Frankly, the idea at the IRS was to articulate a sensible rule and leave it to the tax-exempt land trust community to administer and police that rule. In other words, *the land trust community should be the first line of defense against bad or abusive conservation easement donations*.") (emphasis in original). *See also supra* note 20, identifying Small as the principal author of the Regulations.

191. *See* Treas. Reg. §1.170A-14(e)(2).

192. *Id*.

193. *Id. See also* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 12-3 (noting that the use of the word "significant" to modify "naturally occurring ecosystem" in the Regulations is important in that it apparently acknowledges that a complete prohibition on the use of pesticides is unrealistic and, thus, permits the use of pesticides to destroy agricultural pests). The Regulations also provide that the inconsistent use standard is not intended to prohibit the use of the farmland for such things as selective timber harvesting or selective farming, if, under the circumstances, those uses do not impair significant conservation interests. *See* Treas. Reg. §1.170A-14(e)(2).

194. Treas. Reg. §1.170A-14(e)(3).

site listed on the National Register of Historic Places would be allowed even though site excavation consistent with sound archaeological practices might impair a scenic view of which the land is a part.[195]

The examples noted above provide very limited guidance regarding the application of the inconsistent use standard.[196] For example, it is not clear if an easement that permits limited development, hunting, or the use of snowmobiles on land that provides habitat for wildlife would violate the standard.[197] Accordingly, the inconsistent use standard, like its permissible development brother, leaves considerable room for subjective judgment and places much of the responsibility for ensuring that the development and use rights retained in an easement do not interfere with the conservation purposes of the easement on the government agencies and charitable organizations accepting tax-deductible easement donations.[198]

Since the enactment of §170(h) in 1980, the IRS has exercised very little oversight over the easement donation process. Requests for private letter rulings on the issue of whether a proposed donation will satisfy the deductibility requirements under §170(h) are relatively rare,[199] and even

195. *Id.*

196. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 12-2 (noting that the inconsistent use standard, which was derived from the Senate Report, "is a good example of something that sounds good but is difficult to articulate in an Income Tax Regulation in a way that both makes sense and is helpful," that the standard "raises more questions than it answers," and that the examples in the Regulations that attempt to illustrate both the inconsistent use standard and the permissible development standard are flawed).

197. *See id.* at 12-2 and 12-3. Presumably the answer would depend upon the conservation purposes of the easement, the level of impact such uses would have on the habitat, and, perhaps in the case of some uses, local or regional habit or custom. *See id.* (noting that "[w]hile most land conservation organizations in Western states would likely not think twice about a donor's reservation of hunting rights, many conservation organizations in the Northeast would either try to discourage a donor from such a reservation of rights or would refuse to accept such a donation.").

198. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 5-5, 15-10 (noting that the Treasury intentionally avoided providing a clearer rule on inconsistent uses because it did not want to be put in a position of deciding which uses are "better" than others, thus avoiding the difficult value judgments in questions ranging from whether duck hunting is a permissible use to what to do about the easement donor who wants to cut down trees and make a park and picnic area for the county, and that the only good answer is to rely on the donee organization to exercise good judgment about what will or won't be permitted.)

199. *See* Stephen J. Small, *Second Supplement (1988-1995),* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 1 (noting that from 1982 through 1987 the IRS published thirty-two private letter rulings addressing §170(h), from 1988 through 1995 the IRS published only eight private letter rulings addressing that section, and that there are fewer private letter rulings being published because fewer landowners (and land trusts) now believe they need advance guidance from the IRS as to whether a particular donation meets the requirements of §170(h)); Stephen J. Small, *Third Supplement (1996-2000)*, FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 1 (noting that from 1996 through the middle of 2000 the IRS published six more private letter rulings addressing §170(h), but only two of those dealt with the fundamental issue of whether an easement donation met the requirements for deductibility under §170(h)). From the middle of 2000 to the writing of this article the IRS

in the context of a private letter ruling, the IRS appears to defer to the judgment of the agency or organization accepting the easement regarding whether the donation complies with the more subjective standards under §170(h).[200] In addition, anecdotal evidence indicates that the IRS does not target easement donation transactions for audit,[201] and even when it does audit such transactions, it ignores the issue of whether the easement donation satisfied the deductibility requirements under §170(h) and focuses its enforcement efforts on the issue of easement valuation.[202]

The IRS's decision to not challenge easement donations on the issue of satisfaction of the deductibility requirements under §170(h) is not surprising, given that satisfaction of many of those requirements is beyond the ken of IRS personnel to evaluate. The IRS simply is not equipped to determine, for example, whether a landowner's retained rights to develop a portion of land subject to an open space easement will "interfere" with the essential scenic quality of the land or the governmental conservation policy that is being furthered by the donation.[203]

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published only two additional private letter rulings addressing the issue of whether an easement donation meets the requirements for deductibility under §170(h). *See* Priv. Ltr. Rul. 2002-08-019 (Nov. 26, 2001) and Priv. Ltr. Rul. 2004-03-044 (Oct. 9, 2003).

200. S*ee, e.g.,* Priv. Ltr. Rul. 2002-08-019 (Nov. 26, 2001) (ruling, without any apparent independent inquiry into the issue, that the proposed development of approximately 20 percent of land to be encumbered by an easement qualifying for the deduction under the "protection of habitat or ecosystems" conservation purpose was "not so significant as to impact the endangered or threatened species on the property.").

201. Over the years, Stephen J. Small has gathered anecdotal evidence that the IRS is not targeting easement donation transactions for audit. *E.g.,* SMALL, BOOK III, *supra* note 133, at 97-98 (reporting that during 2000 and 2001 the author asked various audiences of land trust personnel and other professionals engaged in the field for a show of hands from those who knew of any conservation easements that were being audited. In a total audience of approximately 1800, only approximately fifteen hands were raised); Stephen J. Small, *Third Supplement (1996-2000),* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 1 (reporting a similar trend in the 1990s). *See also supra* note 20, identifying Small as a nationally recognized expert in conservation easement transactions.

202. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 9-5 (noting that not one single case had come to the author's attention in which the deduction for donating an easement was denied on the grounds that the donation did not meet the requirements of the statute); Hutton, *The Munificent Conservation Easement*, *supra* note 93, at 5 (noting that the IRS has shown almost no inclination to assert deficiencies based upon the failure to qualify for the deduction under §170(h), and that challenges by the IRS—and there have been many—seem always to be directed at the taxpayer's appraisal).

203. *See supra* note 187 and surrounding text for a discussion of the subjective permissible development standard applicable to open space easements. *See also* Hutton, *The Munificent Conservation Easement*, *supra* note 93, at 5 (noting that the IRS is a beleaguered and somewhat impoverished agency required by Congress to make many evaluations it is ill-equipped to make, including perhaps the qualification of conservation easements under standards that may involve measurements of habitat quality, sufficiency of scenic resources, or the relative merits of local conservation policy).

Given the subjective nature of important aspects of the conservation purposes test under §170(h), the low level of oversight exercised by the IRS over the easement donation process, and the fact that a prospective easement donor interested in the federal tax benefits must find a government agency or publicly-supported charity willing to accept his easement, the ultimate responsibility for ensuring that donated easements accomplish the type of land conservation envisioned by Congress when it enacted §170(h) devolves to easement donors and to the agencies and organizations that agree to accept and enforce their easements.[204] Accordingly, the following sections examine the extent to which we can reasonably rely on easement donors and donees to ensure that donated easements accomplish the type of land conservation and, thus, provide the level of public benefit envisioned by Congress when it enacted §170(h).

1. Voluntary Compliance by Easement Donors

For a number of reasons it appears that we can rely on most easement donors to voluntarily comply with the objective requirements for the various federal tax incentives, and to be conservative in their interpretation of the more subjective requirements (such as the permissible development and inconsistent use standards). First, the stakes involved in an easement donation are quite high. As discussed in Part II.A.2, the market and transaction costs associated with an easement donation are significant, an easement donation involves a permanent loss of some autonomy with respect to the use and management of the encumbered land, and an easement donation is not reversible should the landowner have a change in fortunes (or a change of heart). Moreover, although the tax savings generated by an easement donation typically will reimburse the donor for only a modest percentage of the market cost of the easement,[205] such savings nonetheless generally will amount to thousands or even hundreds of thousands of dollars.[206] Given the stakes,

204. *See* Treasury Decision 8069, 51 Fed. Reg. 1496, 1498 (Jan. 14, 1986) (in discussing the donation of an easement for the purpose of protecting "open space," the Treasury acknowledged that, although a degree of certainty is available to donors in jurisdictions that have clearly articulated conservation policies, as with any subjective test, there ultimately must be some exercise of judgment and responsibility by both donors and donees.) It should be noted, however, that the IRS is not bound by its past pattern of nonenforcement of the requirements under §170(h), and the various subjective standards in that section arguably act as backstops with regard to public benefit because they reserve to the IRS the right to audit and litigate such matters in the future if it determines that donors are proposing, and donees are accepting, abusive easements.

205. *See supra* Part II.A.3.d.

206. *See, e.g., supra* Part II.A.3.a, describing how the High-Income Landowner who donates an easement valued at $500,000 will receive income tax savings with a present value of $133,237 (assuming the phase-in technique is not employed).

it is reasonable to assume that easement donors interested in benefiting from the tax incentives are likely to go to some trouble and expense to ensure that their donations will, in fact, qualify for the incentives.[207] It also is reasonable to assume that a donor's desire for certainty with regard to qualification for the tax incentives will increase as the value of the donated easement increases, thus providing some measure of comfort that the most expensive donation transactions (from the perspective of foregone revenues) also are the transactions most likely to be in compliance with the requirements for the tax incentives.[208]

Second, while there is a possibility that the IRS's low audit rate (and failure to question whether an easement donation satisfied the requirements under §170(h) even when it does conduct an audit) has caused easement donors to be less concerned about complying with the requirements for the tax incentives, such a cavalier attitude on the part of easement donors is unlikely. The IRS is not bound by its past pattern of non-enforcement of the requirements under §170(h), so a donor's risk of audit and denial of tax benefits, while low, is not nonexistent. Arguably, a donor faced with a low, but relatively easy to avoid risk of rather disastrous consequences—the denial of substantial tax benefits with respect to an irreversible transaction that has significant long-term effects—will make some effort to voluntarily comply with the requirements for the tax incentives.[209]

Finally, the significant component of personal sacrifice currently involved in the typical easement donation (at least in states other than Virginia and Colorado) acts as a crucial implicit check on abuse in the donation process. While the anticipated tax savings from an easement donation remain relatively modest, landowners must be motivated to donate their easements in part by non-tax factors, such as a strong personal attachment to and concern about the long-term stewardship of their land.[210] To the extent easement donors are motivated by a genuine

207. The "trouble and expense" generally involves engaging legal counsel to assist with the donation transaction, although on rare occasions it also involves requesting a private letter ruling. *See* Hutton, *The Munificent Conservation Easement*, *supra* note 93, at 5 (noting the considerable efforts of land trusts and tax advisors to insure compliance with the qualification requirements under §170(h)). The temporary suspension of easement donation programs following the enactment of §170(h) in 1980 also supports the conclusion that easement donors generally wish to comply with the qualification requirements for the deduction. *See* Browne, *supra* note 36, at 153 (noting, in an article published shortly after the enactment of §170(h), that "potential donors will not be persuaded by lawyers' opinions couched in 'more probable than not' language; they want assurances of no loss of tax benefits").

208. As the value of a donated easement increases, so does the market cost associated with the donation and, in general, the dollar amount of the anticipated tax savings.

209. *See* Hutton, *The Munificent Conservation Easement*, *supra* note 93, at 5 (noting that, despite the IRS's pattern of non-enforcement of the qualification requirements under §170(h), "it is still appropriate to worry about conservation purposes, no one wants to be the first case").

210. *See supra* Part II.A.6.

attachment to and concern about the stewardship of their land, they are less likely to donate easements that will permit their land to be developed or used in ways inimical to its conservation values.

2. Easement Donee Selection Criteria

Government agencies and land trusts that wish to encourage easement donations have a powerful incentive to structure their easement selection criteria with an eye toward the requirements set forth in §170(h). As discussed above, easement donors generally can be expected to go to some trouble and expense to ensure that their donations qualify for the deduction under §170(h). Accordingly, government agencies and land trusts that do not base their easement selection criteria on one or more of the conservation purposes enumerated in §170(h) can expect to receive few easement donations. It is not surprising, therefore, that the government agencies and land trusts that wish to attract easement donations typically use one or more of the conservation purposes enumerated in §170(h) as the framework for their easement selection criteria.[211]

As noted in Part I, land trusts provided significant guidance to both Congress and the Treasury in the structuring of §170(h) and the Regulations.[212] Land trusts also have taken an active role in encouraging state and local governments to develop "clearly delineated governmental conservation policies" upon which easement donors qualifying for the deduction under the "open space" conservation purpose can rely.[213]

Despite the foregoing, one cannot assume a perfect congruency between the easement selection criteria of government agencies and land

211. *See, e.g.,* VIRGINIA OUTDOORS FOUNDATION, EASEMENT GUIDELINES 4-5, *at* www.virginiaoutdoorsfoundation.org/VOF/Guideline.htm (last visited Dec. 29, 2003) [hereinafter VOF GUIDELINES] (providing that easements that protect wildlife habitat and historic, scenic, open space, and recreational properties—all valid conservation purposes under §170(h)—are eligible for acceptance by the Virginia Outdoors Foundation); *see also* LAND TRUST ALLIANCE STANDARDS AND PRACTICES GUIDEBOOK 8-16 to 8-17 (on file with author and available from the LTA) [hereinafter LTA GUIDEBOOK] (noting that:

> the IRS's. . .criteria for determining the deductibility of conservation easements can be used by land trusts as a guide to test the public benefit of easements. . ., tax-deductible or not. In effect, these rules define conservation values that are considered to be in the national interest (and thus their protection is worthy of federal tax benefits). . .If a property does not meet the criteria. . .it should be a warning signal to the land trust—the land trust needs to scrutinize the transaction to be sure it has sufficient public benefit to proceed).

212. *See supra* notes 51 and 52 and accompanying text.

213. *See supra* note 187 (describing the "open space" conservation purpose under §170(h)); TAX STRATEGIES IN LAND CONSERVATION TRANSACTIONS, *supra* note 93, at 3-12 (noting that much useful long-range planning has involved land trusts in the development of governmental policies designed to facilitate the qualification of easement donations for the deduction under §170(h)).

trusts and the various requirements set forth in §170(h). While it is in the self-interest of government agencies and land trusts to conform their easement selection criteria to the requirements set forth in §170(h), such agencies and organizations give no assurance to either donors or the IRS that the easements they accept satisfy those requirements.[214] Furthermore, the mission of the government agencies and land trusts that accept donated easements is to provide public benefit through land conservation measured by their own lights, and not necessarily by the standards set forth in §170(h). Nevertheless, it is not unreasonable to assume that the combination of an easement donor's self-interest in qualifying for the deduction under §170(h) and the donee agency or organization's interest in structuring its selection criteria to facilitate tax-deductible easement donations will operate to ensure satisfaction of at least the objective requirements under §170(h).[215]

The more subjective determinations to be made under §170(h), such as whether and the extent to which retained development and use rights "interfere" with the conservation purposes of an easement or are "inconsistent" with significant conservation interests, present a more intractable problem.[216] Those determinations often go to the heart of whether an easement will adequately protect the conservation values of the land and, due to their subjectivity, they are potential "weak points" that could be exploited by aggressive donors and complicit donees. However, discussed below are a number of forces that encourage government agencies and land trusts to accept only those easements containing restrictions on development and use sufficient to protect the conservation values of the land, and to reject the low quality offerings of more aggressive easement donors.

a. Public Accountability

Government agencies, by definition, exist to serve the public, and to the extent they engage in easement acquisitions, those acquisitions should

214. *See, e.g.,* VOF GUIDELINES, *supra* note 211, at 6 (noting that "[t]he Virginia Outdoors Foundation cannot guarantee that an easement will qualify for a federal income tax deduction under IRS criteria. Donors should consult with qualified tax advisors to determine the tax effect in their particular situation."); LTA GUIDEBOOK*, supra* note 211, at 12-19 (stating that "[t]he land trust does not make assurances as to whether a particular. . .easement donation will be deductible. . . or what the resulting tax benefits of the deduction will be").

215. For example, many land trusts provide prospective donors and their legal counsel with a "form" easement that contains the provisions necessary to satisfy the objective requirements of §170(h) and the Regulations, such as a provision mandating that the land trust receive a portion of the proceeds from the sale of the land if the easement is extinguished due to changed conditions. *See* Treas. Reg. §1.170A-14(g)(6) and *supra* note 96 (discussing that requirement).

216. *See supra* Part II.B for a discussion of the subjective "permissible development standard" applicable to open space easements and the equally subjective "inconsistent use standard" applicable to all easements.

be designed to benefit the public.[217] In addition, government agencies are accountable to the public through the one-person, one-vote democratic system, and that dependence upon public support should, as a general rule, compel such agencies to accept only those easements that provide public benefit. However, the accountability of government agencies to the public is not perfect, and there may be circumstances in which the review of an easement by a government agency is influenced by politics or other factors that have little to do with the public value of the easement.[218] The Treasury recognized this danger, and refused to allow the acceptance of an open space easement (the type of easement the Treasury believed presented the greatest potential for abuse) by a government agency to establish conclusively that the easement was donated pursuant to a "clearly delineated governmental policy."[219] Thus, to be assured of qualifying for the deduction under §170(h), the donor of an open space easement to a government agency must provide additional evidence demonstrating satisfaction of the "clearly delineated governmental conservation policy" requirement. [220]

Virtually all land trusts function as publicly-supported charitable organizations.[221] They are organized and operated specifically to provide benefits to the public, and their activities are subject to oversight by state regulators (generally the state attorney general), the IRS, and the public. However, oversight by state regulators and the IRS is minimal and rarely involves any inquiry into a land trust's land protection activities.[222] Thus, the most important form of oversight arguably comes from the individual and corporate donors that provide land trusts with the funds necessary to finance their ongoing operations. To maintain their status as publicly-supported charities and, thus, as qualifying recipients of tax-deductible

217. *See, e.g.,* VOF GUIDELINES, *supra* note 211, at 1 (noting that, in considering the acceptance of an easement, "[t]he Trustees shall make a determination that acceptance of the easement brings a public benefit to the Commonwealth").

218. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 8-5.

219. *Id.* See *supra* note 187 for a discussion of the "clearly delineated governmental conservation policy" requirement.

220. *See* Treas. Reg. §1.170A-14(d)(4)(iii)(B) (providing that, while acceptance of an open space easement by a government agency (whether federal, state, or local) *tends* to establish that the easement was donated pursuant to a "clearly delineated governmental conservation policy," such acceptance, without more, is not sufficient) (emphasis added).

221. See *supra* note 184 and accompanying text.

222. *See* TAX STRATEGIES IN LAND CONSERVATION, *supra* note 93, at 6-1 to 6-2 (noting that both state officials and the IRS can and do monitor land trust performance, although such monitoring rarely (if ever) involves measuring organizational achievements and, instead, is focused on potential transgressions of the relevant statutory standards relating to nonprofits); Susan N. Gary, *Regulating the Management of Charities: Trust Law, Corporate Law, and Tax Law*, 21 U. HAW. L. REV. 593, 620 n. 220, 623 (1999) (noting that the number of IRS staff is declining at a time when the charitable sector is growing rapidly, and that from the perspective of state attorney general oversight, the worst abuses by charities receive attention, but many problems probably go undetected or unaddressed).

easement donations, land trusts must receive a substantial portion of their support from direct or indirect contributions from the general public.[223] Accordingly, they have a compelling incentive—survival—to be responsive to the land protection preferences of the public, or at least the segment of the public that constitutes their donor base.[224] In fact, land trusts may be more accountable to the public than government agencies because of their direct reliance on the public for their ongoing support.[225]

b. Financial Incentive

Since government agencies and land trusts are, in effect, spending someone else's money to acquire easements donated under §170(h), they might be expected to exercise less care in the selection of donated easements than in the selection of easements they purchase directly.[226] That concern should not be overstated, however, because government agencies and land trusts accepting easement donations have a significant financial incentive to be selective and accept only those easements that best advance their particular land protection goals. Unlike the acceptance of a cash donation, the acceptance of an easement donation confers no economic benefit upon a government agency or land trust. Instead, an easement represents a liability to the accepting agency or land trust because it entails ongoing and sometimes costly monitoring and enforcement responsibilities, which typically must be undertaken on a very limited budget.[227] Thus, to the extent government agencies and land

223. *See supra* note 184 and accompanying text.

224. *See* Gary, *supra* note 222, at 616 (noting that "as a practical matter, to be able to attract future gifts from the same donors or from other donors, a charity must not stray far from its mission and must manage its assets effectively").

225. *See, e.g.,* FAIRFAX & GUENZLER, *supra* note 11, at 209 (noting that some of the best routes to public accountability are found in nonprofit organizations, which must work assiduously to appeal to potential donors).

226. The funds available to "purchase" easements through the tax incentive program are effectively unlimited and involve no fundraising or grant proposal work on the part of the government agencies and land trusts accepting easement donations. In addition, government agencies and land trusts have no direct involvement in the expenditure of funds in the context of the tax incentive program (that is, no one at the agency or land trust is writing checks to easement donors). Accordingly, it is not unreasonable to assume that government agencies and land trusts might exercise a lower level of quality control, scrutiny, and prioritization with regard to donated easements than they would with regard to easements they purchase directly with limited funds derived from government grants or donor contributions.

227. *See, e.g.,* William T. Hutton, *Easements as Public Support: The "Zero Value" Approach, Part II: Two Legal Issues, in* CONSERVATION EASEMENT HANDBOOK, *supra* note 2, at 136 (noting, with regard to an easement donation, that "From the donee's perspective. . .the donated silk purse is transformed, at the moment of conveyance, into a sow's ear destined for perpetual care."); Janet Diehl, *Part One: Managing an Easement Program, in* CONSERVATION EASEMENT HANDBOOK, *supra* note 2, at 24 (quoting Art Reese, Chief of Habitat and Technical Services for the Wyoming Department of Game and Fish, as stating "some agencies ignore the reality that easement. . .acquisitions have inbred constant and long-term costs and obligations associated

trusts take seriously the perpetual monitoring and enforcement obligations they incur upon accepting an easement, they can be expected to be discriminating in their selection processes.

As an example of the operation of public accountability and financial incentives, assume a government agency or land trust that acquires land and conservation easements to protect wildlife habitat is offered an easement on an attractive parcel of land, but the donor insists on retaining significant subdivision and development rights. Even if the retained rights arguably would comply with an aggressive interpretation of the "permissible development" and "inconsistent use" standards under §170(h), the government agency or land trust might decline to accept the easement for a number of reasons. First, acceptance and stewardship of a habitat protection easement that permits a significant level of subdivision and development could be perceived as an inappropriate use of public resources. In addition, the government agency or land trust would have to assume that, at some point, the retained subdivision and development rights would be fully exercised. At that point, the government agency or land trust would be required to monitor the activities of, and enforce the terms of the easement against multiple landowners who were not involved in the easement donation transaction and may not have the same conservation proclivities as the easement donor. The land trust community fully expects easement challenges and violations to increase as easement-protected properties are transferred by sale, gift, or bequest to individuals who were not involved in the easement donation transactions.[228] Accordingly, the government agency or land trust might well determine that the habitat protection benefits of the proposed easement simply are not worth the projected long-term costs of monitoring and enforcing the easement.

3. Public Benefit Conclusion

Landowners interested in claiming charitable deductions for irrevocable easement donations arguably have a significant incentive to comply with at least the objective requirements of §170(h). Moreover, while the tax incentives remain modest, easement donors are likely to be motivated in part by a desire to protect their land and, thus, unlikely to

with them. . .the maintenance and monitoring costs are a long-term commitment to the goals and objectives precipitating the acquisition. . .It is the long-term annual monitoring and maintenance costs that can erode an agency budget"); *see also* Collective Defense Resources, *infra* note 231, at v (noting that "traditionally, the land conservation community has focused on acquisition, not on securing funds for stewardship or defense costs").

228. *See, e.g.,* Collective Defense Resources, *infra* note 231, at v (noting that "the conservation community anticipates a wave of litigation as successor landowners assume control of easement-protected properties").

donate easements that permit their land to be developed or used in ways inimical to its conservation values. However, relying on easement donors to police themselves obviously would be unwise, particularly given the current popular and political support for increasing the tax incentives. Accordingly, much of the responsibility for ensuring that donated easements accomplish the type of land conservation envisioned by Congress when it enacted §170(h) rightly should rest with the government agencies and land trusts accepting easement donations.

Despite the public accountability and financial incentives that act to encourage government agencies and land trusts to accept only those easements that provide significant benefits to the public, the reliability of such agencies and organizations as gatekeepers depends to a large extent upon their ability to create and consistently implement appropriate easement selection criteria, and to recognize and fulfill their long-term monitoring and enforcement responsibilities—tasks that clearly require both financial and staffing resources. New land trusts, which are created in growing numbers each year, existing land trusts that are under-funded and staffed largely or entirely with volunteers, and government agencies new to easement acquisition or with their own financial and staffing troubles, might, because of exigency or inexperience, accept easement donations that do not provide the level of public benefit envisioned by Congress when it enacted §170(h).[229]

The land trust community is aware of and responding to the challenges presented by both the easement selection process and the ongoing monitoring and enforcement responsibilities that accompany easement acquisitions. The general concern of the land trust community is that one errant land trust accepting questionable easements or failing to carry out its monitoring and enforcement responsibilities could have a negative effect on the entire land trust community and on the use of conservation easements as a land protection tool.[230]

229. *See* Martha Nudel, *Land Trusts Grow Stronger With More Staff, Larger Budgets,* Vol. 21, No. 2 EXCHANGE, THE JOURNAL OF THE LAND TRUST ALLIANCE 5 (2002) (noting that the 2000 Census found that approximately half of the nation's local, state, and regional land trusts are run entirely by volunteers); SMALL, BOOK III, *supra* note 133, at 12 (noting that "[t]oo many organizations with no experience, no guidance, no checklist, and no criteria, are now accepting conservation easements."); Small, *The Good and the Not-So-Good, supra* note 190, at 33 (noting that "there are those who are packaging and donating conservation easements that allow *far too much building for the land.* And there are land trusts that accept such conservation easements and are either unaware of the federal tax code rules or ignore the federal tax code rules").

230. *See, e.g.,* Andrew Zepp, *LTA to Launch Land Trust Quality Initiative*, Vol. 19, No. 4 EXCHANGE, THE JOURNAL OF THE LAND TRUST ALLIANCE 19 (2000) (noting that given the explosive growth of both land trusts and the use of conservation easements, concerns about land trust quality and effectiveness increasingly were being voiced, and some wondered if the missteps of one land trust [could] affect the ability of others to conserve land.").

As part of a drive to enhance the quality of land trusts, in 2001 the LTA launched the Land Trust Quality Initiative. Through this program the LTA has been assisting land trusts in building their organizational competence and adopting the Land Trust Standards and Practices (the "Standards and Practices").[231] The Standards and Practices, which were first created in 1989, are an evolving set of fifteen standards that articulate guidelines for the responsible and professional operation of land trusts.[232] The LTA has been aggressively pushing the adoption of the Standards and Practices by all land trusts and, as of October 2003, approximately 90 percent of the LTA's sponsor member land trusts had formally adopted the Standards and Practices.[233]

However, voluntary adoption of largely aspirational standards does not necessarily a paragon of easement selection and stewardship make. Indeed, serious concerns would remain even if all of the land trusts in the nation adopted the Standards and Practices. Alternatively, Congress and the public could feel far more confident that donated easements are providing, and will continue to provide, the requisite level of public benefit if the land trusts and government agencies accepting easement donations were required to meet certain basic expertise, practice, and resource standards through a more formal accreditation program.[234]

231. *See id.* The LTA also commissioned a study of the monitoring and enforcement challenges facing easement holders, which was completed in 2002. *See* DARLA GUENZLER, BAY AREA OPEN SPACE COUNCIL, CREATING COLLECTIVE EASEMENT DEFENSE RESOURCES: OPTIONS AND RECOMMENDATIONS v-iv (2002) (on file with author) [hereinafter COLLECTIVE DEFENSE RESOURCES] (this detailed and comprehensive report acknowledges that the dramatic growth in the use of conservation easements has not been matched by a commensurate growth in the ability of easement holders to steward their easements, but notes that there still is time to build the financial, legal, and organizational resources needed to respond to stewardship challenges, and offers an array of strategies for addressing those challenges).

232. Land Trust Alliance, *Land Trust Standards and Practices*, *at* http://www.lta.org/resources/
standards.html (last visited Dec. 29, 2003); *see also* LTA GUIDEBOOK, *supra* note 211. The LTA Guidebook contains a detailed discussion of each of the Land Trust Standards and Practices (the "Standards and Practices"), and was created to help land trusts understand and implement the Standards and Practices. The LTA developed the Standards and Practices at the urging of many land trusts, "who believe a strong land trust community depends on the credibility and effectiveness of all its members." Land Trust Alliance, *Land Trust Standards and Practices*, at xv.

233. *See* LTA's Summary of the Land Trust Standards and Practices (on file with author); LTA Guidebook, *supra* note 211 (noting that the LTA is encouraging land trusts to adopt the Standards and Practices and, more recently, conditioned eligibility for its capacity-building grants programs on the adoption the Standards and Practices); *see also* Land Trust Alliance, *Sponsor Membership*, *at* http://www.lta.org/sponsors.htm (last visited Dec. 29, 2003) (noting that "sponsor" membership is available only to land trusts, that sponsor members are required to adopt the Standards and Practices, and that new sponsor members are given one year to adopt the Standards and Practices). Sponsor members receive a variety of benefits from the LTA. *See Id.*

234. *See* COLLECTIVE DEFENSE RESOURCES, *supra* note 231, at 67—68 (making a compelling case for the accreditation of land trusts).

Whether intentionally or not, the LTA laid some of the groundwork for a more formal accreditation program in connection with its Land Trust Quality Initiative. Some entities already treat adoption of the Standards and Practices as a *de facto* accreditation of land trusts. For example, adoption of the Standards and Practices is a prerequisite for land trusts to receive grants from both the Doris Duke Charitable Foundation and New Hampshire's Land and Community Heritage Investment Program.[235] In addition, municipalities receiving grants from the New Hampshire program are required to adopt part of the Standards and Practices, indicating that accreditation could apply to government agencies as well as land trusts.[236]

Until October of 2003, however, the extent to which the LTA was moving toward the development of a more formal accreditation program for land trusts was not clear. While the LTA was aggressively pushing its members to adopt the Standards and Practices, it appeared reluctant to develop a more formal set of accreditation standards. The LTA's position with regard to accreditation changed in October of 2003, when its Board of Directors approved a Strategic Plan for the years 2004 through 2008 (the "Strategic Plan").[237]

The Strategic Plan provides, *inter alia*, that the "LTA will research and develop an integrated program of training, assessments, and credentialing based on the *Land Trust Standards and Practices*."[238] The LTA's change of heart regarding accreditation was the result of increased critical scrutiny of land trust activities by the national media, and a

235. *See* Kendall Slee, *Land Trust Standards and Practices: Guidelines With Room For Diversity*, Vol. 21, No. 2 EXCHANGE, THE JOURNAL OF THE LAND TRUST ALLIANCE 12 (2002); *see also* LTA GUIDEBOOK, *supra* note 211 (noting that, as the Standards and Practices become established in the land trust movement, they are beginning to be used by other organizations as a screen to determine a land trust's competence and legitimacy, and providing as examples that: (i) the Society for the Protection of New Hampshire Forests serves as a conservation easement back-up grantee only for land trusts that have adopted the Standards and Practices, (ii) the Trust For Public Land requires land trusts to comply with "Part One" of the Standards and Practices (pertaining to organizational strength) to participate in its Land Counselor training program and, (iii) in Maryland, land trusts must adopt and remain in compliance with the Standards and Practices to qualify for two grant programs offered by the state.)

236. Slee, *supra* note 235, at 12. Although government agencies that accept easement donations face most of the same challenges as land trusts, there is evidence that they are less vigilant with respect to their stewardship responsibilities than are land trusts and, thus, that they are in equal or greater need of accreditation. *See, e.g.,* BAY AREA OPEN SPACE COUNCIL, ENSURING THE PROMISE OF OPEN SPACE EASEMENTS 14, 21, 28 (1999) (finding that 70 percent of easements held by public agencies were not monitored, as compared to 25 percent of easements held by non-profits, and noting, with respect to public agencies, the "second-class" standing of easements, the chronic low funding always diverted from easement stewardship to more pressing needs, and the difficulty in adapting practices used with respect to fee holdings to easement holdings).

237. *See* LAND TRUST ALLIANCE, STRATEGIC PLAN 2004-2008 2 (on file with author) [hereinafter STRATEGIC PLAN].

238. *Id.* at 9.

growing fear on the part of the LTA that credentialing standards might be imposed on the land trust community by a government agency.[239] The Strategic Plan notes that the LTA has traditionally served as the 'standard bearer' for the land conservation community, and that the best response to the threat of governmental regulation is a "single, national set of standards and a credentialing process that is designed and managed by the land trust community."[240]

Although the LTA recognizes the pressing need for a more formal land trust accreditation program, and would prefer to have that program designed and managed by the land trust community (rather than a government agency), it also understands that its members are likely to resist accreditation.[241] Accordingly, the Strategic Plan provides that the LTA "will design an education program to build awareness of the threats facing the land trust community and the benefits of a credentialing program," and that the LTA's approach to assessment and credentialing "will be positive, voluntary, and incentive-driven."[242]

In developing the accreditation program, the LTA will likely wrestle with the difficulty of balancing meaningful, enforceable standards with the dangers of top-down micro-management. Accreditation standards will have to be crafted carefully to avoid adversely impacting the grassroots nature and resulting unique strengths of land trusts—namely their ability to respond quickly and creatively to land protection challenges; their ability to gain "kitchen table" access to and credibility with private landowners; and their often superior knowledge of local landscapes and the needs of the communities in which they operate.[243] Simple, easily implemented metrics for accreditation probably would be more effective than requiring (and testing) compliance with a detailed and comprehensive set of standards. Such simple metrics might include a minimum number of years a land trust must be extant before it is

239. *Id.* (noting that,

> [a]s land trusts get involved in complex, large transactions, there will be growing pressure from government agencies to regulate and set standards for land trusts. The U.S. Senate has launched an investigation of certain conservation practices, and land trusts are receiving increased critical scrutiny from the national media. Sooner or later, the government will demand stricter standards and credentialing for land trusts; the question is whether it will be imposed by a government agency or adopted voluntarily by land trusts.).

See supra note 15 discussing a series of Washington Post articles critical of The Nature Conservancy and land trust activities, and the Senate Finance Committee's response to those articles.

240. STRATEGIC PLAN, *supra* note 237, at 9.

241. *Id.* (noting that "many land trusts do not yet appreciate the need for credentialing").

242. *Id.*

243. *See supra* note 11 and accompanying text. In particular, care would have to be taken to avoid creating insurmountable barriers to entry for small, local land trusts, which embody many of the unique strengths of land trusts.

accredited to hold easements,[244] a minimum level of stewardship funding,[245] and, perhaps for smaller, newer land trusts, an exception from the previous two requirements as long as they have a co-holding relationship with an existing, accredited land trust. A fourth requirement applicable to all land trusts might involve mandatory continuing education for key employees and board members.

Whether the LTA will be able to craft meaningful accreditation standards for its diverse members, and convince those members of the importance of accreditation, remains to be seen. However, if the LTA is able to develop and implement an effective accreditation program, Congress and the public will have far greater confidence in the selection and stewardship capabilities of land trusts, and will be more likely to respond favorably to the LTA's continued requests to increase the tax incentives available with respect to easement donations.[246] An effective accreditation program also would reduce the number of incompetent and rogue land trusts, whose actions threaten to call into question both the credibility of the land trust community and the use of conservation easements as a private land protection tool.[247]

C. Valuation

The basic question—what is a conservation easement worth?—seems innocuous enough, but it opens a proverbial can of worms. Beginning in

244. Two states already impose such a requirement. Colorado requires that an organization be in existence for two years before accepting an easement. COLO. REV. STAT. § 38-30.5-104(2) (2003). Virginia requires that an organization have a principal office in the commonwealth for at least five years before accepting an easement. VA. CODE ANN. § 10.1-1010 (2002).

245. Funding requirements might be based on the type or class of easements, the amount of acreage protected, or other factors. *See* Lesley Ratley-Beach, Barbara Wagner, and Darby Bradley, *Easement Stewardship: Building Relationships for the Long Run*, Vo. 21, No. 2 EXCHANGE, THE JOURNAL OF THE LAND TRUST ALLIANCE 6-10 (2002) (describing the sophisticated system used by the Vermont Land Trust to evaluate stewardship funding needs for its easements).

246. *See* STRATEGIC PLAN, *supra* note 237, at 3-4 (noting that the LTA's "top policy priority" is the passing of federal legislation to provide new tax incentives for land conservation). The LTA's putting of the cart before the horse (that is, lobbying for increases in the federal tax incentives before implementation of a successful accreditation program) is perhaps understandable given that its lobbying efforts rarely yield immediate results.

247. *See supra* note 229 and accompanying text (discussing the incompetence of some land trusts); Stephen J. Small, *"Local Land Trust Signed A Fraudulent Tax Form!"—The Daily News, July31,2004,* Vol. 22, No. 3 EXCHANGE: THE JOURNAL OF THE LAND TRUST ALLIANCE 5, 5 (Fall 2003) [hereinafter Small, *Fraudulent Tax Form*] (noting that "bad 'conservation deals' are starting to happen, albeit in small numbers;" that "the land trust movement that historically has been good at policing itself needs to be increasingly aware of this emerging problem;" and that although "many of the organizations formed to hold the questionable easements in these deals are outside the mainstream of the land trust movement," that won't prevent "one bad story about a misnamed 'conservation' group from tainting the more than 11,000 easements held by true land conservation groups").

1970, the IRS tried for three years to come up with a set of guidelines for the valuation of conservation easements, ultimately giving up and closing the study project.[248] Immediately thereafter, in a 1973 Revenue Ruling, the IRS endorsed the use of the "before and after" method, pursuant to which the value of a conservation easement generally is equal to the difference between the fair market value of the land immediately before the donation of the easement (the "before-easement value") and the fair market value of the land immediately after the donation of the easement (the "after-easement value").[249]

When the charitable income tax deduction provision was being revised in 1980, the Treasury insisted that Congress not mandate the use of the "before and after" method in the statute because it wanted to preserve some administrative flexibility in crafting an easement valuation rule in the Regulations.[250] However, six years later, when the Treasury issued the Regulations, it apparently was no closer to deciding on a definitive easement valuation rule and its continuing struggle to determine the most appropriate method of valuing an easement is reflected in the Regulations.

The Regulations first provide that the value of an easement for purposes of the charitable income tax deduction under §170(h) is the easement's "fair market value" and, for purposes of charitable donations of property, fair market value generally is defined as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."[251] The Regulations then provide that if "a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a governmental program)," is "available to use as a meaningful or valid comparison," then the fair market value of the donated easement must be based on the sales prices of such comparable easements.[252] However, because the Treasury recognized that conservation easements are rarely bought and sold, the Regulations further provide that, if appropriate market data is not available, donors should determine the fair market value of their easements using the "before and after" method.[253]

In drafting the Regulations, the Treasury apparently felt constrained to apply to easement valuation the same "fair market value" concept it

248. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 17-5.
249. *See id.*; Rev. Rul. 73-339, 1973-2 C.B. 68.
250. *See* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 17-5, 17-6.
251. *See* Treas. Reg. §§1.170A-14(h)(3)(i), 1.170A-1(c)(2).
252. *See* Treas. Reg. §1.170A-14(h)(3)(i).
253. *Id.* The indirect "before and after" method clearly is the Treasury's second choice for determining the fair market value of a donated easement.

relies on to value other types of property donated to charity.[254] However, the "willing buyer, willing seller" standard makes little sense in the context of easement valuation. When a landowner donates an easement to a government agency or land trust, he does not convey a thing of value to the donee to be used in accomplishing the donee's mission so much as he volunteers to have the use of his land permanently regulated in the public interest. In the hands of a government agency or land trust, an easement primarily consists of the right to protect the existence and continued flow of certain "public goods."[255] Specifically, by undertaking to enforce the perpetual restrictions on development and use in an easement, the holder of the easement guarantees the long-term flow of public goods from the conservation values of the encumbered land.[256] Because there is little excludable private benefit inherent in an easement that might make it attractive to any buyer except a representative of the public, easements are not susceptible to direct valuation in real markets.[257]

Given the foregoing, it is not surprising that eighteen years after the issuance of the Regulations, most if not all donated easements continue to be valued using the before and after method.[258] In fact, the before and after method is a well-established appraisal technique for valuing partial

254. The Treasury regulations provide that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution, with the fair market value being established under the "willing buyer, willing seller" standard. *See* Treas. Reg. §1.170A-1(c)(1), (2) and *supra* note 251 and accompanying text.

255. *See* JOSEPH M. DODGE, THE LOGIC OF TAX 125 n. 71 (1989) (defining a public good as "a benefit that is generally available to the public in such a way that the use thereof by one person does not necessarily preclude use by another").

256. Under the broad conservation purposes test of §170(h), the public goods protected by an easement could include aesthetic pleasure from scenic views, protection of biodiversity, actual or potential production of agricultural and forest products from high-quality soils, maintenance or enhancement of water quality from vegetated riparian areas, and any number of other "ecosystem services." *See* Gretchen C. Daily, *Introduction: What Are Ecosystem Services?, in* NATURE'S SERVICES, SOCIETAL DEPENDENCE ON NATURAL ECOSYSTEMS 3-4 (Gretchen C. Daily ed., 1997) (defining "ecosystem services" as the conditions and processes through which natural ecosystems, and the species that make them up, sustain and fulfill human life).

257. *See, e.g.,* James Boyd et. al., *The Law and Economics of Habitat Conservation: Lessons from an Analysis of Easement Acquisitions,* 19 STAN. ENVTL. L.J. 209, 234 (noting that "because there is no conventional market for easements, the usual procedure for valuing an asset—simple observation of an equilibrium market price resulting from a large volume of transactions—cannot be followed").

258. SMALL, BOOK III, *supra* note 133, at 38. In *Browning v. Commissioner*, the IRS tried to apply the Regulations' "substantial record of comparable easement sales" rule, asserting that the prices paid for easements in a county's direct purchase program established the fair market value of the taxpayer's easement for purposes of §170(h). 109 T.C at 312 (1997). The Tax Court disagreed, however, holding that the record of sales from the county's bargain purchase program was not "available to use as a 'meaningful or valid' comparison" as required by the Regulations because the sales were not produced in an "uninhibited market." *Id*. at 319.

interests in land, and the federal government frequently uses it in the context of government acquisitions and eminent domain cases.[259]

The before and after method does, however, have a number of shortcomings. First, although the purpose of providing tax incentives to easement donors is to encourage them to voluntarily protect the flow of public goods from their land, the before and after method does not in any way measure the value of those public goods. Instead, the before and after method measures only the market cost of an easement donation, or the extent to which placing permanent restrictions on the development and use of land reduces the fair market value of the land.[260]

A second major shortcoming of the before and after method is its complexity and reliance on often speculative values. A before and after easement appraisal actually involves two appraisals: (i) one of the before-easement value of the land, which should be the same as any run-of-the-mill appraisal of a fee interest in land, and (ii) another of the after-easement value of the land, which necessarily will be speculative in real estate markets where few easement-encumbered properties have been bought and sold. Because very few real estate markets exist in which a substantial number of easement-encumbered properties have been bought and sold, appraisers generally resort to various "valuation-by-analogy" techniques in estimating the after-easement value of land.[261]

The "enhancement rule" adds a further layer of complexity and speculation to the easement valuation process. As noted in Part II.A.3.a, the charitable income tax deduction generated by an easement donation must be reduced to the extent the easement enhances the value of other land owned by the donor, a member of the donor's family, or certain other related persons.[262] Estimating the value of such "enhancement" can

259. *See* U.S. DEPT. OF JUSTICE, UNIFORM APPRAISAL STANDARDS FOR FEDERAL LAND ACQUISITIONS 50 (Appraisal Institute, 2000) [hereinafter THE YELLOW BOOK].

260. *See* Boyd et al., *supra* note 257, at 244 ("The appraised value of an easement is its private value, the opportunity cost of the development restriction, not its social value, which may reflect broader environmental and aesthetic attributes of the property."). A number of issues are raised by the disconnect between the value of an easement for purposes of the charitable income tax deduction under §170(h) and the value of the public goods that are protected by the easement. However, for purposes of this article, it is assumed that the market cost of an easement is the appropriate measurement of "value" to use in the context of a tax incentive program because it represents the approximate price the public would have to pay to purchase the easement from a hypothetical landowner motivated solely by economic considerations. *See infra* notes 391-394 and accompanying text (explaining why paying more than a very modest premium over market cost for an easement would be bad public policy).

261. For example, appraisers often cite to comparable sales of land burdened by analogous restrictions, such as zoning rules, location in a floodplain, or steep topography. *See* JAMES H. BOYKIN, TRANSFER METHODS AND VALUATION PROCEDURES FOR CONSERVATION EASEMENTS 34 (1998) [hereinafter VALUATION PROCEDURES FOR CONSERVATION EASEMENTS].

262. *See supra* note 120 and accompanying text (explaining the concept of enhancement and its impact on the valuation of conservation easements). The enhancement rule is intended to

be quite difficult for an appraiser because measuring the extent to which placing permanent restrictions on the development and use of one parcel of land affects adjacent land values tends to be highly speculative.[263]

A third major shortcoming of the before and after method is its susceptibility to abuse. Conservation easements are subject to a wide range of arguable values under the before and after method, and the boundary between reasonably supportable and truly abusive values for easements is blurred. That fact, coupled with the lack of negotiation with respect to valuation in the context of an easement donation, presents a difficult problem for the IRS. Unless and until an audit is conducted, the IRS must rely on a one-sided assertion of value by the taxpayer who has a financial incentive to assert the highest value he thinks he can get away with.[264] Moreover, the uncertainty surrounding easement valuation increases the administrative cost to the IRS of successfully refuting what it considers to be abusive valuations,[265] a factor that may contribute to the anecdotally reported low audit rate of conservation easement donations.[266]

Uncertainty as to the value of easements will reduce the efficiency of the charitable deduction program even if taxpayers are not asserting abusive values because taxpayers generally will assert values on the high side of the median supportable value for their easements. The more uncertain the value of an asset, the more "room" there is between the median supportable value and the highest supportable value for such asset, the farther the taxpayer's value will tend to range on the high side of the median supportable value, and the more tax revenues will be foregone to obtain charitable donations of that asset type. Consequently, a deductibility program will be less efficient with respect to hard-to-value assets than easier-to-value assets, all other factors being held constant.[267]

limit an easement donor's charitable income tax deduction to the *net* market cost incurred as a result of the donation.

263. *See* VALUATION PROCEDURES FOR CONSERVATION EASEMENTS, *supra* note 261, at 30 (describing the difficulties associated with estimating the value of enhancement in an easement appraisal).

264. *See* Browne, *supra* note 36, at 149 (noting that "hard bargaining and use of independent appraisers by both sides" are not elements of the Treasury's deductibility program "unless and until the landowner's tax return is audited").

265. To challenge a taxpayer's asserted valuation of an easement the IRS must engage in (or threaten to engage in) an often complicated, time consuming, and expensive appraisal process that could culminate in the even more onerous process of litigation.

266. *See supra* note 201 and accompanying text.

267. The Treasury acknowledged this problem in the 1987 Report, wherein it noted the difficulty associated with valuing easements and suggested that, to the extent donors overvalue easements, the charitable income tax deduction available with respect to easement donations "is less efficient, since more tax revenue is foregone for each dollar of actual value of conservation easements donated." 1987 REPORT, *supra* note 18, at 10; *see also* Browne, *supra* note 36, at 149 (noting that "the result of inflated values that escape audit and correction is the loss of the

While the potential for valuation abuse in the context of easement donations is apparent, the extent to which such abuse actually occurs remains unclear. In the 1987 Report, the Treasury presented the results of two studies that it felt supported the notion that overvaluation was a particularly severe problem for easement donations.[268] The first study examined all non-cash charitable contributions reported on 1982 federal tax returns and indicated that taxpayers overvalued such contributions by 9 percent in the aggregate.[269] The Treasury noted that because conservation easements are far more difficult to value than most non-cash contributions, the 9 percent figure "may represent a lower bound estimate for easement overvaluation," but it offered no evidence to support that conclusion.[270]

The second study, conducted by the General Accounting Office, surveyed data from forty-two audits of deductions claimed with respect to easement donations between 1974 and 1980 and found that the easements in question were overvalued by an average of 220 percent.[271] However, that finding is highly suspect because "overvaluation" was implicitly defined as the extent to which a taxpayer's asserted value exceeded the IRS's asserted value, rather than the extent to which a taxpayer's asserted value exceeded some independent, objectively determined value.[272] A quick glance at the litigated easement valuation cases shows that the IRS tends to assert very low values for easements, and the courts disagree with the IRS's asserted values more often than they disagree with taxpayers' asserted values, sometimes by a wide margin.[273] To the author's knowledge, no further studies assessing the overvaluation of donated easements have been conducted.

The following sections examine in detail the issue of valuation abuse in the context of the federal tax incentive program intended to stimulate easement donations. Section 1 evaluates the various existing safeguards against overvaluation, including the substantiation and reporting requirements, the overvaluation penalties, enforcement efforts by the IRS, the role of the agencies and organizations that accept easements, and the effect of easement appraisal standards and practices. Section 2 discusses an appraisal method that has emerged as a potential tool of

bargain element in the Treasury's program and thus the elimination of an important public benefit").

268. 1987 REPORT, *supra* note 18, at 11-12.

269. *Id.* at 11.

270. *Id.*

271. *Id.* at 12; U.S. General Accounting Office, Report To The Joint Committee On Taxation, Information on Historic Preservation Tax Incentives 34-38 (Mar. 29, 1984).

272. *Id.*

273. *See* Appendix A. In seven of the seventeen reported cases in which the IRS challenged the taxpayer's asserted value for an easement encumbering land, the IRS asserted a value of zero for the donated easement and, in each case, the court disagreed. *Id.*

valuation abuse. Section 3 concludes by suggesting several strategies that may be implemented to assess and, if necessary, quell valuation abuse.

1. *Safeguards Against Overvaluation*

a. *Substantiation and Reporting Requirements*

The Treasury regulations under §170 of the Code require a taxpayer claiming a charitable deduction for the donation of property with a value in excess of $5,000 to: (i) obtain a "qualified appraisal" of the property, which must be prepared by a "qualified appraiser," (ii) attach a summary of that appraisal to the return on which the taxpayer first reports the deduction, and (iii) retain the full appraisal report in the taxpayer's records.[274] Those requirements attempt to ensure that a taxpayer's assertion of the value of a charitable gift is supported by a detailed, timely appraisal prepared by a professional appraiser who is relatively free of conflicts of interest, has the requisite expertise to appraise the type of asset donated, and is subject to civil penalties and (perhaps) professional ruin if he "falsely or fraudulently overstates the value of the contributed property."[275] The appraisal summary filed with the taxpayer's return provides salient information to the IRS regarding the donated property, the appraisal report, the appraiser, and the donee.[276] Both the appraiser and the donee must sign the appraisal summary,[277] although by signing the appraisal summary the donee only acknowledges receipt of the donation and does not thereby concur with the value claimed.[278]

274. Treas. Reg. §1.170A-13(c). The appraisal summary is reported on a form supplied by the IRS specifically for that purpose (Form 8283—Non-cash Charitable Deductions).

275. *See* Treas. Reg. §1.170A-13(c)(3)(iii). Civil penalties would arise under §6701 of the Code ("§6701"), which imposes a $1,000 penalty for knowingly facilitating the understatement of tax liability by another person. Professional ruin arguably would come about if the appraiser is blacklisted pursuant to 31 U.S.C. §330(c), pursuant to which the Secretary of the Treasury may, after notice and opportunity for a hearing, sanction an appraiser who has been penalized under §6701 by: (i) providing that the appraiser's appraisals "shall not have any probative effect" in administrative proceedings before the Treasury or the IRS, and (ii) barring the appraiser from presenting evidence or testimony in such proceedings. Under Treas. Reg. §1.170A-13(c)(3)(iii), the appraiser signing an appraisal summary (Form 8283) expressly is brought within the purview of both §6701 and 31 U.S.C. §330(c). The "tax shelter" penalties under §6700 of the Code also may apply to appraisers.

276. Treas. Reg. §1.170A-13(c)(4).

277. *Id.*

278. Treas. Reg. §1.170A-13(c)(4)(iii). The donee must sign the appraisal summary (Form 8283) to acknowledge that the gift has been made and that it is bound by certain reporting requirements in the event it disposes of the donated asset within two years. The Regulations (and Form 8283) explicitly state that the donee does not, by signing the form, express its agreement with the stated value of the gift. *Id.*

b. Overvaluation Penalties

Taxpayers who overstate the value of their charitable gifts for purposes of the federal tax incentives are subject to number of penalty provisions.[279] Several general aspects of the various civil penalty statutes are noteworthy. First, overvaluation must be rather extreme to trigger penalties. The taxpayer's asserted value must be twice the "real" value[280] to trigger the first tier penalty (20 percent of the underpayment), and four times the "real" value to trigger the second tier penalty (40 percent of the underpayment).[281] Second, the penalties themselves, while not insignificant, are not draconian. For example, a donor who claims his easement is worth $500,000, the value of which ultimately is determined to be only $250,000, theoretically could face a penalty of up to $17,500.[282]

Another interesting aspect of the penalties is the "reasonable cause exception" under §6664(c) of the Code, which excuses from penalties an otherwise guilty taxpayer who: (i) acted in good faith and with reasonable cause, (ii) relied on a "qualified appraisal" prepared by a "qualified appraiser," and (iii) "made a good faith investigation of the value of the contributed property."[283] Whether the taxpayer relied on a qualified appraisal prepared by a qualified appraiser can be assessed objectively.[284] However, the other two standards are subjective and might present an obstacle to the Treasury in imposing penalties except in the most egregious instances of valuation abuse. Given the tendency of easement donors to be inexpert in the arcana of easement valuation, one wonders how much judgment as to valuation the average donor is capable of exercising independent of his appraiser, and, thus, what would be required to prove a donor did not act in "good faith" and with "reasonable cause" or failed to make a "good faith investigation."[285] The

279. *See* I.R.C. §6662(a) (imposing penalties for valuation misstatements); I.R.C. §6663 (imposing a penalty equal to 75 percent of an underpayment attributable to fraud); I.R.C. §6700 (imposing a penalty on persons participating in an abusive "tax shelter"). Criminal tax fraud and other criminal tax offenses are created under Chapter 75 of the Code and could be asserted in connection with egregious easement valuation abuse.

280. That is, "the amount determined to be the correct amount of such valuation." I.R.C. §6662(e)(1)(A).

281. I.R.C. §6662(h).

282. If the donor claimed the entire $500,000 deduction against his income in the first year, the underpayment would be the product of the donor's marginal income tax rate and the amount of the overvaluation (.35 x $250,000 = $87,500, assuming a marginal income tax rate of 35 percent). The penalty would be equal to 20 percent of the $87,500 underpayment, or $17,500. The $87,500 underpayment also would have to be paid, with interest. *See* I.R.C. §6662.

283. I.R.C. §6664(c).

284. *See* Treas. Reg. §1.170A-13(c)(3) for the definition of "qualified appraisal" and Treas. Reg. §1.170A-13(c)(5) for the definition of "qualified appraiser".

285. *See also* BORIS I. BITTKER & MARTIN J. MCMAHON, JR., FEDERAL INCOME TAXATION OF INDIVIDUALS 45-14 (1995) (noting that taxpayers routinely have avoided the negligence penalty on the grounds of "reasonable cause" and "good faith"); *cf.,* Van Zelst v.

extent to which valuation penalties are assessed on easement donors is unknown, although it is noteworthy that penalties were imposed in only one of the seventeen reported cases in which the IRS challenged the taxpayer's asserted value for an easement encumbering land.[286]

c. Enforcement by the IRS

As noted in Part II.B, the IRS has focused its enforcement efforts under §170(h) on the issue of easement valuation. Nearly all of the cases actually litigated by the IRS with respect to conservation easements since 1987 have turned on the issue of valuation.[287] However, from the IRS's perspective, its litigation of easement valuation disputes has been less than wholly successful.

In the seventeen cases reported to date involving the valuation of conservation easements encumbering land,[288] the courts have adopted the IRS's asserted value only twice, and those were the second and third decisions in the line of cases.[289] Taxpayers have fared better, with the courts adopting their asserted values with little or no adjustment in seven of the cases.[290] In the eight other cases, the courts tended generally to favor the taxpayers' assertions of easement value.[291] The taxpayers'

Commissioner, 70 T.C.M. (CCH) 435 (1995), *aff'd* 100 F.3d 1259 (7th Cir. 1996) (assessing penalties on a taxpayer who donated land to the National Park Service and claimed a charitable income tax deduction equal to *ninety-one times* the amount he had paid for the land two years before the donation, and stating that "[m]ere reliance on an appraiser or expert in a matter does not automatically shield a taxpayer from the negligence addition [to tax under then-effective §6653]; a taxpayer must affirmatively establish that his reliance was reasonable, prudent, and in good faith").

286. *See* Stanley Works v. Commissioner, 87 T.C. 389 (1986) (imposing an increased interest rate on underpayments of tax under then-applicable I.R.C. §6621 due to the taxpayer's valuation overstatement).

287. For summaries of the cases, *see* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, as supplemented through 2000.

288. *See* Appendix A. Cases involving conservation easements encumbering historic structures, or "historic preservation easements," involve different valuation issues and, thus, were not considered for purposes of this article. *See, e.g.,* Hilborn v. Commissioner, 85 T.C. 677, 689 (1985).

289. In *Akers v. Commissioner*, 48 T.C.M. (CCH) 1113 (1984), *aff'd* 799 F.2d 243 (6th Cir. 1986), the court adopted the IRS fallback position of $114,000, rejecting its first position that the value of the easement was zero and the taxpayers' position that the value of the easement was $789,000. In *Todd v. United States*, 617 F. Supp. 253, 255-56 (W.D. Pa. 1985), the IRS's single unqualified victory, the taxpayers had asserted an easement value of $353,000, but the court agreed with the IRS's valuation of $20,800.

290. *See* Appendix A. In *Schwab v. Commissioner*, 67 T.C.M. (CCH) 3004 (1994), the court accepted the taxpayer's $550,000 valuation (although the court required a minor $6,000 reduction in that valuation), and rejected the taxpayer's alternative $825,000 valuation as well as the IRS's position that the easement had zero value. In *Browning v. Commissioner*, 109 T.C. 303 (1997), the court accepted the taxpayers' $518,000 valuation and rejected the taxpayer's alternate $563,000 valuation as well as both IRS positions of $309,000 and $367,000.

291. *See* Appendix A.

success in the courts likely is attributable to the fact that they and their appraisers generally are more prepared and thorough in their analysis of easement valuation, and more credible and convincing as witnesses than the IRS and its appraisers.[292] In fact, the clearest lesson that can be drawn from the valuation case law is that taxpayers should hire reputable, experienced, and credible appraisers.[293]

Other useful principles regarding easement valuation are difficult to divine from the rather garbled and inconsistent opinions in the easement valuation cases. The courts—particularly the Tax Court, which decided fifteen of the seventeen cases[294]—have been faced with the unenviable task of resolving valuation disputes based only upon the often cynically result-oriented and occasionally nonsensical easement appraisals offered by the IRS and taxpayers. Moreover, the courts readily admit that easement valuation is an area in which they have no expertise.[295] Accordingly, it is not surprising that the courts have failed to provide clear and consistent easement valuation standards.

It is curious, however, that the IRS and the courts seldom refer to existing appraisal standards—beyond the sketchy guidance provided in the Regulations—to inform their analyses of easement valuation. One source of appraisal standards that has long been available is the guidebook published by the United States Department of Justice to promote uniform real property appraisals among the various agencies acquiring real property on behalf of the United States (due to the color of its cover, the guidebook generally is referred to as the "Yellow Book").[296]

292. *See* Stephen J. Small, *Third Supplement (1996-2000),* FEDERAL TAX LAW OF CONSERVATION EASEMENTS, *supra* note 20, at 1 (noting that "well prepared landowners and experienced appraisers generally win against a poorly prepared IRS").

293. *See* SMALL, BOOK III, *supra* note 133, at 65 ("If you read all the tax cases in which the IRS challenges the value of an easement donation, you will generally find that if the landowner has a really good appraiser . . . [who] prepares a thorough, honest, comprehensive appraisal, the landowner wins in court"); *see also* William T. Hutton, *Of Easements, Appraisers, and "Fundamental" Errors*, *in* THE BACK FORTY ANTHOLOGY 5.47 (William T. Hutton ed., 1995) (noting that, while in the past the Tax Court could be counted on to split the difference between the values asserted by the IRS and the taxpayer, leading to aggressive taxpayer appraisals and "lowball deficiency notices" by the IRS, more recently "the Court has been increasingly disposed to lean heavily in the direction of the more competent appraiser, and the old 'go for broke' strategy may no longer be advisable"); Buffalo Tool & Die Mfg. Co. v. Commissioner, 74 T.C. 441, 452 (1980) (for authority of a court to find one party's valuation evidence more convincing than the other's, thus giving a final result that "will produce a significant financial defeat for one or the other rather than a middle-of-the-road compromise").

294. *See* Appendix A. In *Fannon v. Commissioner*, 842 F.2d 1290, (4th Cir. 1988), the Fourth Circuit modified and remanded the original Tax Court case, *Fannon v. Commissioner*, 52 T.C.M. (CCH) 1113 (1986).

295. *See, e.g.,* Fannon v. Commissioner, 56 T.C.M. (CCH) 1587 (1989) (noting that the parties' disparate positions on valuation "places the Court in the unenviable position of applying its judgment in an area where it has no particular expertise").

296. THE YELLOW BOOK, *supra* note 259.

Reference to the Yellow Book arguably would have allowed the IRS and the courts to infuse their easement valuation analyses with much more clarity and consistency.[297]

It also is important to note that the incidence of reported cases involving the valuation of easements encumbering land has never been high, and has dropped off in recent years.[298] Moreover, there is anecdotal evidence that easement donations generally are not targeted for audit.[299] The apparent low level of enforcement of easement valuation by the IRS should not be surprising, however, given: (i) the uncertainty associated with the valuation of easements, which makes it difficult and expensive for the IRS to successfully challenge suspected abusive valuations, (ii) the IRS's well-known shortfalls in funding and staffing, and (iii) the IRS's substantial failures in the few easement valuation disputes it chose to litigate, which likely discouraged the agency from pursuing similar cases.

d. Responsibility of Easement Donees

As noted above, the Regulations require government agencies and land trusts to sign the appraisal summary for every easement donation they accept, effectively precluding such entities from claiming to be totally ignorant of the values asserted for donated easements.[300] On the other hand, the Regulations do not impose liability on easement donees for abusive or erroneous valuations.[301] Thus, the degree of donee involvement in the valuation process is left to the donees.

The guidebook created by the LTA to help land trusts understand and implement the Standards and Practices (the "LTA Guidebook")[302]

297. Another potential source of appraisal standards are the guidelines for the valuation of conservation easements published by the LTA. *See* Land Trust Alliance & National Trust for Historic Preservation, APPRAISING EASEMENTS, GUIDELINES FOR VALUATION OF LAND CONSERVATION AND HISTORIC PRESERVATION EASEMENTS (Land Trust Alliance, 3rd ed. 1999) [hereinafter APPRAISING EASEMENTS]. APPRAISING EASEMENTS, which was published by the LTA in 1984, was cited in an early historic preservation easement valuation case, and may have contributed to what seems to be a relatively high level of consistency and sophistication in the ensuing line of historic preservation easement valuation cases. *See* Hilborn v. Commissioner, 85 T.C. 677, 689-690 (1985); Richmond v. United States, 699 F. Supp. 578, 581 (E.D. La. 1988); Dorsey v. Commissioner, 59 T.C.M. (CCH) 592 (1990). However, APPRAISING EASEMENTS is not cited in any of the seventeen cases involving the valuation of conservation easements encumbering land.

298. In the seventeen reported cases, the years of donation cluster in the late 1970s and early 1980s, with only two of the cases involving donations in the early 1990s. *See* Appendix A.

299. *See supra* note 201 and accompanying text.

300. That is, unless the donee signs the appraisal summary (Form 8283) while the valuation amount is still blank, which practice is permitted by the Regulations. *See* Treas. Reg. §1.170A-13(c)(4)(iv)(D).

301. *See* Treas. Reg. §1.170A-13(c)(4)(iii) (stating that "[t]he signature of the donee on the appraisal summary does not represent concurrence in the appraised value of the contributed property").

302. *See* LTA GUIDEBOOK, *supra* note 211.

discusses an easement donee's responsibility with respect to appraisals at some length.[303] The LTA Guidebook essentially advises donees to walk a fine line: they should be as helpful to the donor and the donor's appraiser as possible without taking on liability by purporting to sanction an appraisal.[304] When an easement donee becomes aware of an apparently abusive easement appraisal, the LTA Guidebook suggests the following responses: (i) simply informing the landowner of the donee's opinion that the appraisal is suspect or abusive, (ii) having the land trust's attorney so inform the landowner in writing, with explicit reference to the overvaluation penalties the landowner might face, (iii) suggesting the landowner obtain another appraisal, and (iv) refusing to proceed with the transaction.[305]

The LTA Guidebook cautions that easement donees have an interest in discouraging valuation abuse for the following reasons: easement donees will want to avoid the appearance of being a party to a transaction that unfairly benefits a private individual; easement donees will want to maintain their credibility in the community; and easement donees will want to avoid situations where irate donors blame them when the IRS challenges the donors' easement valuations.[306] In addition, the stakes are high for the land trust community in general. If valuation abuse increases to the point where it creates a public opinion backlash, the credibility of the land trust community with the public and Congress could be damaged, and the tax incentives offered with respect to easement donations could be reduced or eliminated.[307]

303. *See id.* at 12-12 to 12-16.

304. *See id.*; *see also* APPRAISING EASEMENTS, *supra* note 297, at 39-41.

305. LTA GUIDEBOOK, *supra* note 211, at 12-15. The LTA GUIDEBOOK does not address the potential situation in which the donee already has accepted the easement—signed, delivered, and recorded—when the donor presents the donee with an appraisal summary (Form 8283) asserting what appears to be an egregious overvaluation. In that situation, the donee could inform the landowner of the donee's opinion regarding the appraisal and suggest that the landowner obtain another appraisal. The donee also could refuse to sign the appraisal summary unless and until the donor obtains a more conservative appraisal, though query on what grounds, given that the appraisal summary does not ask the donee to vouch for the valuation figure, but only to acknowledge that it has received the donation, which unquestionably it has.

306. *See* LTA GUIDEBOOK, *supra* note 211, at 12-15.

307. *See* APPRAISING EASEMENTS, *supra* note 297 (noting that

> [o]pposition to easements in Congress or at the Internal Revenue Service could lead to eliminating or seriously restricting the tax deductions that are such a critical incentive for donors. Although there is no uniformity of opinion about the proper role for the donee in the appraisal process, every donee has an interest in assuring the integrity of the appraisal process affecting charitable gifts);

see also Small, *Fraudulent Tax Form, supra* note 247 at 5-7 (noting the threat of abusive conservation easement appraisals by "disreputable dealmakers," the need for "heightened vigilance on the part of land trust professionals," the fact that these issues have taken on heightened visibility after the publication of a series of articles by The Washington Post raising

Easement donees perform a certain amount of "gate-keeping" with regard to other aspects of the deductibility requirements under §170(h), and at least two commentators have called for some donee responsibility in the area of valuation as well.[308] However, few donees have the technical competency or resources to police valuation—to do so properly they presumably would have to hire their own appraisers. Thus, while making donees responsible for easement overvaluations arguably could significantly reduce valuation abuse,[309] it would severely strain the resources of all but the largest land trusts, and may not be the most efficient way to address valuation problems.

e. Easement Appraisal Standards and Practices

Much of the responsibility for curtailing easement valuation abuse falls on the shoulders of the appraisal profession. Three major factors contribute to this state of affairs: (i) the low level of IRS oversight and enforcement activity, (ii) the fact that the agencies and organizations that accept easement donations rarely involve themselves in valuation issues, and (iii) the fact that the Code, the Regulations, and the easement valuation case law strongly encourage easement donors to rely heavily upon "qualified appraisers" for easement valuation, and then provide what appear to be rather lenient exceptions from overvaluation penalties for donors who do so.[310] As discussed below, such heavy reliance on appraisers may not be warranted.

i. Professional Standards

There is no particular reason to believe that appraisers will not honor their professional standards and intentionally overvalue conservation easements.[311] Some appraisers known to the author consider

questions about some of the deals and practices of The Nature Conservancy, and that "a single bad headline can hurt us all").

308. *See* Browne, *supra* note 36, at 153 ("some responsibility may reasonably be assigned to land trusts to police the aggressive valuations that undermine the bargain feature of Treasury's program"); Small, *Fraudulent Tax Form, supra* note 247 at 7 (insisting that land trusts "start thinking about what [they] will do if [they] are asked to sign a Federal Form 8283 with a claimed valuation so high that it could be abusive.").

309. Easement donees could be made responsible, for example, by placing their status as organizations eligible to receive tax-deductible charitable contributions at risk in the event they accept a certain number of donations that subsequently are determined to have been overvalued by a certain percentage.

310. *See supra* Part II.C.1.a - d.

311. *See generally* the various standards of ethical behavior and competence applicable to appraisers in THE APPRAISAL FOUNDATION, THE UNIFORM STANDARDS OF PROFESSIONAL APPRAISAL PRACTICE (The Appraisal Foundation ed., 2003) [hereinafter USPAP], *available at* http://www.appraisalfoundation.org. USPAP represents the generally accepted and recognized standards of appraisal practice in the United States. *Id*. at Preamble.

it a point of professional pride to write only fully supported appraisals.[312] However, appraisers are hired by easement donors, who have a financial incentive to pressure appraisers to assert advantageous values, and professionals in general have a natural desire to please their clients. Moreover, where reasonably supportable values for hard-to-value assets like easements vary over a wide range, and the boundary between supportable and abusive valuations is blurry at best, the practical ability of the appraisal profession to prevent any but the most egregious valuation abuse is necessarily limited. Indeed, the substantial overvaluation percentage required to trigger the statutory penalties for taxpayers and appraisers indicates that Congress and the Treasury are aware of the difficulties appraisers face when valuing hard-to-value assets.[313]

ii. Appraisal Practices

When enacting §170(h) in 1980, Congress predicted that the uncertainty inherent in valuing easements would decline over time as more easement-encumbered properties are bought and sold, and appraisers are thus provided with data useful in determining the effect of various types of easement restrictions on the fair market value of land.[314] Anecdotal information suggests that Congress's prediction may have come true in some geographic areas. For example, valuation problems seem to be of little concern in Vermont, where approximately 8 percent of the private land in the state—between 1,300 and 1,400 properties—is protected by easements, and appraisers have a rich set of easement-specific data to use in their appraisals.[315] In addition, a handful of appraisers have become "easement specialists," and have compiled significant databases of easement-specific sales information[316] and refined their analysis and interpretation of that data in their appraisals.[317]

312. *See, e.g.,* CLARK CONVERSATIONS, *infra* note 316.

313. *See* Boyd et al., *supra* note 257, at 246 (noting that the size of the overvaluation required to trigger the statutory penalties underscores "the lack of precision in appraisal valuations").

314. *See* SENATE REPORT, *supra* note 18, at 606 (stating the Committee's intention that, "as the use of conservation easements increases, valuation would increasingly take into account the selling price value, in arm's-length transactions, of other properties burdened with comparable restrictions"); *see also* Burton S. Kliman*, The Use of Conservation Restrictions on Historic Properties as Charitable Donations for Federal Income Tax Purposes,* 9 ENVTL. AFF. 513, 540 (1981) (stating that easement valuation "will undoubtedly become a much more refined process in the future").

315. Email from Darby Bradley, President of the Vermont Land Trust (Mar. 18, 2003) (on file with author); *see also* Ratley-Beach, et al.*, supra* note 245. Vermont appraisers presumably have developed a relatively high level of easement appraisal expertise in the course of appraising well over a thousand easements.

316. Telephone conversations with Louis E. Clark, MAI (Aug. 5, 2002 and Mar. 28, 2003) [hereinafter CLARK CONVERSATIONS] (Mr. Clark, based in Tallahassee, Florida, is an expert

The growing volume of easement-specific data and the increasing expertise of a small group of easement specialists appear to be reducing the uncertainties associated with easement valuation in some geographic areas and in more high-profile easement donation transactions (where the donor is likely to consult an easement specialist).[318] In most parts of the country, however, easement-specific data is still scarce or simply non-existent. In addition, the extent to which easement specialists and their practices are reducing the uncertainties associated with easement valuation in general is unclear. In many parts of the country there seems to be frustratingly little trickle-down of expertise from the easement specialists to the appraisers who prepare most of the easement appraisals. Confidential conversations with land trust personnel, attorneys, and appraisers who work with conservation easements lead this author to believe that, in many parts of the country, appraisers remain ignorant or misinformed about the proper way to conduct a conservation easement appraisal.[319] Thus, it often is difficult for an easement donor to heed the admonition of the courts to hire a good appraiser, since "good" in this context means expert in the art of appraising easements. In many cases, a conscientious donor would be forced to hire two appraisers—a reputable

easement appraiser who has performed numerous high-profile easement appraisals, including several appraisals of easements encumbering land owned by Ted Turner in various parts of the country. He also has compiled an extensive database of easement-specific sales information.); For Land's Sake, Vol. 25 (2002) (on file with author) [hereinafter For Land's Sake] (In its newsletter, Norman C. Wheeler & Associates, a real estate firm that specializes in easement appraisals throughout the intermountain West, claims to have developed a database of "over 150" easement-specific transactions).

317. *See, e.g.,* For Land's Sake, *supra* note 316 ("Our database at this time tends to indicate that encumbered sale properties running in the 160- to 640- acre size bracket are reflecting value diminutions in the 30 percent to 40 percent range in general, with properties larger than 640 acres continuing to reflect fairly consistent losses in the 40 percent to 50 percent range. These data are based mostly on the restrictions of typical open space conservation easements."). *See also* Valuation Procedures For Conservation Easements, *supra* note 261, at 32-36 (describing the ways in which an appraiser might systematically analyze easement-specific data).

318. Helpful studies on conservation easement valuation are hard to come by. *But see, e.g.*, Valuation Procedures For Conservation Easements, *supra* note 261, at 45 (The author's small-scale study showed that appraisals of donated easements on fourteen operating dairy farms in Vermont indicated an average diminution of 45 percent and an average after-easement value of $820 per acre. Subsequent sales of those fourteen farms "in a relatively flat market" averaged $800 per acre); Clark Conversations, *supra* note 316 (reporting his finding that subsequent sales of large easement-encumbered parcels in the southeast United States generally indicate slightly less diminution of value than was claimed in the appraisals conducted at the time the easements were donated, the difference being attributed partly to appreciation and partly to an increased acceptance of easement-burdened land in the marketplace; i.e., the "fear discount" has disappeared).

319. Perhaps not much has changed in this respect since 1981, when one commentator noted, citing a conversation with an appraiser, that "[w]hile appraisal techniques in many areas are sophisticated, few appraisers understand the potential complexities in valuing conservation restrictions." Kliman, *supra* note 314, at 540 n.144.

local appraiser who knows little or nothing about appraising easements but is knowledgeable about the local real estate market, and a regional or national easement specialist to look over the local's shoulder. Unfortunately, hiring two appraisers would increase the already substantial transaction costs associated with an easement donation.

2. Inflating the Before-Easement Value

An easement donor employing the "before and after" method of easement valuation can inflate the value of his easement by: (i) exaggerating the extent to which the easement restrictions reduce the value of the land, which would result in an unreasonably low after-easement value, (ii) exaggerating the value of the land immediately before the donation of the easement, which would result in an unreasonably high before-easement value, or (iii) employing some combination of the two foregoing techniques.

Determining the before-easement value of land should be no different from any run-of-the-mill appraisal of a fee interest in land. Thus, it is not surprising that the Treasury has generally dismissed the before-easement component of an easement appraisal as being of little concern, and has assumed that easement donors inflate the value of their easements by asserting unreasonably low after-easement values.[320] However, such a sanguine approach to the before-easement component of an easement appraisal is not warranted. Easement donors who intend to assert aggressive or abusive easement values can employ a complex land appraisal method, generally referred to as the "subdivision development analysis,"[321] to significantly exaggerate the before-easement value of their land and, because of the complexity of that analysis, the IRS and the courts cannot easily recognize or refute the resulting easement valuation.

The subdivision development analysis is a valid method for estimating the fair market value of land in certain circumstances.[322] Such analysis is intended to mimic the valuation process that would be employed by a prospective purchaser interested in acquiring the subject property for development. The appraiser first determines the total gross

320. *See* 1987 REPORT, *supra* note 18, at 11 (in which the Treasury states that "it is generally not difficult to estimate the value of a property in the absence of an easement").

321. The subdivision development analysis, which is a type of discounted cash flow analysis, also is referred to as the "development," "cost of subdivision," "cost of development," "land residual," or "lot method" analysis. SMALL, BOOK III, *supra* note 133, at 72; VALUATION PROCEDURES FOR CONSERVATION EASEMENTS, *supra* note 261, at 39-43; THE YELLOW BOOK, *supra* note 259, at 44; Clemens v. Commissioner, 64 T.C.M. (CCH) 351 (1992); Glick v. Commissioner, 73 T.C.M. (CCH) 1925 (1997).

322. *See, e.g.,* THE APPRAISAL OF REAL ESTATE 342-46 (Appraisal Institute, 12th ed., 2001) [hereinafter THE APPRAISAL OF REAL ESTATE]; USPAP, *supra* note 311, at 85.

proceeds that would be realizable from lot sales if the property were developed to its fullest extent. The gross proceeds figure is then discounted for the various factors that a prospective purchaser-developer would consider, such as the risk and delay associated with obtaining any necessary approvals or zoning changes; the time it would take to sell all of the lots; the various costs associated with developing the property such as marketing, engineering, and infrastructure costs; and the profit a purchaser-developer would demand given the overall risk and difficulty of pursuing the development project. That discounted figure is then presented as the "fair market value" of the property.[323]

The subdivision development analysis appears to be gaining in popularity as the *de rigueur* method of determining the before-easement value of land in a conservation easement appraisal. That is troubling for a number of reasons. First, the subdivision development analysis can produce unrealistically high values if the appraiser overestimates the gross proceeds realizable from the imagined development, or, more importantly, fails to account for all of the costs and risks associated with the development in a detailed and realistic manner.[324] Even minor errors in the discount rate applied to the estimated gross proceeds from the imagined development can create large variances in the ultimate value determined.[325] Second, no matter how much care and skill is employed in preparing a subdivision development analysis, its estimate of fair market value will almost always be more speculative than the estimate obtained using a more traditional appraisal method, such as the sales comparison approach.[326] Third, many, if not most easement appraisers who employ the subdivision development analysis to determine the before-easement value of land are likely doing so in contravention of established appraisal rules, which dictate that such analysis should be used as the sole or primary appraisal method only in relatively rare circumstances. Generally, two conditions must be present before the subdivision

323. *See* THE APPRAISAL OF REAL ESTATE, *supra* note 322, at 342-46 ; VALUATION PROCEDURES FOR CONSERVATION EASEMENTS, *supra* note 261, at 39-45; *Clemens,* 64 T.C.M. (CCH) 351; *Glick*, 73 T.C.M. (CCH) 1925.

324. *See, e.g.,* THE APPRAISAL OF REAL ESTATE, *supra* note 322, at 342 (noting that "when used on its own without an abundance of reliable market data, [the subdivision development analysis] can be the least accurate raw land valuation technique"); THE YELLOW BOOK, *supra* note 259, at 19, 45; *see also* VALUATION PROCEDURES FOR CONSERVATION EASEMENTS, *supra* note 261, at 39, 41.

325. *See* VALUATION PROCEDURES FOR CONSERVATION EASEMENTS; *supra* note 261, at 41 ("Unrealistic assumptions and misleading market forecasts can cause compounded errors").

326. Under the traditional "sales comparison approach," the subject property is compared directly with other similar properties that recently have sold in the market. *See* THE DICTIONARY OF REAL ESTATE APPRAISAL 255 (Appraisal Institute, 4th ed., 2002) [hereinafter THE DICTIONARY OF REAL ESTATE]. At least one easement specialist rarely relies on the subdivision development analysis except to confirm a sales comparison approach. CLARK CONVERSATIONS, *supra* note 316.

development analysis can be used to establish the value of land: (i) the "highest and best use" of the land must be for subdivision purposes[327] *and* (ii) the traditional sales comparison approach[328] to valuing land must not be available because comparable sales do not exist, or are so few and dissimilar to the subject property that a sales comparison approach would involve unacceptably speculative adjustments and assumptions.[329] Finally, the complexity involved in the subdivision development analysis makes abusive before-easement valuations difficult for the IRS to recognize and refute.

The case law is inconsistent in its treatment of easement appraisals that employ the subdivision development analysis. In some instances the courts appear to not be aware of (or to simply ignore) the fact that a subdivision development analysis is appropriate only in limited circumstances.[330] Moreover, the courts' attention to the complexity of the analysis ranges from what appears to be careful scrutiny[331] to acceptance of the taxpayer's asserted values almost without question.[332]

327. The highest and best use of land is "the reasonably probable and legal use of [land] which is physically possible, appropriately supported, financially feasible, and that results in the highest value." *See* THE DICTIONARY OF REAL ESTATE, *supra* note 326, at 135.

328. *See supra* note 326.

329. *See* THE APPRAISAL OF REAL ESTATE, *supra* note 322, at 346; THE YELLOW BOOK, *supra* note 259, at 19, 45; USPAP, *supra* note 311, at 85; *Glick*, 73 T.C.M. (CCH) 1925; Akers v. Commissioner, 799 F.2d 243, 246-47 (6th Cir. 1986).

330. *See, e.g.*, Symington v. Commissioner, 87 T.C. 892, 896 (1986) (after determining that the before-easement highest and best use of the land was residential subdivision, the court unquestioningly allowed the taxpayers to use the subdivision development analysis to establish the before-easement value of the land even though comparable sales of apparently unrestricted, similarly-sized parcels located near the subject were available to use in a sales comparison approach, and the court then compounded its error by allowing the taxpayers to use those comparable sales in the *after*-easement appraisal); *cf.* Fannon v. Commissioner, 56 T.C.M. (CCH) 1587 (1989) (after determining that the before-easement highest and best use of the land was residential subdivision, the court rejected the subdivision development analysis proposed by the taxpayers at trial in favor of the sales comparison approach that the taxpayers' expert had used in his original appraisal to establish the before-easement value of the land; the court noted that the values of the large parcels analyzed in the original sales comparison approach "reflected the possibility that they would be subdivided in the future, and, thus, their values were appropriately used to determine the [before]-easement value").

331. *See, e.g.,* Clemens v. Commissioner, 64 T.C.M. (CCH) 351 (1992).

332. *See, e.g.,* Schapiro v. Commissioner, 61 T.C.M. (CCH) 2215 (1991) (where the court adopted the taxpayer's appraisals of the before-easement values of two parcels using what essentially was a subdivision development analysis that did not discount the gross proceeds to account for the costs and risks associated with development under the rationale that the taxpayers could perform the subdivision development themselves "with a minimum of expense"). The Schapiro decision prompted the IRS to issue an Action on Decision recommending noncompliance and stating that "the court erred on a legal matter when it adopted the petitioners' expert's version of the development analysis because his method did not take into account all of the development costs and, therefore, overstated the value of each parcel of land before the granting of the easement." Action on Decision Re: John and Eleanor Schapiro v. Commissioner, AOD 1991-023, 1991 WL 772481 (1991).

Given the difficulties both the IRS and the courts have in understanding and evaluating an easement appraisal that employs the subdivision development analysis, such analysis presents aggressive easement donors with an enticing opportunity to inflate the before-easement value of their land and, thus, the value of their easements.[333]

3. Valuation Conclusion

The following factors combine to virtually assure that at least some easement valuation abuse is occurring: (i) the lack of clear and comprehensive easement valuation standards upon which appraisers, taxpayers, the IRS, and the courts can rely, (ii) the large dollar value of the tax benefits available to easement donors, and (iii) the weakness of the current safeguards against overvaluation. Moreover, it is likely that the level of abuse will increase as generous state tax incentives combine with the federal incentives to make an easement donation, coupled with an aggressive or abusive valuation, a potentially profit-making enterprise.

In light of the foregoing, it clearly would behoove the Treasury to devise some means of both assessing and quelling valuation abuse. However, a brute expansion of IRS enforcement activity is not the answer. In the absence of clear and comprehensive easement valuation standards, stepped-up IRS enforcement activities are likely to be no more successful than they were in the 1980s. Indeed, during that period the Tax Court repeatedly warned the IRS and taxpayers that it is not the best forum in which to resolve easement valuation disputes.[334]

It appears that a necessary first step in assessing and eventually quelling valuation abuse is the development of clear and comprehensive easement valuation standards upon which all parties can rely. Valuing easements for purposes of the federal tax incentive program need not be a mysterious and uncertain enterprise. Other federal agencies have been valuing easements and similar partial interests in land for many years,[335] and their experience, as well as the Yellow Book[336] could prove

333. *See* Joe Stephens and David B. Ottaway, *Developers Find Payoff In Preservation,* Wash. Post, Dec. 5, 2003 A1 (describing a myriad of allegedly abusive conservation easement donation transactions, including one in which "investors paid about $10 million for the land and shared in a tax write-off 'in the $20 million range'. . .[t]he deduction was based, in part, on an appraiser's assessment of how much the land would have been worth had they filled the acreage with 1,400 homes.").

334. *See supra* note 295.

335. Telephone conversation with James D. Eaton, MAI of the Appraisal Unit, United States Department of Justice, and author of the 2000 revision to the Yellow Book (March 28, 2003) [hereinafter EATON CONVERSATION]; *see also* THE YELLOW BOOK, *supra* note 259, at 47-5.

336. Although much of the Yellow Book is not relevant to easement appraisals, it does contain several clear explanations and standards that easement appraisers would find useful, especially with respect to the basic concept of a "before and after" easement appraisal. *See* THE

invaluable in crafting easement valuation standards for purposes of the federal tax incentive program.[337] Additional sources of information include the easement specialists, who have developed sophisticated easement valuation methods and extensive databases, and a number of publications that specifically address the issue of easement valuation.[338]

It would not be unprecedented for the Treasury to call upon experts outside of the agency in addressing easement valuation and abuse. In fact, the history of the development of the IRS's Art Advisory Panel offers a close analogy to what may be the current or impending situation facing the land trust community. In the 1960s, in an environment of high marginal income tax rates and steady appreciation in the value of works of art, donors were inflating the value of their gifts of artwork to museums for purposes of the charitable income, gift, and estate tax deductions, and museums were aware of the rampant abuse.[339] Numerous highly publicized cases of artwork valuation abuse "raised the ire of rural Congressmen" who were "not disposed to the cultural pursuits of urban, predominantly Eastern establishments" and were suspicious of the "capricious price structure" of artwork, while liberals objected to the inequity of a tax advantage that primarily benefited the wealthy.[340] In 1968, the House of Representatives voted in favor of a bill that would have repealed the charitable deductions for donations of "tangible property" (including artwork) by a wide (394-30) margin.[341] The House's passage of the bill caught the art community by surprise - they had not mounted a very effective campaign for retaining the deductions.[342]

YELLOW BOOK, *supra* note 259, at Sections B-47 and B-63; *see also id.* at Section B-11 (discussing enhancement), *id.* at Sections A-19 and B-44 (discussing the subdivision development analysis and when it is appropriate); *id.* at 36 and Section B-11 (discussing the importance of the highest and best use concept in easement appraisals); and *id.* at 88-93 (discussing the use of data from direct easement purchase programs).

337. While in drafting the Regulations the Treasury appears to have borrowed some of the concepts employed by other federal agencies in valuing conservation easements and other partial interests in land (such as the "before and after" and "enhancement" concepts), the Treasury has, in large part, ignored both the valuation experience of the other federal agencies and the Yellow Book. An explanation may lie in the fact that the Treasury tends to be rather isolated from the rest of the federal government, at least for purposes of seeking appraisal wisdom. EATON CONVERSATION, *supra* note 335.

338. *See, e.g.*, VALUATION PROCEDURES FOR CONSERVATION EASEMENTS, *supra* note 261; APPRAISING EASEMENTS, *supra* note 297.

339. *See IRS Art Advisory Panel: Hearing Before Subcomm. on Oversight of the House Comm. on Ways and Means,* 99th Cong. 46-49 (1986) (statement of Alexandre P. Rosenberg, Dir., Paul Rosenberg & Co.) [hereinafter ROSENBERG STATEMENT]; Thomas R. Mullaney, *How Museums Rescued The Tax-Deductible Donation,* THE NEW ART EXAMINER, April 1980, at 3 [hereinafter, HOW MUSEUMS RESCUED THE TAX-DEDUCTIBLE DONATION] (quoting Sherman E. Lee, Director of the Cleveland Museum of Art, as stating that "[m]useums had been aware for many years of the problems and of the tremendous abuses that existed.").

340. *See* HOW MUSEUMS RESCUED THE TAX-DEDUCTIBLE DONATION, *supra* note 339.

341. *Id.*

342. *Id.*

However, following the passage of the bill, the art community realized Congress was serious and apparently "got religion very quickly."[343] The art community understood that the charitable income, gift, and estate tax deductions had been indispensable to the rise of the art museum in the United States, and that "some form of internal police monitoring was necessary to save the goose that laid the golden egg."[344]

On February 1, 1968, The New York Times ran a headline story entitled, "10 Experts to Aid Tax Men on Art," with the subheading, "Aim is to Prevent Abuses in Listing Gifts to Museums."[345] The story reported that Sherman Lee, then President of the Association of Art Museum Directors, and Frederick Adams, the former President of the Pierpont Morgan Library, had proposed to the Commissioner of the IRS the idea of creating a panel of art experts that could assist the IRS with the valuation of artwork.[346] The Commissioner of the IRS accepted the idea, and proceeded to establish the Art Advisory Panel, which, in its first iteration consisted of five museum directors, two art dealers, one art consultant, one art historian, and one art collector.[347] The panelists received no salary for their services but were reimbursed for their per diem expenses.[348]

By the time the bill that would repeal the charitable deductions for donations of tangible property made its way to the Senate, the Art Advisory Panel had been in existence for eighteen months and had established a good reputation.[349] In its first year, the panel had advised the IRS with regard to the value of 229 works of art, had reduced the aggregate value of such works by roughly 25 percent from the taxpayers' asserted $30 million value, and apparently had not had its valuations challenged by any taxpayer.[350] Other steps in the "save-the-art-deduction" campaign included: the formal incorporation in June 1969 of the American Association of Museum Directors so that they could speak with "one voice" on issues such as federal tax policy; the testimony before Congress of directors of major museums who argued that the Art Advisory Panel, rather than the proposed legislation, was the preferred route to curbing valuation abuses; articles and editorials in The New York Times advocating retention of the charitable deductions for artwork

343. *Id.*

344. *Id.* (noting that gifts of art to museums are the lifeblood of many institutions, and that if museums had to rely on their acquisition of funds alone, they would either have to cease filling their galleries with new art, close their doors, or return to being the musty, quiet repositories of art they had been in the not too distant past).

345. *Id.*

346. *Id.*

347. *Id.*

348. *Id.*

349. *Id.*

350. *Id.*

donations, including one in which a donor was quoted as saying, "I can't afford to **pay** to give something away;" and vigorous lobbying of the Treasury by the museums, which ultimately led the Treasury to issue a statement in support of retaining the charitable deductions for donations of tangible property in September of 1969.[351]

Despite the valiant efforts of the museums, in November of 1969, the Senate Finance Committee voted 8-6 in favor of repeal of the charitable deductions for donations of tangible property.[352] However, two weeks later, the Senate Finance Committee reversed itself and voted 10-7 in favor of retaining the deductions.[353] The Senate Finance Committee's sudden reversal was due to an intensive lobbying effort mounted by museums, universities, and churches, as well as the existence of the Art Advisory Panel, which apparently convinced the committee that there was a way to police valuation abuse.[354] One commentator noted that:

> The Art Advisory Panel appeared on the scene at the right time. It may be credited, indirectly, with saving not only Uncle Sam millions in found tax revenues but also museums and private collectors from having to live in what would have been a radically different, and most probably poorer, art world.[355]

The Art Advisory Panel now consists of twenty-five volunteer art experts who meet once or twice a year in each of several specialty areas to review problematic taxpayer appraisals referred to them by the IRS Office of Art Appraisal Services.[356] The recommendations of the Panel as to value become the position of the IRS.[357]

In the 1987 Report, the Treasury noted that the creation of an easement advisory panel, similar in function to the Art Advisory Panel, might be helpful in curbing easement valuation abuse.[358] The Treasury did not elaborate on that suggestion, however, and nothing ever came of it. In light of the increasing popularity of easement donations and the significant potential for easement valuation abuse, the Treasury should reconsider the creation of an easement advisory panel.

The "Easement Advisory Panel" could be composed of easement specialists, attorneys, and other professionals who have experience with conservation easement donation transactions. Although the purpose of

351. *Id.*
352. *Id.*
353. *Id.*
354. *Id.*
355. *Id. See also* ROSENBERG STATEMENT, *supra* note [339], at 46-49 (discussing the circumstances surrounding the creation of the Art Advisory Panel).
356. Karen E. Carolan, *Documenting Art Appraisals for Federal Tax Purposes*, 297 PLI/PAT 797, 823-25 (1990); INTERNAL REVENUE SERVICE, INTERNAL REVENUE MANUAL §4.48.2.1 (2001), *available at* http://www.irs.gov/irm/part4/index.html (last visited Dec. 29, 2003).
357. INTERNAL REVENUE MANUAL §4.48.2.1.
358. 1987 REPORT, *supra* note 18, at 12.

the Easement Advisory Panel would be the same as that of the Art Advisory Panel - to minimize valuation abuse - for a number of reasons it may be preferable to limit the role of the Easement Advisory Panel to promulgating and updating easement valuation standards, rather than having the panel actually review suspect easement appraisals. First, the members of the Art Advisory Panel are volunteers and, to avoid conflicts of interest, they agree to refrain from performing appraisals for federal tax purposes while serving on the panel.[359] Serving as a volunteer and agreeing to not be involved in easement donation transactions might prove a hardship for members of the Easement Advisory Panel, at least for the easement specialists and attorneys.

Second, once the Easement Advisory Panel promulgates clear and comprehensive easement valuation standards, the IRS should be able to train its staff appraisers to apply the standards and properly review even complex easement appraisals.[360] For example, the Easement Advisory Panel could create a "model easement appraisal report" that would instruct appraisers to address the important issues identified in the Regulations, such as enhancement and whether a substantial record of comparable easement sales exists. The model easement appraisal report also could state the Treasury's position with regard to whether and when it will accept an easement appraisal that employs the subdivision development analysis to determine the before-easement value of the land. The easement valuation standards could encourage appraisers to follow the model easement appraisal report by stating that the IRS will intensely scrutinize appraisals that do not conform to the model.

Finally, there is some indication that, at least in the late 1970s, the Art Advisory Panel was able to review only a small fraction of suspect art appraisals, and that its review of even that small fraction was a "hurried affair" conducted under conditions that often were not optimal.[361]

359. Carolan, *supra* note 356, at 824.

360. The need for appraisal review by the Art Advisory Panel arguably is more acute than the need for appraisal review by an Easement Advisory Panel because the valuation of art involves even more complexity, subjectivity, and speculation than the valuation of easements. *See, e.g.,* William M. Speiller, *The Favored Tax Treatment of Purchasers of Art,* 80 COLUM. L. REV. 214, 227-229 (1980) (describing some of the many variables that must be considered when valuing objects of art; e.g., even similar works by the same artist will vary in quality, size, subject matter, condition, provenance, and rarity; works of art frequently are misattributed and thus incorrectly valued; "auction fever" and wining and dining of clients by dealers can inflate prices; and low auction attendance because of bad weather can lead to unrealistically low prices). *See also* ROSENBERG STATEMENT, *supra* note 339, at 47 (contending that, without the Art Advisory Panel, the IRS is unlikely to be able to acquire the appropriate level of expertise required to engage in the valuation of the most important, highly valued works of art that are donated to charities).

361. *See* Tom Mullaney, *IRS Art Advisory Panel: A Regulatory Paper Tiger?,* THE NEW ART EXAMINER, May 1980, at 3-4 (describing a number of problems with the IRS's use of the Art Advisory Panel, including the fact that the appraisal reviews conducted by the panel each year

Confining the Easement Advisory Panel's role to crafting clear and comprehensive easement valuation standards that can then be implemented by IRS staff appraisers would avoid placing an unrealistic burden on the panel.

Another strategy that might be borrowed from the IRS's treatment of art valuation is the opportunity provided to the donor of a work of art to submit his appraisal to the IRS for approval prior to filing the tax return on which he first claims a deduction for the donation. In 1996, the IRS set up a procedure whereby a taxpayer may, for a fee, seek an advance ruling on the valuation of a work of art valued at $50,000 or more.[362] The ruling is available only after the donation is complete and the donor has obtained a qualified appraisal of the work of art, and will either approve the taxpayer's appraisal or state the IRS's determination of value along with its reasons for disagreeing with the taxpayer's appraisal.[363] The taxpayer must submit the ruling with his tax return even if he disagrees with it.[364] A similar opportunity to obtain an advance ruling on an easement appraisal might be attractive to donors who desire a high degree of certainty at the time they file their tax returns.[365] An advance ruling would be attractive, however, only if donors have confidence that the IRS will review easement appraisals consistently and according to a generally agreed-upon set of easement valuation standards.

III. INCREASING THE TAX INCENTIVES

The foregoing discussion lays the groundwork for assessing whether, and the manner in which, the federal tax incentives available with respect to easement donations should be increased. The land trust community is aggressively lobbying Congress to increase the federal tax incentives, and states have begun enacting generous state tax incentives that significantly increase the total tax savings accruing to an easement donor.[366] At the

were "only the tip of the iceberg," and that because the panelists' time is valuable and discussion may be prolonged, the panel often evaluated only a fraction of the appraisals referred to it by the IRS). *But see also* HOW MUSEUMS RESCUED THE TAX-DEDUCTIBLE DONATION, *supra* note 339 (noting that "[m]useum professionals generally give [the Art Advisory Panel] high marks and say that it has helped immeasurably in keeping everyone honest").

362. *See* Rev. Proc. 96-15, 1996-1 C.B. 627.

363. *Id.*

364. *Id.*

365. For example, donors in Virginia or Colorado who intend to sell their state income tax credits may be very interested in such an advance ruling. Eliminating the risk of subsequent adjustment to the value of the donation by the IRS would make the state income tax credits far more attractive to prospective buyers.

366. *See supra* note 14 (noting that Congress has held numerous hearings on land conservation issues in recent years, and that the land trust community consistently has lobbied for increases in the federal tax incentives at those hearings), *supra* note 246 (noting that the LTA's "top policy priority" for the years 2004 through 2008 is the passage of federal legislation

same time, however, little thought is being given to the efficiency of the tax incentives, the fact that some landowners might not be appropriate targets of a tax incentive program, or the potential for exploitation of the incentives by profit-motivated easement "donors." Those issues, which must be considered when analyzing any proposal to increase the tax incentives, are addressed below.

A. *Efficiency*

1. *The Concept of Efficiency*

Beginning with the most basic level of analysis, the federal tax incentives intended to stimulate the donation of easements would be "efficient" if the aggregate value of the easements obtained as a result of the incentives (that is, the aggregate value of the easements obtained from landowners who require the financial inducement of the tax incentives to donate) exceeds the aggregate cost of the incentives in terms of foregone revenue. To illustrate that concept, assume each of one hundred landowners donates an easement valued at $1 million and receives tax savings with a present value of $350,000 as a result. If ten of the landowners would have donated their easements in the absence of the tax incentives, and the remaining ninety required the financial inducement of the tax incentives to donate, the tax incentive program would be efficient because the $90 million value of the easements obtained as a result of the program far exceeds the $35 million cost of the program. Alternatively, if ninety of the landowners would have donated their easements in the absence of the tax incentives, and only ten required the financial inducement of the tax incentives to donate, the tax incentive program would be inefficient because the $35 million cost of the program would exceed the $10 million value of the easements obtained as a result of the program.

Unfortunately, we do not know the percentage of landowners who require the financial inducement of the tax incentives to donate, much less the value of their easements.[367] We also do not know the aggregate cost of the various incentives.[368] In the face of such uncertainty regarding

to provide new tax incentives for land conservation), and *supra* Part II.A.3.c (discussing the generous state tax incentives enacted by Virginia and Colorado).

367. *See supra* Part II.A.

368. *See* Small, *An Obscure Tax Code Provision, supra* note 20, at 56 (noting that between the relative obscurity of §170(h) and the relatively low land values at that time, both the House and the Senate committee reports on the 1980 legislation estimated that the federal government would lose $5 million annually in income tax revenue as a result of the charitable income tax deduction available with respect to easement donations, but that at least one easement donated in 1998 had a value of more than $10 million.); JOINT COMMITTEE ON TAXATION, GENERAL

the basic efficiency of the federal tax incentive program, any proposed increase in the incentives should be approached with a considerable amount of caution and an eye toward enhancing, or at least not materially reducing, the efficiency of the program.[369]

Changes in the tax incentives can affect the efficiency of the program in either direction, depending upon various factors. For example, if the tax incentive program is operating efficiently, it nonetheless may be made *more* efficient if the incentives (and, thus, the cost of the program) can be reduced without causing a reduction in donations. To illustrate, return to the example discussed above where ninety of the landowners required the financial inducement of a tax incentive to donate, and the tax incentive program was efficient because the $90 million value of the easements obtained as a result of the program exceeded the $35 million cost of the program. If each of the ninety landowners would have been willing to donate his easement in exchange for tax savings with a present value of only $250,000 (rather than $350,000), the program could have been made more efficient by reducing the tax incentives to that level and saving $10 million of revenue without reducing the aggregate value of the easements obtained.

Similarly, an increase in the tax incentives would be efficient and could improve the overall efficiency of the tax incentive program if the increase triggers additional easement donations with a value in excess of the cost of the increase. To illustrate, assume each of one hundred landowners donates an easement appraised at $1 million and receives tax savings with a present value of $350,000 as a result thereof. If fifty of the landowners required the financial inducement of a tax incentive to donate, the tax incentive program would be efficient because the $50 million aggregate value of the easements obtained as a result of the program would exceed the $35 million cost of the program. However, if the present value of the tax savings accruing to each landowner donating an easement was increased to $400,000, and that increase triggered the donation of fifty additional $1 million easements: (i) the increase would be efficient because the $50 million value of the easements obtained as a result of the increase would exceed the $25 million cost of the increase[370]

Explanation of Tax Legislation Enacted in 1997 (1997) (estimating that §2031(c) would reduce federal fiscal year budget receipts by $7 million in 1999, $15 million in 2000, $25 million in 2001, $35 million in 2002, $48 million in 2003, $51 million in 2004, $56 million in 2005, $60 million in 2006, and $64 million in 2007). To the author's knowledge there has been no attempt to update the revenue loss estimate relating to §170(h), or to determine the actual annual aggregate revenue cost of the various tax incentives intended to stimulate the donation of easements, which include not only §170(h) and §2031(c), but also §2522(d).

369. This is true regardless of whether the current federal tax incentive program is efficient or inefficient.

370. The $25 million "cost of the increase" represents the excess of the $60 million cost of the new program ($400,000 x 150 easements) over the $35 million cost of the old program.

and (ii) the overall efficiency of the tax incentive program also would increase because, on average, the cost of each easement obtained as a result of the program would decrease.[371]

Alternatively, if an increase in the tax incentives did not trigger additional donations with a value in excess of the cost of the increase, the increase would be inefficient and could have an adverse impact on the overall efficiency of the tax incentive program. To illustrate, assume the same facts as in the example in the preceding paragraph, except that the present value of the tax savings accruing to each landowner is increased to $500,000, and the increase triggers the donation of only ten additional $1 million easements. In this case: (i) the increase would be inefficient because the $20 million cost of the increase would exceed the $10 million value of the easements obtained as a result of the increase[372] and (ii) the overall efficiency of the tax incentive program would be reduced because, on average, the cost of each easement obtained as a result of the program would increase.[373] In this case, the increase primarily would confer windfall benefits on the one hundred landowners who would have donated their easements absent the increase.

2. *The Federal Tax Incentives*

There exists a rather obvious opportunity to improve the efficiency of the tax incentives available with respect to easement donations. As currently drafted, the estate tax exclusion under §2031(c) can apply to the estate of any decedent dying after 1997.[374] Thus, the exclusion under §2031(c) is available with respect to land encumbered by an easement that is included in an estate even if the easement was donated *before* the enactment of §2031(c). In such a case, the easement donation clearly was not stimulated by the incentive provided under §2031(c), and the revenue foregone as a result of the exclusion would do nothing more than confer a windfall benefit on the happy beneficiaries of the estate. Amending §2031(c) to provide that the exclusion applies only with respect to land encumbered by a qualifying easement donated *after* the date of the

371. Under the old program, $35 million of revenue was foregone to obtain easements with an aggregate value of $50 million, for an average "cost" per easement of $700,000, whereas under the new program, $60 million of revenue was foregone to obtain easements with an aggregate value of $100 million, for an average "cost" per easement of only $600,000.

372. The 20 million "cost of the increase" represents the excess of the $55 million cost of the new program ($500,000 x 110 easements) over the $35 million cost of the old program.

373. Under the old program, $35 million of revenue was foregone to obtain easements with an aggregate value of $50 million, for an average "cost" per easement of $700,000, whereas under the new program, $55 million of revenue was foregone to obtain easements with an aggregate value of $60 million, for an average "cost" per easement of $916,666.

374. Pursuant to §2031(c), up to 40 percent of the value of land encumbered by a conservation easement can be excluded from a decedent's estate for estate tax purposes. *See supra* notes 58 and 125 and accompanying text for a description of the estate tax exclusion.

enactment of §2031(c) would improve the efficiency of the tax incentive program by reducing the cost of the program without affecting donation behavior.

In addition, even amended as suggested above, §2031(c) might still be an example of an inefficient increase in the tax incentives available with respect to easement donations. Although §2031(c) was enacted in 1997 ostensibly to provide a meaningful incentive to land rich, cash poor landowners,[375] it was not specifically targeted to that income group, and any landowner donating a qualifying easement is eligible for the estate tax exclusion. Thus, one effect of §2031(c) is to provide an additional quantum of tax savings to the class of landowners that already receives disproportionately greater tax savings as a result of the charitable income and gift tax deductions—high-income landowners with sufficient wealth to be concerned about the estate tax. Moreover, as a result of the passage of the 2001 Act, which increases the amount that an individual can pass free of estate tax at death to $3,500,000 by 2009, the number of land rich, cash poor landowners with sufficient wealth to be concerned about the estate tax is likely declining.[376] Thus, it is possible that §2031(c) does not trigger the donation of additional easements with a value in excess of the cost of the provision and, instead, primarily confers windfall benefits on the beneficiaries of the estates of high-income, relatively wealthy landowners who would have donated their easements in the absence of §2031(c).[377]

Proposals to further increase the federal tax incentives available with respect to easement donations should be similarly analyzed for efficiency. One bill recently introduced in Congress (but ultimately not passed) would have increased the amount of the charitable income tax deduction that can be claimed annually by an easement donor from 30 to 50 percent of the donor's AGI, and allowed the donor to carry forward any unused deduction for fifteen years.[378] The land trust community actively lobbied for those changes as a means of making the federal tax incentives more compelling to land rich, cash poor landowners.[379]

375. *See supra* notes 56 and 57 and accompanying text.

376. *See supra* note 133 and accompanying text.

377. Although certain requirements in addition to those set forth in §170(h) must be satisfied to be eligible for the estate tax exclusion under §2031(c), it would be difficult to argue that those requirements increase significantly the benefits to the public that flow from donated easements and, thus, that the additional cost to the public associated with §2031(c) is justified by higher quality easements. For articles discussing the requirements of §2031(c) *see supra* note 58.

378. *See* S. 476, 108th Cong. §106 (2003). Under the bill, the donor could claim the deduction over a period of sixteen years—the year of the donation and the following fifteen years.

379. *See* Russel Shay, *Public Policy Update: New Year's Resolutions*, 22 EXCHANGE: THE JOURNAL OF THE LAND TRUST ALLIANCE 4 (2003) (noting that the LTA was championing the changes to make the federal tax incentives more attractive to land rich, cash poor landowners).

The following chart illustrates the present value of the aggregate tax savings that would accrue to the High, Middle, and Low-Income Landowners (discussed in Part II.A.3.a) from the donation of an identical $500,000 easement if the charitable income tax deduction were modified in accordance with the above described bill. The chart also compares those tax savings to the present value of the aggregate tax savings that would accrue to such landowners under the existing deduction provision (without the use of the phase-in technique).

	High-Income Landowner	Middle-Income Landowner	Low-Income Landowner
Adjusted Gross Income	$250,000	$ 75,000	$ 35,000
Marginal Income Tax Rate	35%	27%	15%
Charitable Contribution	$500,000	$500,000	$500,000
Annual Deduction[380]	$125,000	$ 37,500	$ 17,500
Years Deductible[381]	4	14	16
Annual Tax Savings[382]	$ 43,750	$ 10,125	$ 2,625
Aggregate Tax Savings[383]	$175,500	$ 135,000	$ 42,000
Present Value of Aggregate Tax Savings Under Proposal[384]	$155,135	$ 96,815	$ 28,449
Present Value of Aggregate Tax Savings Under Existing Law[385]	$133,237	$ 30,835	$ 7,994

The chart illustrates that even though the deduction, as modified, would significantly increase the present value of the aggregate tax savings accruing to the Middle and Low-Income Landowners, those landowners still would be reimbursed for only a modest percentage of the reduction in the value of their land (approximately 19 and 6 percent, respectively), and the reimbursement would take a significant number of years.

380. The annual deduction is equal to 50 percent of the landowner's AGI.

381. It would take the High-Income Landowner only four years to claim the full $500,000 deduction (at a rate of $125,000 per year), while it would take the Middle-Income Landowner fourteen years to claim the full $500,000 deduction (at a rate of $37,500 per year for the first thirteen years and $12,500 in the fourteenth year). The Low-Income Landowner would be able to claim only $280,000 of the $500,000 deduction during the sixteen-year period (at a rate of $17,500 per year).

382. The annual tax savings is the amount of additional income tax that would have been paid by the landowner in the absence of the annual deduction, assuming the additional income would have been taxed at the landowner's marginal income tax rate.

383. For the High- and Middle-Income Landowners, the aggregate tax savings is limited to the amount of the deduction multiplied by the landowner's marginal income tax rate. For the Low-Income Landowner, the aggregate tax savings is limited to the $280,000 amount that could be deducted multiplied by the Low-Income Landowner's 15 percent marginal income tax rate.

384. The present values were calculated assuming a discount rate of 5 percent.

385. *See supra* note 111, and accompanying chart.

Moreover, the modified deduction also would increase significantly the present value of the aggregate tax savings accruing to the High-Income Landowner, who already receives disproportionately greater tax savings as a result of the deduction. Thus, it is possible that the modified deduction would fail to inspire many middle and low-income landowners to donate easements, and, instead, would primarily confer windfall benefits on high-income landowners who find the existing federal income and estate tax incentives (tilted as they are in favor of such landowners) sufficiently enticing. On the other hand, it is possible that virtually all of the "low hanging fruit" has been picked from the most affluent landowners, and that the modified deduction would trigger the next wave of easement donations from landowners at the upper end of the income scale who can afford to significantly reduce the value of their land without financial distress, but require slightly greater tax savings than are offered under the existing incentive provisions.

It is, of course, exceedingly difficult to assess whether a proposed increase in the federal tax incentives (such as the one described above) is likely to be efficient. However, the difficulties associated with such an assessment should not cause policy makers to avoid the question of efficiency altogether (as presently appears to be the case). At a minimum, the effect of a proposed increase in the incentives on the tax savings accruing to donors of varying income and wealth levels should be examined. If such an analysis reveals that the increase is likely to confer significant windfall benefits on landowners who already receive disproportionately greater tax savings from the existing tax incentives - that is, high-income landowners with sufficient wealth to be concerned about the estate tax - consideration should be given to reducing those potential windfall benefits.[386] Such benefits could be reduced by, for example, reducing the increased incentive as the AGI of the donor (and, thus, the benefit to the donor from the existing federal charitable income tax deduction) rises.[387]

In addition, some attempt should be made to gather reliable evidence on the income and wealth characteristics of the landowners who own land with the type of conservation values Congress deems worthy of protection under §170(h) (the "target pool" of landowners). Such evidence could prove invaluable in assessing the efficiency of proposed increases in the federal tax incentives. For example, if it were determined that the target pool consists primarily of low-income landowners, it would

386. Of course, it is possible that Congress would deliberately enact a tax incentive provision likely to confer significant windfall benefits on high-income, wealthy landowners simply to garner the political favor of its wealthiest and most politically influential constituents.

387. A number of federal income tax benefits are reduced as a taxpayer's AGI rises. *See, e.g., supra* note 107 (discussing §68, which reduces the amount of certain itemized deductions that can be claimed in any year by a taxpayer with AGI above a certain threshold).

be clear that changes to the federal tax incentives such as those discussed above are unlikely to be efficient. Alternatively, if it were determined that the target pool consists primarily of high to middle-income landowners, changes to the federal tax incentives such as those discussed above would have an increased chance of being efficient, in that they might well trigger the next wave of easement donations from landowners at the upper end of the income scale. To date, however, apart from the testimony of representatives of the land trust community,[388] no attempt appears to have been made to gather information on the target pool of landowners.

3. The State Tax Incentives

The recent enactment in Virginia and Colorado of generous and egalitarian state income tax credits also raises serious efficiency concerns. First, it is not at all clear that such credits will operate efficiently by triggering additional easement donations with a value in excess of the cost of the credits. Although the credits are likely to stimulate donations from land rich, cash poor landowners who do not find the existing federal tax incentives to be compelling, they also are likely to confer substantial windfall benefits on more affluent landowners who would have donated in response to the federal incentives alone. Neither state legislature made any attempt to minimize the potential windfall benefits by, for example, reducing the amount of the credits accruing to a donor as the AGI of the donor rises.[389]

The state income tax credits also raise the specter of a different type of inefficiency, usually referred to as "transactional inefficiency." In this context, the term refers to the danger that, through a combination of federal and state tax savings, the donor of an easement may effectively be "paid" more than the market cost of his easement.[390] Whether in the context of a direct purchase program or an incentive program, paying more for easements than a very modest premium over their market cost would be bad public policy.[391] Even if an easement can be expected to

388. *See supra* Part II.A.5.

389. *See supra* Part II.A.1, Part II.A.3.c, and Part II.A.3.d, which discuss the design of the Virginia and Colorado income tax credits. *See also supra* note 387, which discusses how income tax benefits can be reduced as a taxpayer's AGI rises.

390. *See supra* note 142, describing how at least one land trust operating in Virginia has advertised the potential that an easement donor could be reimbursed for close to or even more than the full market cost of a donated easement through a combination of the federal and state tax incentives.

391. Only in very rare cases would paying a significant premium be warranted. *See, e.g.*, THE YELLOW BOOK, *supra* note 259, at 91 (listing "legitimate reasons" why a government agency might pay a price for land in excess of the price indicated by an approved appraisal, including, *inter alia*, the threat of imminent destruction of the property for the government's purposes, the

provide benefits to the public far in excess of its market cost, the public need only outbid developers for the development value of the land.[392] Overpaying for easements would confer undue windfalls on landowners at taxpayers' expense, wasting limited funds that could be spent in other ways to achieve conservation goals.[393] Furthermore, transactional inefficiency is particularly ill-advised in the context of a low-oversight tax incentive program. Where generous state tax incentives combine with the federal incentives to create a reasonably likely prospect of making a profit from an easement "donation," severe pressure will be placed on the easily exploitable aspects of the tax incentive program.[394] Accordingly, when considering proposals to increase the tax incentives for easement donations, whether at the federal or state level, serious consideration should be given to the combined effect of all of the various incentives available to landowners.

B. The Land Rich, Cash Poor Red Herring

In lobbying for increases in the federal tax incentives available with respect to easement donations, members of the land trust community consistently have argued that such increases are necessary to provide land rich, cash poor landowners with a meaningful incentive to donate easements.[395] It seems clear that the existing federal tax incentives do not provide a compelling incentive to land rich, cash poor landowners.[396] However, it is less clear that land rich, cash poor landowners actually own land with the type of conservation values Congress deems worthy of protection under §170(h).[397] Moreover, even if it were determined that a

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fact that the tract is a key component of a larger project, and an assessment that paying the premium is cheaper than alternatives such as condemnation or a delayed project).

392. *See, e.g.*, *id.* at 36 (noting that, in the context of appraising land and interests in land for federal acquisition, the federal government will not pay based on an appraisal that uses any estimate of "public interest value" to inflate market value); *see also* PARTIAL INTERESTS IN LAND, *supra* note 87, at 24 (noting that the "before and after" method could be understood as a measure of the effect of a ghostly third participant in the "market" for conservation easements; that is, the developers, "since they represent the demand for land conversion").

393. *See* Boyd et al., *supra* note 257, at 244 ("Because over-compensation erodes the public funds available for conservation, it is clearly desirable to limit the windfall" paid to landowners.)

394. *See infra* Part III.C. for an in-depth discussion of potential exploitation of the tax incentives.

395. *See supra* note 14 and accompanying text.

396. *See supra* Parts II.A.2 and 3, which discuss the significant costs associated with an easement donation, the limited ability of less affluent landowners to discount those costs, and the rather paltry tax savings offered to less affluent landowners through the existing tax incentives.

397. *See supra* note 388 and accompanying text, noting that, apart from the testimony of representatives of the land trust community, no attempt has been made to gather information on the income and wealth characteristics of landowners who own land with the type of conservation values targeted for protection under §170(h).

significant percentage of land rich, cash poor landowners own land with the type of conservation values Congress deems worthy of protection under §170(h), federal tax incentives simply may not be the most appropriate means by which to acquire easements from such landowners.

The federal tax incentives available with respect to easement donations are *charitable* provisions - they are designed to encourage easement donations by landowners who have both the will and the means to significantly reduce the value of their land in exchange for modest, partially compensating payments from the taxpaying public in the form of tax savings. Thus, the most appropriate targets of the federal tax incentives are relatively affluent landowners who do not intend to develop or otherwise use their land in ways inimical to its conservation values. As discussed in Part II.A.2, in large part because of their financial position, relatively affluent landowners are likely to aggressively discount both the market and transaction costs associated with an easement donation. Land rich, cash poor landowners, on the other hand, are far less likely to be able to aggressively discount such costs. Such landowners often rely upon the development value of their land and, by definition, may not have ready cash with which to pay the transaction costs associated with an easement donation. Given the foregoing, it is reasonable to assume that, as a general rule, a greater economic incentive will be required to trigger easement donations from land rich, cash poor landowners than is required to trigger easement donations from more affluent landowners.[398]

However, the fundamental mathematics of the charitable income tax deduction work against efforts to use that mechanism to provide a meaningful incentive to land rich, cash poor landowners. The maximum amount of tax savings that a land rich, cash poor landowner could receive as a result of the deduction is limited to the value of the easement multiplied by the landowner's marginal income tax rate, which, under our progressive rate structure, necessarily will be lower than the rate applicable to the middle and high-income landowners. Moreover, the low annual AGI of a land rich, cash poor landowner severely restricts the tax savings that can accrue to such landowner in any year as a result of the deduction.

The difficulty of providing a meaningful incentive to land rich, cash poor landowners through the mechanism of the charitable income tax deduction is illustrated in the following chart, which indicates the present value of the tax savings that would accrue to the High, Middle, and Low-Income Landowners (discussed in Part II.A.3.a) as a result of the

398. *See supra* note 173, citing to testimony from representatives of the land trust community that some farmers and ranchers simply need to be paid (presumably fair market value or close thereto) for their easements.

donation of a $500,000 easement under: (i) existing law, (ii) the proposal discussed in the previous section, which would increase the amount of the charitable income tax deduction that can be claimed annually by an easement donor from 30 to 50 percent of the donor's AGI, and allow the donor to carry forward any unused deduction for fifteen years ("Proposal 1"), and (iii) a second proposal, which would allow landowners whose income is predominantly from farming or ranching to claim the deduction generated by an easement donation to the extent of 100 percent of their AGI in any year and to carry forward any unused deduction for fifteen years ("Proposal 2").[399]

	High-Income Landowner	Middle-Income Landowner	Low-Income Landowner
Adjusted Gross Income	$ 250,000	$ 75,000	$ 35,000
Marginal Income Tax Rate	35%	27%	15%
Charitable Contribution	$ 500,000	$ 500,000	$ 500,000
Aggregate Tax Savings under Proposal 2[400]	$ 175,500	$ 135,000	$ 75,000
Present Value of Aggregate Tax Savings Under Proposal 2[401]	$ 162,698	$ 112,377	$ 52,690
Present Value of Aggregate Tax Savings Under Proposal 1[402]	$ 155,135	$ 96,815	$ 28,449
Present Value of Aggregate Tax Savings Under Existing Law[403]	$ 133,237	$ 30,835	$ 7,994

As the chart illustrates, the proposed modifications to the charitable income tax deduction would significantly increase the present value of the aggregate tax savings accruing to the Middle and Low-Income Landowners. However, while such increases might well be sufficient to trigger some donations from landowners in the middle-income range, it is difficult to imagine how even Proposal 2 could be enticing to many low-income farmers and ranchers, offering them, as it does, roughly ten cents on the dollar for a half-million dollar easement. The inadequacy of the

399. Proposal 2 also was included in the bill recently introduced in Congress (but ultimately not passed). *See supra* note 378 and accompanying text.

400. Under Proposal 2, the aggregate tax savings for each landowner would be limited to the amount of the deduction multiplied by the landowner's marginal income tax rate.

401. This assumes that the income of each landowner is predominantly from farming or ranching and, thus, that each qualified for the modified deduction. Under Proposal 2, it would take the High, Middle, and Low-Income Landowners two, seven, and fifteen years, respectively, to claim the full $500,000 deduction at a rate of 100 percent of their AGI annually. The present values were calculated assuming a discount rate of 5 percent.

402. *See supra* note 384 and accompanying chart.

403. *See supra* note 111 and accompanying chart.

incentive provided to low-income landowners through the deduction is even more apparent when one considers that such landowners are likely to rely heavily on the development value of their land as collateral for loans and as a source of cash in the event of economic exigency or upon retirement.[404]

Moreover, a policy of ratcheting up the incentive offered by the charitable income tax deduction until it reaches the "price point" of land rich, cash poor landowners—that is, the lowest amount such landowners are willing to accept in exchange for their easements—is highly questionable given the inherent inequity of the incentive. Some land rich, cash poor farmers and ranchers, due to a strong personal attachment to their land and their way of life—*and* a desperate need for cash in an economic climate that is difficult for agricultural producers—may be particularly vulnerable to an offer of modest tax savings in exchange for the donation of an easement that does not materially interfere with their current use and enjoyment of their land. However, finding the "price point" of such landowners using an incentive that provides them with substantially less tax savings than are provided to their middle and high-income counterparts for easement donations of identical value raises serious questions regarding the equitable allocation of the economic cost of land conservation, and may create potentially dangerous long-term monitoring and enforcement problems.[405]

404. To the extent a landowner depends upon the development value of his land as an asset to be sold during his lifetime, he may compare the tax savings generated by an easement donation to the net sales proceeds attributable to the development value of his land that would be generated from a sale of the land. Thus, it is instructive to estimate such net proceeds in a "worst case" scenario. Assuming the landowner has zero basis in the land and would pay a 10 percent sales commission and a 20 percent capital gains tax on the proceeds net of the commission, the $500,000 market cost that the landowner would relinquish through an easement donation would net the landowner approximately $360,000 in a sale of the unencumbered land ($500,000 sales proceeds, less a $50,000 commission, less a $90,000 capital gains tax). Even taking into consideration the fact that the $500,000 of development value would be reduced to $360,000 by the sales commission and capital gains tax, the $52,690 of tax savings offered to the low-income farmer or rancher in exchange for the development value of his land under Proposal 2 still appears meager.

405. The modest cash infusion to a land rich, cash poor farmer or rancher from the donation of an easement eventually would be consumed, and the easement, once perceived as an economic boon, may come to be viewed by the farmer or rancher (or his or her heirs) as an unreasonable and, perhaps, unconscionably-obtained restriction on the development and use of the land. At that point, challenges to the easement can be expected. Where disputes actually end up in court, the land rich, cash poor farmer or rancher, whether the original donor or his or her heir, is likely to be a very sympathetic plaintiff. The unhappy experience of the National Park Service with a program involving the purchase of scenic easements along the Blue Ridge and Natchez Trace Parkways during the 1930s should be viewed as a cautionary tale. A 1968 article describes that experience as follows:

> The purchase of the easements was negotiated by state agents. It has been suggested that this procedure resulted in the landowners not being fully apprised of the rights they were relinquishing, since the state agent tended to be concerned only with getting

It would be theoretically possible to enact a federal tax incentive that would provide land rich, cash poor landowners with tax savings much closer in amount to the market cost of their easement donations.[406] It also would be possible to target such an incentive to land rich, cash poor landowners (by, for example, reducing the benefit accruing to a landowner from the incentive as the AGI of the landowner rises), thus minimizing the potential for windfall benefits. However, such an incentive would suffer from a variety of problems inherent in the use of a tax incentive to conduct what essentially is an easement purchase program.[407] In addition, such an incentive would be exceedingly costly and, thus, politically unpalatable, particularly in light of the growing federal deficit.[408] Accordingly, if it is determined that a significant number of land rich, cash poor landowners own land with the type of conservation values Congress deems worthy of protection under §170(h), serious consideration should be given to seeking protection of that land through

> the landowner's signature on the easement deed. Moreover, there were no set standards for appraising the rights acquired. The states were given a lump sum and instructed to buy as many scenic easements as possible. Consequently, there was much dickering and very little uniformity in the prices paid. The net result was that many landowners did not understand just what rights they had sold, and many of them were bitter at what they regarded as unfair treatment when they discovered that they had been paid less than other landowners were paid for the same easement over similar land. The difficulty was compounded when the original owners of the servient land were succeeded by their heirs or grantees, who had not signed the easement deeds. The successors of the original grantors. . . often were ignorant of, or did not feel bound by, or were inclined to minimize the importance of, the easements granted by their predecessors in title. As a result, friction between the National Park Service and the servient landowners increased; the number of violations steadily increased; and the cost of policing the scenic restrictions became substantial. . . . As a result of the friction with landowners, difficulty in policing scenic easements, and difficulty in getting. . . courts. . . to grant complete injunctive enforcement, the National Park Service practically discontinued the purchase of scenic easements in the 1950's and turned to a full fee simple purchase program.

Roger A. Cunningham, *Scenic Easements in the Highway Beautification Program*, 45 DENV. L.J. 167, at 182-83 (1968).

406. For example, it would be theoretically possible to enact a refundable and transferable federal income tax credit equal to some significant percentage of the value of a donated conservation easement, much like the state income tax credits enacted in Virginia and Colorado.

407. *See infra* Part III.C, *Potential Exploitation,* describing the dangers associated with using a largely automatic, low-oversight tax incentive program to purchase easements for their market cost or close thereto.

408. One can imagine the heated debate in Congress over a refundable income tax credit equal to 75 percent of the value of a donated easement and pursuant to which the Treasury would write a check to the Low-Income Landowner for $375,000 in exchange for his $500,000 easement. Moreover, because the funds expended through such a tax credit program would not be subject to the annual appropriations process, the aggregate cost of the program would be limited only by the number of willing easement donors.

government easement purchase programs and grants to land trusts to enable them to purchase easements.[409]

Congress could limit the aggregate cost of such easement purchase programs through the annual appropriations process and, although the funding for the programs would be subject to change each year, limiting the application of the programs to land rich, cash poor landowners presumably would make them more attractive to legislators. Such easement purchase programs also would have the advantage of encouraging government agencies and land trusts to prioritize their easement purchase projects and expend the necessarily limited public funds on the easements that have the greatest conservation value.[410]

The Albemarle County, Virginia, Acquisition of Conservation Easements Program (the "ACE Program") is an example of an easement purchase program that both prioritizes easement purchases based on conservation value and is limited in application primarily to land rich, cash poor landowners.[411] Under the ACE Program, the county first ranks easement projects based on their conservation value.[412] The county then pays for approved easements (that is, those easements determined to have the highest conservation value) based on a sliding scale in which the payment, expressed as a percentage of the easement's appraised value, increases as the landowner's historical AGI decreases.[413] Thus, for example, a landowner with historical AGI of $50,000 or less is paid 100 percent of the appraised value of his easement, while a landowner with historical AGI of $200,001 or more is paid only 4 percent of the appraised

409. It should be noted, however, that conservation easement purchase programs are unlikely to do much to combat the underlying problems related to the economic viability of farming and ranching. For land rich, cash poor farmers and ranchers, the sale of a conservation easement may at best provide them with only a temporary solution to their financial woes. *See* Tom Daniels, *Saving Agricultural Land with Conservation Easements in Lancaster County, Pennsylvania*, *in* PROTECTING THE LAND: CONSERVATION EASEMENTS PAST, PRESENT, AND FUTURE 166-185 (Julie Ann Gustanski & Roderick H. Squires eds., 2000) (noting, as a drawback to the public and private agricultural easement acquisition programs in Lancaster County, Pennsylvania, that the payment received by a landowner in exchange for his easement primarily benefits only the current generation).

410. In the context of the federal tax incentive program, where a greater percentage of the cost of the easements is borne by the individual landowners (rather than the public), the threshold conservation purposes test under §170(h) arguably ensures that the public benefit derived from such easements is sufficient to justify their cost to the public, and prioritization is unnecessary.

411. *See Albemarle County Acquisition of Conservation Easements Program (VA)* §1.1-111(B), *available at* http://www.albemarle.org/department.asp?department=planning&relpage=2465 (last visited Dec. 29, 2003) [hereinafter ACE Program].

412. *Id*

413. *Id.*

value of his easement (with the remaining 96 percent possibly qualifying as a charitable donation under §170(h)).[414]

Easement purchase programs structured similarly to the ACE Program are likely to be attractive to legislators making funding decisions because they ensure limited public funds will be expended on easements with high conservation value, and the land rich, cash poor landowners targeted by the programs are likely to be viewed as sympathetic beneficiaries. Moreover, such programs help ensure that limited public funds are not expended to purchase easements from more affluent landowners who would have donated their easements in response to the existing federal and state tax incentives. It is entirely reasonable to assume that affluent landowners who are willing to donate easements in response to the existing tax incentives would feel considerably less charitably inclined in the face of full market cost (or close thereto) easement purchase programs.[415]

414. *Id.* Historical AGI of $50,000 was chosen as the cut-off point for full compensation for the appraised value of an easement based upon: (i) anecdotal reports of the median annual AGI of residents of Albemarle County and (ii) an analysis of the present value of the federal tax savings likely to accrue to landowners with varying annual AGIs as the result of an easement donation. In structuring a federal easement purchase or grant program, a similar analysis, but with more reliable evidence of the annual AGI of landowners owning the type of land targeted for protection under the program, should be performed. Landowners with historical AGI of $200,001 or more are paid 4 percent of the appraised value of their easements under the ACE Program to compensate them for some, if not all, of the transaction costs typically associated with an easement donation and, thus, encourage them to donate easements.

415. In fact, it is quite likely that some existing government easement purchase programs, such as the Forest Legacy Program, which are not targeted to low-income landowners, have the effect of conferring substantial windfall benefits on affluent landowners who would have been willing to donate their easements in the absence of such purchase programs. After all, it would be economically irrational for an affluent landowner to turn down an offer from a government agency to purchase his easement for its market cost (or close thereto) in favor of the modest tax savings provided under the federal tax incentive program, particularly when there is no guarantee that funds turned down would be used to purchase an easement from a more financially needy landowner and, instead, might well be paid to the affluent landowner's equally affluent neighbor. Of course, some affluent landowners simply are not willing to donate easements in exchange for tax savings that would compensate them for only a modest percentage of the market cost of their easements. In fact, one affluent landowner in Albemarle County who wished to sell his easement to the county for its full market cost was extremely critical of the sliding scale compensation provided to landowners under the ACE Program, and has refused to donate his easement. However, limiting the ability of more affluent landowners to benefit from at least some easement purchase programs is justified both to minimize inevitable windfall benefits (some affluent landowners clearly are willing to donate easements in response to partially compensating tax incentives), and because, in situations where a noncharitable affluent landowner has an easement of exceptionally high conservation value, it is quite likely that some government agency or land trust will be willing to pay full market cost or close thereto for the easement.

C. Potential Exploitation

The current federal tax incentive program is a largely automatic, low-oversight program, through which modest incentives are offered to landowners to encourage them to donate easements satisfying the threshold conservation purposes test and other requirements set forth in §170(h). Because the incentives are modest, landowners who donate easements under the current system generally must be motivated to a significant extent by non-tax factors, including at least some personal attachment to and concern about the stewardship of their land.[416]

Substantial and unrestricted increases in the tax incentives (whether at the federal or state level, or through a combination of the two) can be expected to change the profile of the typical easement donor. As the incentives are increased, non-tax factors will become less important components of the motivation required to trigger easement donations and, at some point, dealmakers wishing to exploit the latest tax shelter will begin to supplant landowners who have some attachment to their land as the typical easement donors.[417] The importance of that potential shift should not be underestimated by federal and state legislators, the Treasury, or the land trust community: *the more an easement donation looks like a good business deal, the more strain will be placed on the aspects of §170(h) that are vulnerable to exploitation*.

A substantial increase in the tax incentives without a concomitant increase in the eligibility requirements for such incentives is likely to attract easement donors to the program who are primarily interested in developing, rather than protecting, their land. Such donors are likely to propose easements that provide for the retention of substantial rights to subdivide and develop the encumbered land, albeit at a lower density than may have been allowed by the local zoning and subdivision laws.[418]

416. *See supra* Part II.A.6.

417. At some incentive level, the program will become unacceptably susceptible to exploitation by speculators. The incentive level at which such change will occur is difficult to determine, in part because some willingness to overvalue easements should be expected, particularly among potential speculators. A rule of thumb might be derived from the 200 percent substantial valuation misstatement threshold for imposition of penalties under §6662 of the Code (*see supra* Part II.C.1.b). If tax incentives are raised to a level that would allow a speculator to engage in an easement "donation" transaction and make a significant profit without asserting a valuation for the donated easement in excess of 199 percent of its actual market cost, the program would be unacceptably vulnerable to exploitation. Such a transaction might include: (i) a highly-leveraged land purchase, (ii) a holding period of a year and a day (to ensure that the land qualifies as long term capital gain property and, thus, that the full value of the easement—rather than its basis—is deductible), (iii) an easement donation, (iv) sale of the encumbered land, and (v) the claiming of the tax incentives.

418. Witness what happened recently in Colorado. The generous Colorado income tax credit available with respect to easement donations apparently prompted prospective donors to propose easements "that reserved substantial development rights or that did not have a clear conservation purpose." Conservation Alert Memorandum from Isaacson, Rosenbaum, Woods &

As noted in Part II.B, the Regulations allow the donor of an open space easement to retain development rights that do not "interfere" with the conservation purposes of the easement, and allow the donor of any tax-deductible easement to retain development and use rights that are not "inconsistent" with significant conservation interests. Accordingly, the determination of whether an easement allows the retention of "too many" development rights is inherently subjective. Thus, easements that permit extensive development might be considered to comply with an aggressive interpretation of the §170(h) standards, even though they fail to accomplish the type of land protection envisioned by Congress when it enacted §170(h).[419] In addition, while retaining extensive development rights should cause a commensurate shrinkage in the market cost of the donated easement and, thus, in the amount of the donor's charitable deduction,[420] the donation nevertheless might generate a large deduction for the donor, either because of market conditions or, more likely, an aggressive or even abusive appraisal.[421] When the retention of too many development rights walks hand-in-hand with valuation abuse, insult is

Levy, P.C., Denver, CO, to Friends and Clients 2 (September 2002) (on file with the author). Because of the concern that prospective donors "were proposing conservation easements solely to generate the state income tax credit," the Colorado Legislature amended the state tax credit provision to provide that only those donations that satisfied the deductibility requirements under §170(h) are eligible for the state tax credit. *Id.* Even with that amendment, however, there still is a concern that government agencies and land trusts may be approached with "questionable conservation transactions," and that, unless measures are taken to ensure that tax abuse does not become prevalent, a backlash in the legislature could cause the current generous state tax incentives to be curtailed. *Id*; *see also* Small, *The Good and the Not-So-Good, supra* note 190, at 33-34 (noting that there are easements being donated and accepted by land trusts that allow far too much building on the land, and that, until about two or three years ago, "90-plus percent of the inquiries about conservation easements" were from landowners who really wanted to protect their land, but "[i]n the last two or three years, at least one-third of the inquiries about conservation easements [have] come from landowners who *think they can get away with something* by donating a conservation easement. . .") (emphasis in original).

419. Such easements would provide little public benefit if the conservation values of the "protected" land are likely to be substantially degraded or destroyed by the permitted development. *See, e.g.*, SMALL, BOOK III, *supra* note 133, at 33 (discussing a proposed easement that would reduce subdivision rights with respect to a one hundred acre parcel of land from eighty-eight one-acre house lots to nineteen five-acre house lots, and noting that, "even with extraordinarily careful and sensitive land use planning," it would be virtually impossible to site nineteen houses, access roads, driveways, garages, gym sets, and tv antennas on one hundred acres in such a way that true uninterrupted habitat-sensitive and scenic open space is preserved, and that this sounds like "residential development of a piece of land, not conservation easement planning for which the tax code gives the owner an income tax deduction.")

420. All else being equal, the more development an easement allows, the less the easement will reduce the value of the encumbered land.

421. It is not unreasonable to assume that the donor of an abusive easement also might be inclined to pressure his appraiser to take an aggressive stance with regard to the value of the easement, particularly given that the difficult-to-refute "subdivision development analysis" can be used to establish an inflated before-easement value for the land. *See supra* Part II.C.2 for a discussion of easement overvaluation using the subdivision development analysis.

added to injury because the unnecessarily expensive easement can be expected to provide inferior levels of public benefit.

In many instances, the government agencies and land trusts that accept easement donations can be relied upon to reject the low-quality offerings of easement donors who are interested more in developing than protecting their land. However, the land trust community itself has expressed concerns about the quality and effectiveness of some of the growing number of land trusts.[422] In addition, while the LTA has begun to implement programs to enhance the easement selection and stewardship capabilities of land trusts, a wave of easement donations triggered by federal and state tax incentives that are attractive to aggressive donors who have no attachment to their land could overwhelm the ability of the land trusts (and the often less well-equipped government agencies) to respond to the selection and stewardship challenges. Finally, while the government agencies and land trusts that accept easement donations have various reasons to exercise care and select only quality easements, they do not internalize the public cost of the tax incentives. Thus, their level of care is more or less fixed, and will not necessarily increase in response to a higher level of public investment in donated easements in the form of increased tax incentives.

Most troubling, however, is the danger that rampant exploitation of the tax incentives could lead to a public opinion backlash, culminating in the restriction or even elimination of the incentives by Congress and state legislators, and calling into question both the credibility of the land trust community and the use of conservation easements as a land protection tool. The specter of an army of mercenary easement donors with little or no attachment to their land should give pause to the land trust community and policymakers considering substantial and unrestricted increases in the tax incentives. While society arguably should be willing to pay a high percentage of market cost for easements in some situations, the implementation of such a program through the mechanism of tax incentives is highly questionable. Any program in which the public pays a high percentage of market cost to acquire easements will be unacceptably vulnerable to exploitation unless it provides for a stringent, case-by-case analysis of the specific conservation values to be protected by the easements and the price to be paid for the easements—the kind of analysis that simply is not available in the context of the tax incentive program.

422. *See supra* notes 229 and 230 and accompanying text.

IV. A RESPONSIBLE APPROACH

The federal tax incentives intended to stimulate easement donations should not be increased without some assurance that: (i) the increase will be efficient, (ii) the government agencies and land trusts accepting easement donations have the expertise and resources to appropriately screen and steward the easements donated in response to the increase, and (iii) the increase will not encourage exploitation. Concerns about efficiency and exploitation could be addressed, at least in part, by only modestly increasing the incentives and by designing any increase to minimize potential windfall benefits.[423] In addition, unless and until a formal accreditation program for easement donees is developed and implemented, concerns about the screening and stewardship capabilities of easement donees could be addressed indirectly by tying any increase in the tax incentives to a corresponding increase in the eligibility requirements for the incentives. In effect, the increase in the tax incentives could be designed not simply to encourage the donation of more (and more costly) easements, but to encourage the donation of easements expected to provide a greater level of public benefit.

In recent years, the land trust community has begun to recognize that the conservation objectives of §170(h) are generally best accomplished by protecting larger areas through the acquisition of easements on multiple, contiguous parcels of land—a process often referred to as "landscape preservation."[424] The evolution of the land protection activities of the Montana Land Reliance, a statewide land trust

423. As noted in *supra* Part III.A.2, if it is determined that an increase in the incentives is likely to confer significant windfall benefits on landowners who already receive disproportionately greater tax savings from the existing tax incentives—that is, high-income landowners with sufficient wealth to be concerned about the estate tax—those potential windfall benefits could be reduced by, for example, reducing the increased incentive as the AGI of the donor (and, thus, the benefit to the donor from the existing charitable income tax deduction) rises.

424. *See, e.g.,* Andrew Zepp, *Moving to Landscape-Scale Protection*, Vol. 21, No. 1 EXCHANGE, THE JOURNAL OF THE LAND TRUST ALLIANCE 3 (2002) (describing the land trust movement's growing focus on landscape preservation and noting that "[w]hile pocket parks and neighborhood open spaces are vitally important, it is also essential that land trusts, as a movement, are able to be effective at the landscape level"); John B. Wright, *Reflections on Patterns and Prospects of Conservation Easement Use*, *in* PROTECTING THE LAND: CONSERVATION EASEMENTS PAST, PRESENT, AND FUTURE 501 (Julie Ann Gustanski & Roderick H. Squires eds., 2000) (noting that

> [a]s subdivision, land clearance, and other perturbations increasingly fragment landscapes, conservation strategies aimed at protecting large collective blocks of land and linear corridors of open space are ever more critical for meaningful success to occur. The lessons derived from such fields as conservation biology, landscape ecology, historic preservation, environmental planning, and indeed agricultural economics all converge on a single fact: Small, isolated tracts of undeveloped land are insufficient to secure ecological health, agricultural continuity, and the solace of open spaces so profoundly needed by human beings).

that works to protect ecologically significant lands in Montana, reflects the evolution of the land trust movement as a whole in this regard. In the early years, the Montana Land Reliance acquired conservation easements opportunistically because "there was a strong need to protect qualified projects wherever they appeared so as to build credibility."[425] As the organization and its land preservation accomplishments grew, however, it began to target Montana's key valley ecosystems in an effort to conserve entire landscapes rather than isolated parcels.[426] More recently, the Montana Land Reliance made significant commitments to collaborate with other land protection agencies and organizations to protect two globally important ecosystems, the Greater Yellowstone Ecosystem and the Northern Continental Divide Ecosystem.[427]

To assist land trusts, as well as government agencies, in accomplishing landscape preservation goals, the federal tax incentives could be increased, but only with respect to easements encumbering land that is contiguous to land already protected for conservation purposes (such as National Parks, National Forests, wilderness areas, wildlife refuges, and other similar federal and state-protected conservation areas, as well as private land already encumbered by an easement that qualified for the deduction under §170(h)).[428] Such "landscape preservation" easements could be expected to provide a greater level of public benefit than their isolated cousins because they would be more likely to hold their conservation value over time and more likely to avoid the stewardship difficulties associated with the protection of land adjacent to or surrounded by developed land.[429] Thus, the proposed "contiguity

425. *See* John B. Wright, *The Power of Conservation Easements: Protecting Agricultural Land In Montana, in* PROTECTING THE LAND: CONSERVATION EASEMENTS PAST, PRESENT, AND FUTURE 394 (Julie Ann Gustanski & Roderick H. Squires eds., 2000).

426. *See id.* at 394-95 (noting that "neighborhood conservation projects around Yellowstone and Glacier National Parks and in the Boulder/Stillwater, Smith, Blackfoot, Swan, Nine Mile, and Bitterroot Valleys are outstanding examples of this approach").

427. Montana Land Reliance, *Ecosystem Conservation, at* http://www.mtlandreliance.org/ecocon.htm (last visited Dec. 29, 2003); Wright, *supra* note 425, at 395 (noting that

> in the Greater Yellowstone Ecosystem, the [Montana Land Reliance] works with the Greater Yellowstone Coalition, The Nature Conservancy, the Gallatin Land Trust, and the Jackson Hole Land Trust to create buffers, corridors, and linkages to maintain the biological integrity and scenic beauty of Yellowstone National Park. The trust has acquired easements on 115,000 acres of lower-elevation private lands in the valleys surrounding the park. . . . These lands are an ecological extension of the park, providing critical habitat for elk, deer, moose, bison, grizzly bear, wolves, and migrating waterfowl. . . . These easements create corridors of wildlife habitat, linking private ranchland with public federal national parks, forest, and wilderness areas and state wildlife management sites.)

428. This "contiguity requirement" would be added to the Code and would have to be satisfied by an easement donor interested in benefiting from the increased incentive.

429. Over time, if scattered parcels of land protected by conservation easements become "islands" of open space in an otherwise developed landscape, their conservation value can be

requirement" would indirectly address concerns about the current selection and stewardship capabilities of easement donees.

The proposed contiguity requirement also would have the benefit of being straightforward and objective. Easement donors could feel confident that they were satisfying the requirement, the IRS could easily assess compliance with the requirement, and easement donees could easily integrate the requirement into their programs. Finally, the private decision making that is the hallmark and unique strength of the tax incentive program would be only minimally affected by the proposed contiguity requirement, as the increased incentive potentially would be available with respect to all land in the country,[430] and the contiguity

expected to decline. While the value of a parcel of land as habitat or as an integral part of a functioning ecosystem may be substantial at the time an easement is donated, that value clearly will decline as the surrounding area is converted to residential, commercial, and industrial development. Similarly, the value of a parcel of land as part of a rural, agricultural, scenic, or historic landscape clearly will decline as that landscape becomes fragmented by development. Moreover, an easement protecting an isolated parcel of land in a developing landscape is likely to be subject to increasing termination pressure because the development value of the land will tend to rise at the same time that the conservation value of the land is declining. It also is reasonable to assume that, as development pressures and population densities increase, easements protecting islands of habitat, farmland, forest land, historic land, and other natural areas will become more difficult to monitor and enforce. *See, e.g.*, Rex Springston and Meredith Fischer, *Conservation Easements in Jeopardy*, Richmond Times-Dispatch, Jan. 24, 2003 (www.timesdispatch.com) (last visited September 30, 2003) (describing a challenge to overturn a conservation easement donated to the Virginia Outdoors Foundation in 1976 that encumbers an eighty-one acre parcel of land located in Northern Virginia, and noting that the parcel is worth about $35,000 with the easement restrictions and would be worth about $7 million without them; the area was largely agricultural when the easement was donated but today is an "island of green amid a suburban sea of homes, stores and gas-stations"; and a Virginia state senator described the parcel as "just sitting there empty, becoming a collection point for trash."). *But see also id.* (quoting a representative of the Virginia Outdoors Foundation as stating that "the property provides clean air, a refuge for animals, and a pleasant view for neighbors."). For an example of the benefits associated with landscape preservation*, see, e.g.,* Sharon E. Richardson, *Applicability of South Carolina's Conservation Easement Legislation to Implementation of Landscape Conservation in the ACE Basin*, *in* PROTECTING THE LAND: CONSERVATION EASEMENTS PAST, PRESENT, AND FUTURE 209, 219 (Julie Ann Gustanski & Roderick H. Squires eds., 2000) (describing the coordinated efforts of private landowners, the U.S. Fish and Wildlife Service, the South Carolina Department of Natural Resources, and a number of land trusts to protect land within the "ACE basin," a 350,000-acre region, thirty-five miles southwest of Charleston, S.C., that is within the coastal watersheds of the Ashepoo, Combahee, and Edisto Rivers, and noting that the lack of legal challenges to the conservation easements acquired in the ACE basin, even though ownership of the encumbered lands has changed hands, is attributable to the fact that the critical mass of land conserved in the area has created a high demand among conservation buyers for the land).

430. The proposed contiguity requirement is fundamentally different from the geographic limitation originally imposed on the estate tax exclusion under §2031(c) because all land located in the United States or its possessions potentially would be eligible for the additional incentive. *See supra* note 59 and accompanying text for a description of the geographic limitation originally imposed on the estate tax exclusion under §2031(c). Government agencies and land trusts wishing to stimulate donations in an area targeted for protection could do so by offering to provide the first landowner to donate an easement in the area compensation in an amount equal to the additional tax savings the landowner would have received had his donation satisfied the

requirement would apply only with respect to the increase in the tax incentives (thus leaving the existing tax incentive program intact).

CONCLUSION

The federal tax incentive program for conservation easement donations is an important and, in many respects, invaluable adjunct to other private land conservation programs. However, the success of the program should not blind its proponents to its inevitable inefficiencies and limitations. While the federal tax incentives work remarkably well in encouraging landowners who have both the will and the means to shoulder a significant percentage of the economic cost of protecting the conservation values of their land, continually increasing the incentives in an effort to make them attractive to land rich, cash poor landowners could have disastrous consequences. Thus far, the land trust community has shown a remarkable ability to recognize and confront the challenges presented by the acquisition and long-term stewardship of conservation easements. However, the capacity of land trusts (and the often less well-equipped government agencies) to respond to such challenges is not unlimited, and could be overwhelmed if Congress and the states adopt policies that result in a sudden surge in the number of easement donations. Moreover, significant exploitation and abuse by taxpayers could imperil the very existence of the tax incentive program and call into question both the credibility of the land trust community and the use of conservation easements as a private land protection tool.

Ultimately, a responsible approach is called for: Congress should increase the federal tax incentives only if some assurance can be had that the increase will be efficient, that land trusts and government agencies have the expertise and resources to appropriately screen and steward the anticipated additional easements, and that the increase will not encourage exploitation and abuse.

contiguity requirement. That "seed easement" could then be used to stimulate the donation of landscape preservation easements in the area.

APPENDIX A[i]

Conservation Easement Valuation Cases	Year of Donation	Acres	Location of Land	Taxpayer's Valuation at Trial	IRS's Valuation at Trial	Court's Valuation	Diminution Percentage
Thayer, T.C. Memo 1977-370	1969	59	VA	$ 147,688	$ 60,000	$ 113,000	33%
Akers, T.C. Memo 1984-490[ii]	1977	1,343	TN	$ 789,000	$ 0 or $114,000	$ 114,000	16%
Todd, 617 F.Supp. 253 (1985)	1979	104	PA	$ 353,000	$ 20,800	$ 20,800	2%
Stanley Works, 87 T.C. 389 (1986)	1977	668	CT	$13,000,000 or $ 5,394,000 or $ 6,704,000	$1,100,000	$4,970,000	75%
Symington, 87 T.C. 892 (1986)	1979	61	VA	$ 150,000	$ 0 or $ 1,000	$ 92,370	31%
C.W. Fannon, 842 F.2d. 1290 (4th Cir. 1988)[iii]	1979	308	VA	$ 236,752	$ 0	$ 121,781[iv]	36%
Stotler, T.C. Memo 1987-275	1979	1,584	CA	$ 1,065,000	$ 427,500	$1,065,000	91%
D.L. Fannon, T.C. Memo 1989-136	1978	142	VA	$ 158,682 or $ 285,842 or $ 303,110	$ 0	$ 65,860	37%
Higgins, T.C. Memo 1990-103	1981	23	MD	$ 110,000	$ 50,150	$ 103,000	44%
Schapiro, T.C. Memo 1991-128[v](two parcels)	1981 1984	165 30	MD	$ 375,000 $ 220,031	$281,000 $107,000	$ 375,000 $ 220,031	—[vi] —
McLennan, 24 C1. Ct. 102 (1991)	1980	170	PA	$ 452,818	$ 50,000	$ 223,260	—[vii]
Clemens, T.C. Memo 1992-436	1982	140	MA	$ 910,000	$ 0 or $350,000	$ 703,000	35%

Conservation Easement Valuation Cases	Year of Donation	Acres	Location of Land	Taxpayer's Valuation at Trial	IRS's Valuation at Trial	Court's Valuation	Diminution Percentage
Dennis, 92-2 USTC ¶50,498 (1992)	1980	83	VA	$ 50,610	$7,700	$ 50,610	42%
Schwab, T.C. Memo 1994-232	1983	1,558	CA	$ 825,000 or $ 550,000	$ 0	$ 544,000	—[viii]
Johnston, T.C. Memo 1997-475	1989	4,898	WY	$ 1,131,438	$407,000	$1,131,438	55%
Browning, 109 T.C. 303 (1997)	1990	52	MD	$ 518,000 or $ 563,000	$309,000 or $367,000	$ 518,000[ix]	77%
Strasburg, T.C. Memo 2000-94 (easement and amendment to easement)	1993 1994	320 N/A[x]	MT	$ 1,080,000 $ 290,000	$262,400 $ 0	$ 839,680 $ 290,000	32% N/A

i. The chart lists the reported cases involving the valuation of conservation easements encumbering land for purposes of the charitable income tax deduction under §170(h). The chart does not include cases involving historic preservation easements. With respect to each case, the chart indicates (when available): (i) the year of the donation of the easement, (ii) the number of acres encumbered by the easement, (iii) the state in which the land encumbered by the easement is located, (iv) the value or values asserted by the taxpayer at trial (which may differ from the value originally claimed on the taxpayer's tax return), (v) the value or values asserted by the IRS at trial (which may differ from the value originally claimed by the IRS in its notice of deficiency), (vi) the court's holding with respect to the value of the easement, and (vii) based on the court's holding with respect to the value of the easement, the percent by which the easement reduced the before-easement value of the land it encumbers.

ii. Affirmed 799 F.2d 243 (6th Cir. 1986).

iii. The Fourth Circuit modified the original Tax Court decision, C.W. Fannon v. Commissioner, T.C. Memo 1986-572.

iv. The Tax Court determined that the value of the easement was $90,957. The value set forth in the chart is the Fourth Circuit's holding with respect to the value of the easement on appeal.

v. The Tax Court's decision in *Schapiro* prompted the IRS to issue Action on Decision in John and Eleanor Schapiro v. Commissioner (AOD 1991-023), in which the IRS recommended "nonacquiescence" to the decision.

vi. Neither the before-easement nor the after-easement value of the property is provided in the Tax Court's opinion.

vii. The U.S. Claims Court does not directly determine the before-easement or after-easement values of the property in the course of its calculation of the easement value.

viii. *Schwab* is an anomalous case involving an easement donation by a taxpayer who essentially purchased from the landowner the right to donate the easement, together with other rights including hunting and fishing rights. The court's application of the before and after valuation method is rather confused, and it is impossible to determine a before-easement value for the land from the opinion.

ix. *Browning* involved a "bargain sale" of the easement for a purchase price of $309,000. Thus, the landowner's charitable income tax deduction was limited to $209,000.

x. The 1994 donation in *Strasburg* was an amendment to the easement donated in 1993. In the amendment the landowner relinquished certain development rights that she had retained in the 1993 easement. The court held that the landowner was eligible for a charitable income tax deduction under §170(h) with respect to the donation of the amendment.