Easement Drafting to Avoid Stewardship Tangles

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Stephen W. Lemon
Principal
Martin, Hopkins & Lemon, PC, Roanoke, Virginia

I would like to thank the Land Trust Alliance for allowing me to utilize some Land Trust Alliance prepared materials included in these materials for the sole purpose of presenting this program. Land Trust Alliance retains all copyright and other source rights in and to their materials.

My portion of the materials and presentation are focused on consideration of the following areas:

I. Issues surrounding the siting of retained rights for residences and other supporting buildings, other structures supporting permitted uses such as agriculture and location limitations such as building envelopes and no build zones

II. Issues surrounding the retention of donor rights to surface mine for the extraction of minerals

III. Limited in time ability to amend easements to avoid flaws related to extinguishment and boundary line adjustments pursuant to IRS Notice 2023-30

I. Issues surrounding the siting of retained rights for residences and other supporting buildings, other structures supporting permitted uses such as agriculture and location limitations such as building envelopes and no build zones.

The Internal Revenue Service ("IRS") has been using donor retained rights to make adjustments to easement boundaries as well as the use of indefinite or floating sites for the construction and maintenance of retained building rights as grounds for denying the deductibility of conservation easements.

In its attacks, the IRS cites the parallel requirements of Internal Revenue Code ("IRC") Section 170(h)(2)(C) requiring a restriction granted in perpetuity on the use which may be made of the real property and of Internal Revenue Code ("IRC") Section 170(h)(5)(A) requiring that the easement's conservation purposes are protected in perpetuity.

The line of cases from Belk v. Commissioner (United States Court of Appeals for the Fourth Circuit - case legally binding in Virginia), through Bosque Canyon Ranch v. Commissioner (Fifth Circuit) to Pine Mountain Preserve v. Commissioner (Eleventh Circuit) and Carter v. Commissioner (Eleventh Circuit), which was decided just last fall, are beginning to provide some clarity on the question of challenges to the deductibility of the easement based on retained building rights, but much is yet to be decided and uncertainty remains for both the donor and the holder.

This uncertainty leads to difficult discussions and decisions for both the donor and the holder and can lead to tension between the two. The uncertainty also leads to tension between the donor's desire for certainty regarding the Federal Tax deduction and the Virginia Land Preservation Tax Credits generated by the easement and the inability to predict with certainty the future location of all buildings which may be constructed in the future or the purpose for which the buildings will be needed as agricultural practices and other land uses permitted by the easement evolve.

The issues and the cases cited above are covered in more depth in the following pages.

Text of 26 United States Code Section 170 (h)

§170. Charitable, etc., contributions and gifts

(h) Qualified conservation contribution

(1) In general

For purposes of subsection (f)(3)(B)(iii), the term "qualified conservation contribution" means a contribution-

(A) of a qualified real property interest,

(B) to a qualified organization,

(C) exclusively for conservation purposes.

(2) Qualified real property interest

For purposes of this subsection, the term "qualified real property interest" means any of the following interests in real property:

(A) the entire interest of the donor other than a qualified mineral interest,

(B) a remainder interest, and

(C) a restriction (granted in perpetuity) on the use which may be made of the real property.

(3) Qualified organization

For purposes of paragraph (1), the term "qualified organization" means an organization which-

(A) is described in clause (v) or (vi) of subsection (b)(1)(A), or

(B) is described in section 501(c)(3) and-

(i) meets the requirements of section 509(a)(2), or

(ii) meets the requirements of section 509(a)(3) and is controlled by an organization described in subparagraph (A) or in clause (i) of this subparagraph.

(4) Conservation purpose defined

(A) In general

For purposes of this subsection, the term "conservation purpose" means-

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

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

(iii) the preservation of open space (including farmland and forest land) where such preservation is-

(I) for the scenic enjoyment of the general public, or

(II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy,

and will yield a significant public benefit, or

(iv) the preservation of an historically important land area or a certified historic structure.

(B) Special rules with respect to buildings in registered historic districts

In the case of any contribution of a qualified real property interest which is a restriction with respect to the exterior of a building described in subparagraph (C)(ii), such contribution shall not be considered to be exclusively for conservation purposes unless-

(i) such interest-

(I) includes a restriction which preserves the entire exterior of the building (including the front, sides, rear, and height of the building), and

(II) prohibits any change in the exterior of the building which is inconsistent with the historical character of such exterior,

(ii) the donor and donee enter into a written agreement certifying, under penalty of perjury, that the donee-

(I) is a qualified organization (as defined in paragraph (3)) with a purpose of environmental protection, land conservation, open space preservation, or historic preservation, and

(II) has the resources to manage and enforce the restriction and a commitment to do so, and

(iii) in the case of any contribution made in a taxable year beginning after the date of the enactment of this subparagraph, the taxpayer includes with the taxpayer's return for the taxable year of the contribution-

(I) a qualified appraisal (within the meaning of subsection (f)(11)(E)) of the qualified property interest,

(II) photographs of the entire exterior of the building, and

(III) a description of all restrictions on the development of the building.

(C) Certified historic structure

For purposes of subparagraph (A)(iv), the term "certified historic structure" means-

(i) any building, structure, or land area which is listed in the National Register, or

(ii) any building which is located in a registered historic district (as defined in section 47(c)(3)(B)) and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district.

A building, structure, or land area satisfies the preceding sentence if it satisfies such sentence either at the time of the transfer or on the due date (including extensions) for filing the transferor's return under this chapter for the taxable year in which the transfer is made.

(5) Exclusively for conservation purposes

For purposes of this subsection-

(A) Conservation purpose must be protected

A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

(B) No surface mining permitted

(i) In general

Except as provided in clause (ii), in the case of a contribution of any interest where there is a retention of a qualified mineral interest, subparagraph (A) shall not be treated as met if at any time there may be extraction or removal of minerals by any surface mining method.

(ii) Special rule

With respect to any contribution of property in which the ownership of the surface estate and mineral interests has been and remains separated, subparagraph (A) shall be treated as met if the probability of surface mining occurring on such property is so remote as to be negligible.

(6) Qualified mineral interest

For purposes of this subsection, the term "qualified mineral interest" means-

(A) subsurface oil, gas, or other minerals, and

(B) the right to access to such minerals.

Case Summaries for Belk v. Commissioner, Bosque Canyon Ranch v. Commissioner, Pine Mountain Preserve v. Commissioner and Carter v. Commissioner prepared by the Land Trust Alliance

assess the accuracy-related penalty under I.R.C. § 6662(a) because the taxpayer acted with reasonable cause and in good faith.

- November 2013 Update: In Mitchell II, the Tax Court held that Kaufman III did not affect the instant case, as the scope of that case was limited to the proper interpretation of the proceeds regulation and did not extend to the mortgage subordination regulation. In addition, the court rejected the taxpayer's argument that the mortgage was functionally subordinated to the conservation easement at the time of the gift because the taxpayer had sufficient funds to discharge the debt. Finally, the court noted the recent decision in Carpenter II in holding that the specific provisions of section 1.170A-14(g), including the mortgage subordination requirement, are mandatory and not merely a safe harbor.
- March 2015 Update: Showing deference to the IRS' interpretation of its own regulations, the 10th Circuit affirmed. The court held that § 1.170A-14(g)(2) unambiguously provides that subordination is a prerequisite to a deduction, and cannot occur after the donation. The 10th Circuit also agreed with the Tax Court that the remote future event standard of § 1.170A-14(g)(3) does not apply to the mortgage subordination requirement. Even if it did apply, the risk of a mortgage foreclosure would never be so remote as to be negligible. Furthermore, the 10th Circuit noted that Mitchell's argument about the applicability of the general remote future event standard would render meaningless the more specific subordination mandate.

- Analysis and Notes: Mitchell II is similar in many respects to Carpenter II, and the two cases are best read in tandem. For an earlier ruling that the possibility of foreclosure on a mortgage was not so remote as to be negligible, see Satullo v. Commissioner, below. However, the Satullo court reached that issue only because the mortgage subordination regulation was not in effect at the time.

- Belk v. Commissioner, 774 F.3d 221 (4th Cir. 2014)(Belk III), affirming 140 T.C. No. 1 (U.S.T.C. 2013)(Belk I) and T.C. Memo. 2013-154 (U.S.T.C. 2013)(Belk II)
  - State: North Carolina
  - Procedural Status: Case concluded.
  - Date: 2014
  - Keywords: Amendment; baseline documentation; changed conditions; charitable deduction; exchange; floating building area; golf course; Internal Revenue Code; land swap; private conservation easement; protected in perpetuity; qualified real property interest; savings clause; section 170(h); specific over general.
  - Summary of Facts and Issues: In the mid-1990's B.V. and Harriet Belk acquired and developed (through a limited liability company) a 410-acre residential community composed of 402 single-family house lots and a 185-acre golf course. The golf course was built in the middle of the residential development, and is not contiguous but lies in clusters throughout the residential development. In December 2004 the Belks donated a conservation easement on the golf course to the Smoky Mountains National Land Trust (now known as the Southeast Regional Land Conservancy). One provision of the easement allowed the landowner to substitute land outside of but contiguous with the original protected

property for equal or lesser portions of the original protected property. Such substitution would require SMNLT's approval, based on several different criteria such as no adverse effect on the conservation purposes of the easement or on any environmental features. At the same time, SMNLT's approval was not to be unreasonably withheld, and SMNLT must make a reasonable good-faith effort to help petitioners identify property that is appropriate for substitution. A separate provision in the easement's boilerplate section addressed amendments, and a so-called "savings clause" barred SMNLT from agreeing to any amendment that would disqualify the easement under § 170(h) and applicable regulations. After commissioning an appraisal, the Belks claimed a $10,524,000 charitable contribution deduction. The IRS challenged the deduction because of the substitution provision and on valuation grounds. In particular, the IRS argued that the substitution provision rendered the document a "floating easement," and as such it failed to constitute a "qualified real property interest" under I.R.C. § 170(h)(2)(C) because the restriction on the original protected property was not "granted in perpetuity."

- Holding: The Tax Court held that the conservation easement was not a "qualified real property interest" because the substitution provision allowed the grantor to change the protected property and thus the easement was not "granted in perpetuity" under I.R.C. § 170(h)(2)(C). The Tax Court seemed to suggest, albeit possibly in dicta, that under Treasury Regulation § 1.170A-14(c)(2), the only circumstance justifying removal of any portion of the protected property from the easement is if a "later unexpected change in the conditions surrounding the property… makes impossible or impractical the continued use of the property for conservation purposes." Unlike previous opinions and contrary to the IRS' arguments, the Tax Court went out of its way to distinguish the "granted in perpetuity" provision of § 170(h)(2)(C) from the "protected in perpetuity" provision in § 170(h)(5), with the latter focusing specifically on the conservation purposes. Hence, the Court concluded, although the language of the substitution provision might pass muster under § 170(h)(5) because the substitutions that would adversely affect the conservation purposes were prohibited, it did not meet the requirements of § 170(h)(2)(C).
  - July 2013 Update: In an opinion denying the taxpayer's motion for reconsideration, the Tax Court distinguished this case from the facts in PLR 200403044 and PLR 9603018. In both of these private letter rulings, the taxpayers reserved the limited right to establish building areas in the future on the protected property, subject to the holders' written approval. The Court wrote that "Belk I does not speak to the ability of parties to modify the real property subject to the conservation easement; it simply requires that there be a specific piece of real property subject to the use restriction granted in perpetuity." The Tax Court also affirmed that it was irrelevant "whether the parties could have substituted property by mutual agreement without a substitution provision," because the conservation easement did in fact contain such a provision. Finally, the Tax Court distinguished the instant facts from those in Commissioner v. Simmons, 646 F.3d 6 (D.C. Cir. 2011). In that case, the District of Columbia Court of Appeals held that a provision in a historic

preservation façade easement that allowed the holder to consent to changes in the façade did not render the easement ineligible under 170(h). The D.C. Circuit found that the provision was essentially surplusage because the holder had discretion to agree to change the façade or abandon the easement with or without the existence of the provision. And the D.C. Circuit found that an easement holder would only exercise such discretion at its peril, and was very unlikely to do so. In contrast, the Tax Court in Belk II seemed to suggest that the substitution provision was different because it limited the discretion of SMNLT to object to a substitution.

- December 2014 Update: The Fourth Circuit affirmed the Tax Court, holding that the substitution provision disqualified any charitable deduction. The appellate court found that the plain language of § 170(h)(2)(C), in particular the phrase "*the* real property" (emphasis added), required the identification of a specific parcel of land to be subject to the easement. Furthermore, the court noted that the substitution provision interferes with the integrity of the appraisal and baseline documentation processes, both of which are premised on a defined and static parcel. The court also observed that the Regulations contemplate very rare and narrow circumstances in which terminations or swap amendments can occur, and this very narrowness urges an interpretation that the original parcel be immutable in the document itself. The taxpayer's comparisons to Simmons and Kauffman were deemed inapposite, because those cases turned on the interpretation of perpetuity of purpose and enforcement in § 170(h)(5) and not identification of the protected property in § 170(h)(2)(C). Next, the Fourth Circuit rejected the taxpayer's argument that because North Carolina's conservation easement enabling statute permits amendment, that all easements in the state would fail to qualify. The court again drew a distinction between the substitution provision, which anticipates amending the protected property's boundaries from the outset, and a later swap amendment based on changed conditions. Finally, the court cited Commissioner v. Procter, 142 F.2d 824, 827-28 (4th Cir. 1944) and held that the "savings clause" did not trump the substitution provision because it was a "condition subsequent" clause that altered the gift following an adverse determination by the IRS or a court.

- Analysis and Notes: The specific holding that the substitution provision renders the easement ineligible under 170(h) is of minor import, because that kind of provision is very rare, if not unique, in modern conservation easement drafting. The bigger issue is to what extent these opinions shape the common law around when swap amendments are permitted. A swap amendment is an amendment by which some land is removed and other land is added to a conservation easement's protected property. A footnote in Belk III suggests that because of the word "exchange" in Treasury Reg. § 1.170A-14(c)(2), swap amendments are permitted only in the narrow circumstances set forth therein, i.e. "[w]hen a later unexpected change . . . makes impossible or impractical the continued use of the property for conservation purposes." Even before Belk I came out, land trusts were advised to consult an experienced land conservation attorney before engaging in any swap amendment. In the wake of Belk I, Belk II, and Belk III, that caution is all the

more warranted. Meanwhile, this series of opinions touches on the issue of whether and under what conditions building sites can be fluid when drafting an easement. In three Private Letter Rulings (see PLR 200403044, PLR 9603018, PLR 8240869), the IRS permitted floating building sites subject to certain protections and limitations, but those sites remained part of the conservation easement protected property, unlike the case here. Belk II expressly distinguished the first of those PLR's. An additional factor to consider in evaluating Belk is that golf course conservation easements have often been viewed skeptically by the IRS. See, e.g., RP Golf, LLC v. Commissioner, and Kiva Dunes Conservation, LLC v. Commissioner, both below.

- Reisner v. Commissioner, T.C. Memo 2014-230 (U.S.T.C. 2014)
  - State: New York
  - Procedural Status: Case concluded.
  - Date: 2014
  - Keywords: Appraisal; appraisal penalty; charitable deduction; façade easement; historic preservation easement; Internal Revenue Code; reasonable cause; retroactivity; section 170(h); valuation; zero value.
  - Summary of Facts and Issues: In 2004, Edward Reisner and his wife donated a historic preservation façade easement on their townhouse in Brooklyn to the National Architectural Trust (NAT). They claimed a $190,000 charitable contribution deduction, spread over the 2004, 2005 and 2006 tax years. The IRS challenged the deductions in their entirety and sought gross valuation misstatement penalties for each of the three years. Reisner represented himself *pro se* and eventually conceded that the easement had zero value. He also conceded that he made gross valuation misstatements on his 2004, 2005, and 2006 returns. Reisner and the IRS further stipulated that there would be no gross valuation misstatement penalty for 2004 or 2005 because of the reasonable cause exception of I.R.C. § 6664(c)(1) and (2), in effect before the enactment of the Pension Protection Act of 2006 (PPA). After these concessions, the parties disputed only whether Reisner was liable for gross valuation misstatement penalty for 2006. The Treasury Regulations contain a provision stating that the penalty-bearing portion of the underpayment in the carryover year is attributable to the gross valuation misstatement in the originating year. Reg. § 1.6662-5(c). Meanwhile, the PPA includes a provision that the elimination of the reasonable cause exception applies to "*returns filed* after July 25, 2006" (emphasis added). However, Reisner claimed that because the PPA amendments to section 170(h)(4) concerning façade easements were made effective for "*contributions made* after July 25, 2006" (emphasis added), the provision eliminating the reasonable cause exception should be construed to apply consistently.
  - Holding: The Tax Court held that the clear language of the PPA and the regulations require the imposition of penalties for 2006, dismissing the 170(h)(4) argument as a red herring. The court also cited Chandler v. Commissioner for the notion that the PPA amendment eliminating the reasonable cause exception was not retroactive, because the amended language was in effect when the taxpayers

income threshold, donate a conservation easement over any piece of property (farm or not) and offset all income, including the taxpayer's remaining 50 percent of nonfarm income for that year. On the other hand, a legitimate farmer who sells a conservation easement at a bargain sale (or makes another large real property sale in the same year) could miss being "qualified" because of the disparate impact of that single sale on the farmer's income that year. The Tax Court explicitly acknowledged the challenge but was compelled to follow the statutory language.

- Bosque Canyon Ranch, L.P. v. Commissioner, T.C. Memo 2015-130 (U.S.T.C. 2015), rev'd No. 16-60068, 774 F.3d 221 (5th Cir. Aug. 11, 2017)(Bosque Canyon Ranch II)
  - State: Texas
  - Procedural Status: Case concluded. Settled.
  - Date: 2017
  - Keywords: Appraisal penalty; baseline documentation; capital gain; charitable deduction; floating building area; disguised sale; Internal Revenue Code; private conservation easement; protected in perpetuity; qualified real property interest; reasonable cause; section 170(h); standard of review; substantial compliance; syndication.
  - Summary of Facts and Issues: In 2003, Bosque Canyon Ranch, a Texas partnership, purchased a 3,744-acre ranchland parcel for about $5 million and spent another $2.2 million on improvements over the next two years. In 2005, BCR began marketing limited partnership units at $350,000 per unit. Between October and December 2005, BCR received payments totaling $8.4 million from 24 land unit purchases. Each purchaser became a limited partner, and the partnership subsequently distributed to each limited partner a fee simple interest in an undeveloped five-acre "Homesite" parcel. The majority of the land was held for various outdoor amenities for use by the partners. The distribution of Homesite parcels was conditioned on BCR I granting a conservation easement to the North American Land Trust (NALT) on 1,750 acres of the ranch. BCR granted the easement in December 2005, excluding the Homesites from the easement. But the easement included a provision that the boundaries of the Homesite parcels (and by corollary the easement's internal boundaries with those Homesite parcels) could be adjusted, provided that any such adjustment could not "in [NALT's] reasonable judgment, directly or indirectly result in any material adverse effect on any of the Conservation Purposes" and that the area of each Homesite could not be increased. BCR received an appraisal valuing the easement at $8,400,000 -- the same amount as the total land unit sales. Between 2005 and 2007, BCR set up a separate partnership and structured a virtually identical development and conservation easement arrangement on another 1,732 acres of the ranch. The 2007 easement excluded 23 Homesite parcels and was appraised at $7,500,000. Following these various transactions, the 47 limited partners owned approximately 235 acres, and 3,482 of the remaining 3,509 acres were subject to either the 2005 or the 2007 easement. The IRS challenged the charitable contribution deductions on two separate grounds. First, it cited Belk to claim that

the boundary adjustment provision violated the requirement in § 170(h)(2)(C) that a specific parcel of real property be permanently protected by the easement. Second, it contended that the baseline documentation for each easement was inadequate to meet the requirements of Reg. § 1.170A-14(g)(5)(i). For example, one report included in the baseline for the December 2005 easement was dated March 2007 and thus was added 15 months after that easement's closing. Meanwhile, the Baseline for the December 2007 easement was not signed until November 2008. Furthermore, much of the data in each Baseline was current only as of April 2004, not the date of each easement's respective conveyance. Meanwhile, taking an additional angle, the IRS argued that the sale of partnership interests and subsequent distribution of Homesite parcels was a disguised sale under I.R.C. § 707 and, therefore, the partnerships owed capital gains tax on these transactions.

- Holding: The Tax Court ruled for the IRS in all respects. First, citing Belk, it held that the easements did not qualify for deductions because of the boundary adjustment provision. Second, the court said that the 2005 and 2007 baseline documentations were "unreliable, incomplete, and insufficient to establish the condition of the relevant property on the date the respective easements were granted." The court denied a substantial compliance contention made by the partnerships on the baseline issue. Third, the court held that the transactions between the partnerships and the limited partners were indeed disguised sales. Fourth, the court assessed gross valuation misstatement penalties under I.R.C. § 6662(h). For the 2005 donation, where a reasonable cause exception to the penalty was applicable, the court noted the poor baseline documentation practices in denying this exception.
  - November 2017 Update: In a 2-to-1 split decision, the Fifth Circuit reversed and remanded. As a preliminary matter, the Circuit held that the standard of statutory review for conservation easement deductions should be ordinary, rather than strict. Next, the Court was much more forgiving on the baseline issue, first noting that the Regulation's permissive rather than mandatory language as to what might be included in a baseline indicated an intent to be "flexible and illustrative rather than rigid." The Court determined that the wealth of maps, photos, and habitat reports that were included in the baselines was "more than sufficient to establish the condition of the property prior to the donation." In particular, the Fifth Circuit wrote: "The Tax Court's hyper-technical requirements for baseline documentation, if allowed to stand, would create uncertainty by imposing ambiguous and subjective standards for such documentation and are contrary to the very purpose of the statute. If left in place, that holding would undoubtedly discourage and hinder future conservation easements." Finally, the Court found that allowing limited changes to the internal boundaries was supportive of, and not inconsistent with, the perpetuity requirements of § 170(h). In a key section citing earlier D.C. Circuit and First Circuit appellate decisions, the Fifth Circuit wrote, "The common-sense reasoning that [*Simmons* and *Kaufman*] espoused, i.e., that an easement may be modified to promote the underlying conservation interests, applies equally here. The need for flexibility to address changing or

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unforeseen conditions on or under property subject to a conservation easement clearly benefits all parties, and ultimately the flora and fauna that are their true beneficiaries." The Fifth Circuit also noted approvingly that the homesites were generally clustered in a particular area of the protected properties around the only existing road, and thus it was highly unlikely that the boundary adjustment provision could be abused to allow the homesites to be scattered throughout the protected properties. Moreover, because the potential boundary adjustments were to homesites that were fully within the protected property's external boundaries, the Fifth Circuit distinguished the situation from the Fourth Circuit's decision in Belk v. Commissioner, 774 F.3d 221 (4th Cir. 2014)(Belk III), which held that limited "substitution" changes to the external boundaries of a conservation easement rendered the easement ineligible under § 170(h). One judge out of the three-judge panel filed a separate opinion, dissenting in part and concurring in part. After rejecting the majority's "impermissibly lax standard" for statutory interpretation, the dissent opined that the Bosque easements allowed for more than *de minimis* changes as to which property was protected and therefore failed the Belk test that "a conservation easement must govern a defined and static parcel."

- Analysis and Notes: November 2017 Update: Commentators are lining up to analyze this important case limiting the reach of Belk and Balsam Mountain. We will be watching for the other circuits to evaluate remaining cases in process. For a sampling of the commentary see: NALT, Misti Schmidt, Jonathan Bockian, S. Beaux Jones, Ronald Levitt and Michelle Abroms Levin, and Rob Levin.
  - Previous: This case is significant on a number of levels. First, it represents another application of the principles underlying Belk and Balsam Mountain Investments. (The holder here, NALT, was the same land trust involved in the recent Balsam Mountain Investments case and the 2009 Kiva Dunes case.) Second, the opinion breaks new ground in holding that an inadequate baseline documentation can defeat a tax deduction. Although other Tax Court rulings have touched on baseline issues, never before has the IRS taken direct aim at insufficient baseline practices. This case should be seen as a wake-up call for land trusts to make sure they finish complete and up-to-date baselines prior to closing an easement (See Practice 11B of *Land Trust Standards and Practices*). Third, although the disguised sale issue involves partnership law and is not specific to land conservation, it is nevertheless important to the land trust community because over the last few years a handful of conservation easement promoters have pushed dubious syndication schemes, attracting IRS concern. Typically, substantial overvaluation of the easement appraisal is a key part of these schemes. Here, although the transaction scheme with the limited partners was not a typical syndication because the partners actually received developable residential sites, the two easements combined were valued at $15.9 million but the aggregate purchase price and capital improvements to the property was only $7.17 million, indicating a substantial overvaluation. See the Alliance's Important Advisory: Syndication for more information regarding the need for heightened due diligence and documentation when encountering complex pass-through entity transactions,

especially with the additional factors present in this case of sales to multiple investors and multiples of deduction valuation over the purchase price in just a few years. For another recent disguised sale case, see SWF Real Estate, LLC. v. Commissioner, below.

- RP Golf, LLC v. Commissioner, T.C. Memo. 2012-282 (U.S.T.C. 2012)(RP Golf I); T.C. Memo 2016-80 (U.S.T.C. 2016)(RP Golf II); aff'd 860 F.3d 1096 (8th Cir. June 26, 2017)(RP Golf III)
  - State: Missouri
  - Procedural Status: Case concluded.
  - Date: 2017
  - Keywords: Charitable deduction; clearly delineated governmental policy; enabling statute; golf course; habitat; Internal Revenue Code; mortgage subordination; open space test; oral agreement; private conservation easement; section 170(f)(8); section 170(h); substantial compliance; title.
  - Summary of Facts and Issues: On December 29, 2003, National Golf Club of Kansas City, LLC (National Golf), a subsidiary of RP Golf, LLC, donated a conservation easement on a 277-acre property to the nonprofit Platte County Land Trust (PLT). RP operated two private golf courses on the protected property. The easement's granting provision stated that the grant was made "in consideration of the covenants and representations contained herein and for other good and valuable consideration." In a 2008 letter, PLT thanked RP Golf for the easement and included a statement that it did not provide any goods or services in exchange for the easement. The IRS challenged the deduction for lack of a contemporaneous written acknowledgment and for failure to meet the open space (§ 170(h)(4)(A)(iii)) or wildlife habitat (§ 170(h)(4)(A)(ii)) conservation purposes test. Furthermore, RP Golf did not obtain a written subordination of two mortgages that encumbered the protected property prior to the date of the easement execution. Rather, the subordinations were executed in April 2004 and retroactively made effective as of December 31, 2003, which was one day after the easements were recorded. RP Golf claimed at trial that the mortgagee banks had orally agreed to the easement conveyances before the execution of the easement, even though the mortgages required any such agreements to be in writing. Another issue addressed in the briefs was an alleged discrepancy over the boundaries of the protected property. The protected property was identified in the easement as comprising 277 acres, but included an area of land that National Golf, the easement grantor, was later found not to have owned. It appears that RP Golf inadvertently failed to include this area when it conveyed a deed to National Golf. In any event, RP Golf claimed a charitable deduction of $16.4 million based on an appraisal finding a before value of $17.4 million and an after value of $1 million. The appraisal assumed a protected property of 277 acres.
  - Holding: In a 2012 opinion the Tax Court held, following Simmons and Averyt and breaking with Schrimsher, that the conservation easement itself met the requirements of a contemporaneous written acknowledgment. Without expressly stating so, the easement as a whole made clear that no goods or services were received in exchange for the easement. The phrase "for other good and valuable

case even though the judge conceded in a footnote that the holder's after-easement track record on monitoring and enforcement should have little bearing on how an appraiser would value the easement as of the date of conveyance.

- Pine Mountain Preserve, LLLP v. Commissioner, 151 T.C. No. 14 (U.S.T.C. Dec. 27, 2018)(Pine Mountain I); T.C. Memo 2018-214 (U.S.T.C. Dec. 27, 2018)(Pine Mountain II); rev'd in part, aff'd in part, vacated and remanded, 978 F.3d 1200 (11th Cir. Oct. 22, 2020) (Pine Mountain III)
  - State: Alabama
  - Procedural Status: Case active. On remand to Tax Court.
  - Date: 2020
  - Keywords: Amendment; building areas; charitable deduction; enhancement; exclusively for conservation purposes; floating building area; highest and best use; inconsistent reserved rights; Internal Revenue Code; private conservation easement; protected in perpetuity; qualified real property interest; remoteness; structures; Uniform Conservation Easement Act; valuation.
  - Summary of Facts and Issues: Between 2004 and 2007, Pine Mountain Preserve LLLP (Pine Mountain) purchased 10 contiguous parcels consisting of 6,224 acres of undeveloped land in Shelby County. The total cost of these parcels was $37 million. Pine Mountain conveyed three separate conservation easements to the North American Land Trust (NALT), one each in 2005, 2006, and 2007. The various permitted rights for each easement were important to the Tax Court's analysis, and it is worth taking the time to understand these rights in detail. The 2005 conservation easement covered 559 acres over three noncontiguous parcels. The easement allowed for 10 one-acre Building Areas included as part of the defined protected property. The Building Areas were located within the geographic interior of the protected property, clustered around a man-made lake. A provision of the easement stated that the boundaries of the Building Areas could be adjusted by mutual agreement of Pine Mountain and NALT, so long as the size of the Building Areas was not increased and that the adjustment did not adversely affect the easement's conservation purposes, in NALT's reasonable judgment. One residence and various accessory structures (shed, gazebo, swimming pool, etc.) were permitted within each Building Area. In addition to the permitted rights within each Building Area, the 2005 easement allowed for a variety of other building rights. In particular, the owner of each Building Area could construct one 5,000 square-foot barn within 1,000 feet of each Building Area, which barn could include a residential unit for a caretaker. Each Building Area owner could also clear up to 10 acres outside the Building Area for the barn and riding stables and riding rings, and construct a boat storage building and pier. Separate from each Building Area owner's rights, the 2005 easement further allowed for three acres of clearing for two scenic overlooks, one of which could include a guest bedroom. Other permitted rights outside the Building Areas included establishing new ponds, septic systems, roads, trails, hunting stands, wells and water pipelines to service the Building Areas and abutting land outside of the easement area. Most or all of these additional reserved rights were subject to NALT's approval based on a conservation purposes standard. Finally, the

easement allowed for unlimited division subject to NALT's approval, which was not to be unreasonably withheld. The 2006 easement covered 499 acres over eight noncontiguous parcels and allowed for six one-acre Building Areas. Unlike the 2005 easement, where the Building Areas were initially fixed, in the 2006 easement the locations of the Building Areas were not specified, but rather were subject to NALT's future approval based on a conservation purposes standard. The remaining permitted rights in the 2006 easement were similar to the 2005 easement, including the additional barns and other structures. In addition, a water tower and underground water pipelines were permitted, subject to NALT's approval of the design and location. But no scenic overlooks, riding rings, boat storage buildings, piers, or ponds were permitted. In contrast, the 2007 easement covered 240 acres and did not allow for any Building Areas, nor did it allow for most of the other permitted rights in the 2005 and 2006 easements. All three easements contained a standard amendment provision, allowing for amendments that are "not inconsistent with the conservation purposes." Pine Mountain claimed charitable contribution deductions of $16.6 million, $12.7 million, and $4.1 million, respectively, for its donation of the three easements. At trial, Pine Mountain's appraiser claimed even higher values of $54.7 million, $33.6 million, and $9.1 million. In contrast, the IRS' appraiser found respective values of $1,119,000, $998,000 and $449,000.

- Holding: In an opinion written by Judge Lauber and joined by 10 other judges, the Tax Court held as follows: (1) The standard amendment provision in the easements did not violate the protected in perpetuity requirements of § 170(h). (2) The Court rejected the Fifth Circuit's distinction in BC Ranch II, L.P. between changes to the exterior geographic boundaries of the easement's protected property (as in Belk and Balsam Mountain) and changes to the interior boundaries (as in Bosque Canyon). (3) Similarly, the Court found that because the permitted structures within and around the Building Areas were so extensive, and did not have sufficient restrictions, there was no substantive distinction between an excluded building area (i.e., where the building area is not part of the defined protected property and is completely unencumbered by any of the easement's terms) and an included building area (where the building area is part of the easement's defined protected property and remains subject to some of the easement's terms). (4) Following these principles, the Court rejected the deductibility of the 2006 easement because it did not fix the initial location of the six Building Areas. (5) In a direct comparison to and repudiation of the 5th Circuit in Bosque Canyon, the Court rejected the deductibility of the 2005 easement because the land trust could permit a change in the Building Area boundaries. (6) The totality of the other permitted structures and surface alterations (including the roads, ponds, utility structures, and so forth) within and outside of the Building Areas also prevented the 2005 easement from constituting a "qualified real property interest" under I.R.C. §170(h)(2). (7) The 2007 easement was made "exclusively for conservation purposes," as the IRS did not present any contrary evidence that the reserved rights would impair the easement's purposes.
  - In a vigorous dissenting opinion, Judge Morrison disagreed with the reasoning of holding (1) and disagreed outright with holdings (3), (5), and

(6). In particular, the dissent charged the majority with ignoring the distinctions between an included building area and an excluded building area. The dissent further reasoned that the majority conflated the distinct analyses under § 170(h)(2)(C) and § 170(h)(5)(A). In this view, all of the additional permitted rights that troubled the majority should have been relevant only to the § 170(h)(5)(A) inconsistent uses analysis and not to the § 170(h)(2)(C) qualified real property analysis. Applying these principles, Judge Morrison found that the 2005 easement did not permit inconsistent uses whereas the 2006 easement did. The dissent emphasized that the 10 Building Areas in the 2005 easement were relatively clustered in an already disturbed area that was not sensitive habitat, according to the unrebutted testimony of a NALT biologist.

- In Pine Mountain II, Judge Morrison ruled that the 2007 easement had a fair market value of $4,780,000. The Tax Court agreed with the taxpayer in concluding that it was reasonably probable that the property would be rezoned for development and thus the highest and best use before the easement was for development and the IRS' before value was low by several million dollars. However, the Court also found that the taxpayer's appraiser had significantly overvalued the conservation easement at $98,000 per acre, nearly 50 times higher than the IRS appraisers' per-acre valuation. The Court reasoned that because the development potential of the underlying property was so high, a before-and-after valuation would price the easement out of the market, and thus an exception to the before-and-after general rule was warranted. Moreover, the Court found that the taxpayer had not sufficiently considered the enhancement effect on the abutting unprotected property owned by the taxpayer. Because each appraiser's errors were of the same magnitude and roughly proportional, the Court arrived at a value of $4,780,000, equal to 50% of the taxpayer appraiser's $9,110,000 value plus 50% of the IRS appraiser's $449,000 value.
- November 2020 Update: In a highly anticipated decision, the 11th Circuit reversed the Tax Court's holding on building areas, affirmed on the amendment provisions, and vacated and remanded on valuation. In particular, the 11th Circuit held as follows: (1) Both the 2005 easement and the 2006 easement satisfied the granted-in-perpetuity test of § 170(h)(2)(C) because each was a broad "restriction" that applied to the entire protected property, even if they carved out certain exceptions through the use of building areas. Barring some express time limitation or reversionary provision, the easements must be seen as "perpetual" under the common law definition of the word. (2) The Tax Court's and IRS' interpretation of § 170(h)(2) defied the statute's straightforward language and would render § 170(h)(5)(A)'s protected-in-perpetuity provision superfluous. The 11th Circuit rejected the Tax Court's Swiss Cheese analogy, borrowed from the BC Ranch II opinion, in which the building areas constituted holes in the cheese. Rather the 11th Circuit found that the better analogy was to Pepper Jack, where the building areas remained

subject to the terms of the easement, and did not alter the exterior boundaries. If the IRS or Tax Court seeks to challenge the *quality* of a conservation easement, that analysis is properly channeled through § 170(h)(5)(A), not § 170(h)(2)(C), as suggested by Example 4 in the Treasury Department regulations, § 1.170A-14(f) Ex. 4. (3) The 2005 and 2006 easements were nothing like the easement in Belk but rather were similar to those in BC Ranch II because the building areas could be moved only within the fixed exterior boundaries of the protected property. (4) The 11th Circuit remanded to the Tax Court to decide whether the 2005 and 2006 easements satisfy § 170(h)(5)(A)'s protected-in-perpetuity requirement. (5) The amendment provisions were consistent with the protected-in-property requirement of § 170(h)(5)(A). Under basic contract law, any document is amendable whether or not it contains an amendment provision; if the mere possibility of an amendment foreclosed a deduction, then there would be no such thing as a deductible conservation easement. The possibility that a typical land trust holder would agree to a detrimental amendment is so remote as to be negligible, the standard under § 1.170A-14(g)(3). (6) The Tax Court took too many shortcuts in its valuation analysis, and the 11th Circuit remanded for a "discernible methodology" that more closely hews to the comparable sales approach, as required by the governing regulations. In other words, it was unreasonable for the Tax Court to assume without explanation that each party's errors cancelled each other out in equal measure.

- Analysis and Notes: The 11th Circuit's opinion is a significant victory for the broader land conservation movement, and closely follows the analysis urged by the Land Trust Alliance's amicus briefs in this case. Moreover, the 11th Circuit's analysis here sets up the taxpayers for another win in Carter, a related case pending before the same court. What remains to be seen is whether the IRS will now back off its aggressive and unsupported arguments around building areas and amendment provisions. Land trusts and easement donors operating outside of the 5th Circuit (Texas, Louisiana, and Mississippi) and the 11th Circuit (Georgia, Alabama, and Florida) should still exercise caution until we have a clearer sense of the IRS' next steps. It's worth nothing that in two separate footnotes, the 11th Circuit recommended a deferential approach to land trust easement holders in exercising their discretion to approve or deny a landowner's request. For example, the court noted that NALT was "a sophisticated land-conservation organization, and we have little doubt that when it comes to negotiating conservation easements, it is well positioned and equipped to look after conservation interests." For more analysis of the 11th Circuit's important opinion, see the Alliance's newly updated *Pointers for Balancing Risk When Permitting Structures on Deductible Conservation Easements After the Tax Court Decisions in Pine Mountain Preserve and Carter* (behind paywall for Alliance members). And see additional commentary here.

- Oconee Landing Property, LLC v. Commissioner, No. 11814-19 (U.S.T.C. Aug. 18, 2020)(Order Denying Summary Judgment)

million and the after-easement value was $6.4 million, resulting in an easement value of $7.9 million.

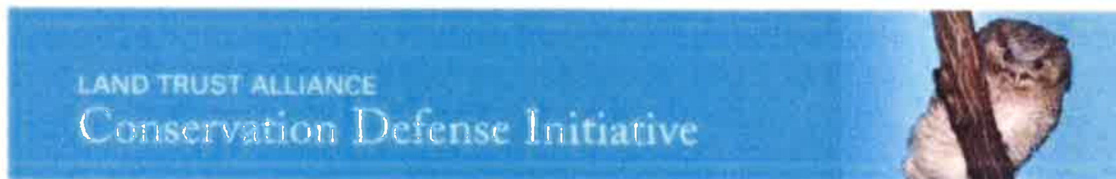
- Analysis and Notes: The 11th Circuit's opinion established significant precedent by fleshing out the habitat and scenic view prongs of the conservation purposes test, and provided a sharp check on the Tax Court's narrower reading of the Regulations. Easement donors and their attorneys should read this opinion carefully to learn lessons on how to document the presence of significant habitat and scenic views. Meanwhile, a similar golf course easement case that was on appeal, Atkinson (see below), was settled by the parties and voluntarily dismissed by the court the same week as the Champions II opinion was handed down.
  - **November 2022 Update: Both Clark and Wingard have been involved in many challenged easement deductions featuring inflated appraisals. And Clark has been a defendant in several fraud and malpractice actions See, e.g., United States v. Zak. Moreover, as a result of IRS scrutiny, Clark surrendered his appraisal license in 2019, several years after performing the appraisal and serving as expert witness in this case. However, the IRS did not raise the issue of either appraiser's checkered past in its briefs, and the Tax Court noted that it did not consider the matter in its opinion. The opinion also comments that although Clark's analysis was not especially compelling, it was still more reliable and coherent than the IRS witness' work. The IRS does not appear to have put its best foot forward in this case.**

- **Carter v. Commissioner, T.C. Memo 2020-21 (U.S.T.C. Feb. 3, 2020), aff'd No. 20-12200 (11th Cir. Sept. 14, 2022)**
  - State: Georgia
  - **Procedural Status: Case active. Remanded to Tax Court**
  - **Date: 2022**
  - Keywords: Appraisal; appraisal penalty; building areas; charitable deduction; floating building area; inconsistent reserved rights; Internal Revenue Code; private conservation easement.
  - Summary of Facts and Issues: In 2005, Dover Hall Plantation, LLC (then owned entirely by Nathaniel Carter), purchased a 5,245-acre tract in Glynn County. In 2011, the LLC conveyed to North American Land Trust (NALT) a conservation easement over 500 acres at the western edge of the parcel. The easement's purposes were to protect wildlife habitat and open space (both scenic views and pursuant to a clearly delineated governmental policy). Under the easement the LLC retained the right to build a single-family dwelling on each of 11 two-acre building areas, which were included as part of the protected property. The locations of the building areas were not fixed in the easement, but rather were to be determined in the future, subject to NALT's approval based on a determination that the locations did not have any material adverse effect on the conservation purposes. The IRS challenged the deduction on a variety of grounds and assessed appraisal penalties. Among the claims by the IRS was that the unfixed floating nature of the building areas disqualified the easement under I.R.C. § 170(h)(2)(C).

- Holding: Further extending the ruling in Belk v. Commissioner that a conservation easement must have fixed boundaries in order to qualify as perpetually protected under § 170(h)(2)(C), the Tax Court denied the deduction. As in Pine Mountain Preserve, the Carter opinion held that if the reserved rights within a building area were extensive, the Tax Court would consider the building area as unprotected for all intents and purposes, thus obliterating the distinction between an included and excluded building area.
  - **November 2022 Update: As expected, the 11th Circuit followed its holding in Pine Mountain Preserve and remanded to the Tax Court for a determination on whether the conservation easement satisfied § 170(h)(5)(A)'s "protected in perpetuity" requirement. This portion of the opinion was one paragraph long and did not contain any new substantive analysis.**
- Analysis and Notes: This case follows on the heels of Pine Mountain Preserve, and the Tax Court's opinion frequently refers to that case. Unfortunately, the Carter opinion causes additional uncertainty by using conflicting language about whether the opinion is limited to fully floating building areas or encompasses all building areas of any kind, and conflating the analysis under § 170(h)(2)(C) and § 170(h)(5)(A). As a result, land trusts will want to advise landowners of the heightened risks around building areas, at least until the appeals conclude. For more on this topic on the Alliance's Learning Center, see *Pointers for Balancing Risk When Permitting Structures on Deductible Conservation Easements After the Tax Court Decisions in Pine Mountain Preserve and Carter.*

- **IRS CCA 202236010, (September 17, 2022)**
  - **State: None**
  - **Procedural Status: Case concluded.**
  - **Date: 2022**
  - **Keywords: Charitable deduction; Internal Revenue Code; mineral rights; private conservation easement; protected in perpetuity.**
  - **Summary of Facts and Issues: This memorandum from the IRS Office of Chief Counsel addressed the following question: Does a conservation easement satisfy the requirements of § 170(h) if the donor of the easement retains a qualified mineral interest, the ownership of the surface estate and mineral interest has never been separated, and under the terms of the deed the donor can use a surface-mining method to extract the subsurface minerals with the donee's approval?**
  - **Holding: The IRS ruled that if the conservation easement permits the owner of an unsevered mineral interest to extract or remove minerals by any surface-mining method, then the conservation easement does not qualify for a deduction under § 170(h) because it fails to satisfy the prohibition on surface-mining methods in § 170(h)(5)(B)(i). Donee approval of the surface-mining method does not rectify the problem. And echoing the holding of Great Northern Nekoosa Corp. v. U.S., 38 Fed. Cl. 645, 649-50 (1997), Reg. §1.170A-14(g)(4)(i), which provides an exception to the disallowance rule where the impact of the mining has a limited, localized impact and is not**

Land Trust Alliance Practical Pointer Pamphlet on Permitted Structures



Pointers for Balancing Risk When Permitting Structures on Deductible Conservation Easements After Tax Court and Appellate Decisions

Summary
Two U.S. Tax Court decisions in the cases of *Pine Mountain Preserve* (2018) and *Carter* (2020) raised questions regarding the permitted extent, use, size and location of building rights in deductible conservation easements, including bargain sales. The U.S. Court of Appeals for the 11th Circuit reversed the *Pine Mountain Preserve* building rights decision in its opinion dated October 22, 2020, *Pine Mountain Preserve, LLLP v. Commissioner*, No. 19-11795 (11th Cir. 2020).

In both cases, the Tax Court said that certain building areas or other structures or surface alteration rights permitted in conservation easements under certain circumstances (but not all) violate the *granted* in perpetuity requirements of the U.S. Tax Code §170(h)(2)(C). The 11th Circuit disagreed unambiguously and reversed and remanded the *Pine Mountain Preserve* building rights decision for a revised opinion from Tax Court consistent with its ruling to decide *Pine Mountain Preserve* under the *protected* in perpetuity requirement of IRC §170(h)(5)(A). The 11th Circuit decision is binding legal precedent for cases in Alabama, Georgia and Florida and strong persuasive authority in other jurisdictions, especially when read together with the earlier opinions on *Champions Retreat* from the 11th Circuit and *Bosque Canyon Ranch* from the Fifth Circuit. See the discussion below for details.

The *Carter* decision by the U.S. Tax Court is on appeal before the 11th Circuit, but we do not have a decision yet. The October 2020 decision in *Pine Mountain Preserve* suggests that the 11th Circuit seems likely to reverse and remand *Carter* as summarily. Whether the IRS will apply this decision outside the 11th Circuit is unknown.

Donors, their attorneys and land trusts must take these decisions into account when deciding whether and how to permit appropriate building rights, including siting building areas and permitting structures and surface alterations outside of building areas. Land trusts should urge landowners to seek qualified tax counsel regarding these cases, as well as all other tax technical and substantive requirements.

The Land Trust Alliance has taken steps to address this situation on behalf of its members both with the IRS and the U.S. Treasury, and by filing friend of the court briefs in Tax Court and appellate courts. We do not yet have a definitive resolution on either the *Pine Mountain Preserve* or the *Carter* appeals it may take some time to resolve these issues fully. While we continue to press our case in the courts, **please evaluate your easement template with your land trust attorney in light of the issues and options below**.

Pointers for Balancing Risk on Permitted Structures

The background and details underpinning the Pointers below follow in the next pages. The Risk Spectrum at the end lays out the various approaches across a spectrum from lower risk to higher risk to non-deductibility of the easement. The case summaries and the following Pointers reflect *Land Trust Standards and Practices* and can help drafters avoid IRS challenges while addressing uncertainty and future needs in light of the *Pine Mountain Preserve* and *Carter* decisions. This Pointer should also help land trusts adapt their easement template as needed, based on the particular land values, facts, circumstances and risk tolerance of the parties, and avoid unnecessary changes based on short-term uncertainty.

Drafting Pointers Summary

(1) *Avoid any specific boundary adjustment or land substitution provision in your conservation easements.*
(2) *Evaluate the risks of building area relocation and fully floating building rights.*[1]
(3) *Avoid inconsistent or excessive permitted structures.*
(4) *Assess the additional risk from partially floating included building areas.*[2]
(5) *Consider the risks of excluding or including building areas.*
(6) *Evaluate the full range of building area options when considering risk.*
(7) *Consider slightly larger or multiple small building areas to add flexibility.*
(8) *Consider alternative included building areas.*
(9) *Fix the location of any major structures and surface alterations outside of building areas.*
(10) *Cluster building areas regardless of exclusion or inclusion in the easement.*
(11) *Document how the building areas support the conservation purposes and perpetual restrictions.*
(12) *Protect intact blocks of undeveloped land, not interstitial areas between developed lots.*
(13) *Combine conservation purposes and holder's sole discretion as the approval standard.*
(14) *Address errors or problems by a post-conservation easement minor boundary adjustment or relocation of building areas, if necessary, consistent with the land trust's amendment policy.*

Background to *Pine Mountain* and *Carter*

In the December 2018 *Pine Mountain Preserve* decision, the U.S. Tax Court ruled that certain provisions regarding building areas and other permitted rights disqualified the deductibility of two separate conservation easements. The 11th Circuit disagreed unambiguously and reversed and remanded the *Pine Mountain Preserve* building rights decision for a revised opinion from Tax Court consistent with its ruling. The *Carter* appeal remains open. In its February 2020 decision in *Carter*, the Tax Court expanded on this prior ruling, especially with respect to fully floating building rights.

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[1] For consistency throughout this document, "fully floating building rights" are those building rights that a landowner may elect to place anywhere on the conserved land. The conservation easement may specify that the land trust must approve the landowner's selection, and may specify other considerations in the land trust evaluation or in the landowner selection, but the fundamental right to build anywhere remains.

[2] For consistency throughout this document, "partially floating included building areas" are those with significant spatial limits on the location where a landowner may select later to build. Usually the spatial limits are within a constrained but somewhat larger building area in which a landowner may select a minor portion of that larger area in which to build a limited number and type of structures subject to land trust prior written approval and subject to consistency with the conservation easement purposes.

Pointers for Balancing Risk on Permitted Structures

Three earlier cases led to the Tax Court's decision in *Pine Mountain Preserve.* These cases dealt with similar issues, starting with the *Belk* (2013) decisions, where the Tax Court held, and the Fourth Circuit affirmed, that a conservation easement did not qualify for a federal income tax deduction because it included a land substitution provision.

In *Belk,* the provision allowed the landowner to substitute land outside, but contiguous with, the original protected property for equal or lesser areas of land within the original protected property. Any such substitution required the easement holder's approval, which the land trust could not unreasonably withhold. It was based on several different criteria, such as no adverse effect on the conservation purposes of the easement or on any environmental features.

The IRS contended, and the courts agreed, that this substitution provision rendered the restrictions a "floating easement," and as such, it failed to constitute a "qualified real property interest" under Internal Revenue Code (IRC) §170(h)(2)(C) because the restriction on the original protected property was not "granted in perpetuity."

When the Fourth Circuit affirmed the *Belk* decision, the court framed its ruling to state that there must be a "specific piece of real property" identified in the easement in order to qualify under §170(h)(2)(C). Also in *Belk,* the Tax Court stated that it was *not* opining on the conditions under which the land trust might later review a request to amend the conservation easement boundaries. Therefore, most practitioners view *Belk* in the limited and narrow context of its unusual substitution provision on the external boundary of the easement.

Balsam Mountain followed *Belk* in 2015. The Tax Court extended the *Belk* holding to a substitution provision with even more conditions but still found it noncompliant. The *Balsam Mountain* easement included a provision that allowed for limited adjustments to the external boundary of the protected property. These adjustments had to meet the following conditions:

(1) No net loss of acreage to the easement's protected property
(2) Any land added to the protected property had to be contiguous to the rest of the protected property
(3) Any land added to the protected property had to have an equal or greater contribution to the conservation purposes than the removed land
(4) The aggregate land removed from the protected property could not exceed 5 percent of the original acreage
(5) The adjustment had to have be made within five years of the easement's original grant date
(6) The holder could reject the adjustment if it resulted in a material adverse effect on the conservation purposes

Even with these additional limitations, the Tax Court ruled that the easement did not qualify for a charitable deduction because, as in *Belk*, there was no specified "qualified real property interest" as required by §170(h)(2)(C).

Bosque Canyon followed later in 2015, and the Tax Court again extended *Belk* on different facts related to the boundaries of building areas excluded from the easement's defined protected property, but located within the geographic perimeter of the protected property.[3] In *Bosque Canyon*, the Tax Court disallowed deductions for two easements because of a provision allowing for adjustments to the boundaries of 47 five-acre "Homesite Parcels" that were clustered in an area inside of the exterior perimeter boundary of the protected property. The adjustment provision prohibited any material adverse effect on any of the conservation purposes and prohibited any increase in size of a Homesite Parcel.

However, the Fifth Circuit reversed in a split two-to-one decision in 2017, finding that allowing limited changes to the boundaries of the excluded Homesite Parcels was supportive of, and not inconsistent with, the perpetuity requirements of §170(h).

In a key section citing earlier D.C. Circuit and First Circuit appellate decisions, the Fifth Circuit wrote, "The common-sense reasoning that [*Simmons* and *Kaufman*] espoused, i.e., that an easement may be modified to promote the underlying conservation interests, applies equally here. The need for flexibility to address changing or unforeseen conditions on or under property subject to a conservation easement clearly benefits all parties, and ultimately the flora and fauna that are their true beneficiaries."

The Fifth Circuit also noted approvingly that the *Bosque Canyon* easement generally clustered Homesite Parcels around the only existing road, and thus it was highly unlikely that the adjustment provision could be abused to allow the Homesite Parcels to be scattered throughout the protected property. Moreover, because the potential boundary adjustments were to areas that were fully located inside the protected property's exterior boundaries, the Fifth Circuit distinguished the situation from the Fourth Circuit's decision in *Belk*. In a dissenting opinion, a Fifth Circuit judge failed to see any material distinction between adjustments to the exterior perimeter boundaries of the protected property and those made to the interior boundaries of the protected property where there are exclusions, as in *Bosque Canyon*.

What the *Pine Mountain Preserve* and *Carter* cases say

Together, *Belk*, *Balsam Mountain* and *Bosque Canyon* frame the Tax Court's decision in *Pine Mountain Preserve*. The court cited these cases specifically in *Carter*. With respect to building areas and other permitted rights, the Tax Court articulated six major holdings together in *Pine Mountain Preserve* and *Carter*, as follows:

(1) Contrary to the Fifth Circuit holding in *Bosque Canyon*, the decision in *Pine Mountain Preserve* states that there is no distinction between changes to the exterior boundaries of the easement's protected property (as in *Belk* and *Balsam Mountain*) and changes to the

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[3] For consistency throughout this document, "excluded" building areas are those located completely outside the protected property description in an easement and not restricted in any way. Conversely, "included" building areas are a part of the protected property but permit some limited structures and may have lighter restrictions. With respect to building areas, an "exterior" building area is sited outside the boundaries of the protected property but may have some restrictions imposed by a nondeductible easement or deed restrictions. An "interior" building area is sited entirely within the perimeter of the protected property. Using these definitions, the Homesite Parcels in *Bosque Canyon* were *excluded* and interior, while the building areas in *Pine Mountain* were *included* and interior.

Pointers for Balancing Risk on Permitted Structures

interior boundaries of the protected property (as in *Bosque Canyon,* where the interior exclusions could be shifted).

(2) Similarly, in *Pine Mountain Preserve*, the Tax Court found that because the permitted structures within and outside of the building areas were so extensive and did not have sufficient restrictions, there was no substantive distinction between excluded and included building areas.

(3) Following these principles, the Tax Court rejected the deductibility of the 2006 *Pine Mountain Preserve* easement because it did not fix the initial location of the six building areas. This was also the case for the 11 fully floating building areas in *Carter.*

(4) In a direct comparison to and repudiation of the Fifth Circuit in *Bosque Canyon*, the Tax Court rejected the deductibility of the 2005 *Pine Mountain Preserve* easement because the express modification provision allowed the land trust to approve a change in the location of the interior included building areas.

(5) The totality of the other permitted structures and surface alterations (including roads and ponds, utilities and so forth) within and outside the building areas also prevented the 2005 *Pine Mountain Preserve* easement from constituting a "qualified real property interest" under IRC §170(h)(2). This was also the case in *Carter*, although the opinion did not delve into this issue.

(6) The court in the *Carter* case took the next step of holding that fully floating building areas are inconsistent with perpetuity under §170(h)(2)(C). Furthermore, the *Carter* opinion causes additional uncertainty by using conflicting language about whether the opinion is limited to fully floating building areas or encompasses all building areas of any kind. As a result, land trusts will want to advise landowners of the risks of included building areas at least until the appeals conclude.

The Appeals

In the appeal of *Pine Mountain Preserve,* the 11th Circuit reversed the Tax Court, unambiguously stating two separate tests for the two separate sections of the regulations, requiring on remand that the Tax Court examine the conservation easement under the *protected* in perpetuity standard (5(A)), not the *granted* in perpetuity standard (2(C)) that the Tax Court used in its original analysis.

We can expect the IRS to continue to audit conservation easements. It is likely that the IRS will examine building rights closely along with other clauses that have been the subject of litigation. The Tax Court tends to disregard appellate decisions with which it disagrees unless subject to the appellate court's jurisdiction. See discussion of *Bosque Canyon* above. Additional cases are likely to refine these issues further in Tax Court and in the appellate courts.

For example, in another appeal decided by the 11th Circuit in *Champions Retreat Golf Founders, LLC v. Commissioner of IRS*, No. 18-14817 (11th Cir. May 13, 2020), the 11th Circuit vacated the Tax Court opinion and remanded the case, holding that, as used in Reg. §1.170A-14(d)(3)(ii), "rare," "threatened" and "endangered" species are not precise technical terms. Instead, the regulation calls for a "flexible" reading. The 11th Circuit's opinion establishes significant precedent by defining the habitat and scenic view prongs of the conservation purposes test and provides a sharp check on the Tax Court's narrower reading of the regulations. While not

turning on the perpetuity standards in 5(A) and 2(C), *Champions Retreat* still affects the Tax Court's overall analysis of the Code and Regulations. The taxpayers in *Carter* also appealed to the 11th Circuit.

If your donors or their advisers fear an IRS audit, they can reduce audit risk of the easement transaction by ensuring the appraisal value is moderate and fully substantiated, having fully substantiated documentation of the entire easement transaction and, finally, drafting all clauses with conservation purposes as the first priority. This includes specified limited permitted rights that comply with §170(h) and are consistent with the stated conservation purposes. Avoid fully floating building rights, especially residential and appurtenant residential ancillary structures. Also avoid numerous structures sited anywhere outside of building areas, especially structures ancillary to residential uses.

Clearly document in the conservation easement -- and further explain in the baseline documentation report -- how the perpetual easement restrictions limit inconsistent uses within any building areas. Also, explain in the easement and in the baseline how the building areas are consistent with and support the land trust's ability to protect the conservation purposes and restrictions in perpetuity across the entire protected property.

The following Pointers will assist drafters and land trust personnel in designing permitted building rights in conservation easements where the landowner intends to take a tax deduction. Land trusts may wish to consider some of the following alternatives, worded as developed by your attorney, staff and board and informed by your state law, policies and experiences. Even with the 11th Circuit reversal and remand, and the additional clarity the 11th Circuit provided in its review of the plain language of the Tax Code and Regulations, some risk remains in drafting building rights. Uncertainty remains as well for land located outside the jurisdiction of the 11th Circuit.

1. *Avoid any specific exterior boundary adjustments or exterior land substitution provisions in your conservation easements.*
   - Even with numerous limitations on a substitution provision in the easement that allows boundaries or building areas to move, the IRS is likely to challenge it, and the Tax Court is likely to disallow the deduction based on *Belk,* regardless of the 11th Circuit *Pine Mountain Preserve* decision.
   - The absence of an express adjustment or substitution provision does not mean that the land trust can never adjust the boundaries of a conservation easement or a building area. As the Tax Court stated in *Belk II*, "*Belk I* does not speak to the ability of parties to modify the real property subject to the conservation easement; it simply requires that there be a specific piece of real property subject to the use restriction granted in perpetuity." The *Pine Mountain Preserve* and *Carter* decisions did not upset this holding. The general amendment and termination provisions apply to any adjustment proposal.
2. *Evaluate the risks of including building area relocation rights and fully floating building rights in your conservation easements.*

Pointers for Balancing Risk on Permitted Structures

- Fixed excluded building areas, fixed exterior or interior included building areas with nondeductible easements or deed restrictions overlaid on the building areas (to prevent subdivision, for example) may be lower risk outside of the jurisdiction of the 11th Circuit. Remember that the IRS may be likely to disallow these based on the *protected* in perpetuity standard (5A). The IRS may assert that reserved building rights are inadequate to *protect* the conservation values identified in the easement in perpetuity. Until all these issues are fully resolved, land trusts, donors and attorneys should consider this risk.

3. *Avoid inconsistent or excessive permitted structures.*
   - Inconsistent permitted rights are a specified factor in determining whether an easement actually protects conservation purposes in perpetuity under §170(h)(5) and Reg. §1.170A-14(e)(2).
   - Neither the Tax Court in *Pine Mountain Preserve* nor the Regulations establish any measurable formula or rubric for determining when permitted rights are excessive and, thus, specific guidance is not possible. However, the Alliance expects the IRS to continue pressing novel interpretations of both the *granted* in perpetuity (2C) standard, as well as new interpretations of the *protected* in perpetuity (5A) standard, which may include disallowance in full of agricultural, forestry and residential uses as inconsistent uses. Although the vast majority of land trusts already appropriately limit the scope of landowner rights, use extra caution with any permitted building rights, unsited structures or other surface alterations, as well as agricultural and forestry uses and structures.
   - Limit permitted structures to protect the conservation purposes and to minimize or eliminate the opportunity for adverse impact to the conservation purposes and perpetual restrictions, including within building areas. Land trust approval of locations and consistency of all structures with the conservation purposes was not sufficient in *Pine Mountain Preserve* or in *Carter* to assure the Tax Court that the easement was restrictive enough to protect perpetual conservation. But it was sufficient for the 11th Circuit who stated affirmatively its assessment that conservation holders have strong incentives to uphold conservation easements.
   - Document the compatibility of any permitted building rights with the conservation purposes and perpetual conservation restrictions.
4. *Assess the additional risk from partially floating included building areas.*
   - In a typical partially floating building area, the easement identifies a portion of the protected property (sometimes called a "potential building area," a "future building area" or a "building zone") within which the landowner, with the holder's prior approval, may delineate a specific included building area later in time.
   - Since *Belk,* a partially floating *excluded* building area (even if subject to holder approval) has been risky. The Tax Court decisions in *Pine Mountain Preserve* and *Carter* increased the risk to a partially floating *included* building area. The 11th Circuit opinion in *Pine Mountain Preserve* may reduce the risk of a fully or partly floating building area, but the land trust should document that alternative locations will protect conservation values to the same degree and not adversely affect the appraised value of the property as determined by the appraiser's analysis of the highest valued site.
   - In Belk II, denying the taxpayer's motion for reconsideration, the Tax Court distinguished *Belk* from the facts in PLR 200403044 and PLR 9603018. In both of these private letter

rulings, the taxpayers reserved the limited right to establish building areas in the future on the protected property, subject to the holder's written approval and consistency with the conservation purposes. The Tax Court's holding in *Pine Mountain Preserve* appears to directly overturn these nonbinding PLRs, as well as conflict with a specific example in the Regulations, see Example 4, §1.170A-14(f). The *Carter* opinion attempts to justify and distinguish Example 4, which is a subject of contention on appeal. The 11th Circuit in the *Pine Mountain Preserve* case, however, specifically reversed the Tax Court on these points.

5. *Consider the risks of excluding or including building areas.*
   - Work closely with your attorney to assess each easement on the individual attributes of the land and then determine what method of providing for building areas is most advisable overall.
   - Documentation of the conservation reasons that support and protect the stated conservation purposes and the remaining restrictions in any building area is more critical than ever.
   - Whether it is now safer to exclude building areas from the protected property than to include them is unknown. Factors to consider include where, how many, for what purpose and the effect on perpetual restrictions and conservation purposes.
   - If using included building areas, the relatively lighter restrictions within those included building areas appear to detract from the Tax Court's overall impressions of the *Pine Mountain Preserve* and *Carter* easements. In light of this recent phenomenon, land trusts and donors, with the advice of their respective expert attorneys, will need to consider the implications carefully when deciding whether to have included or excluded building areas.
   - Although none of these cases considered whether excluded building areas impact deductibility, some tax attorneys believe that excluded building areas may have a relatively lower tax risk than included building areas.
   - Keep stewardship issues at the forefront of consideration, as every building area option presents potential stewardship challenges.
6. *Evaluate the full range of building area options when considering risk.*
   - The *Carter* decision still affects the ability to allow building areas to fully float. Land trusts should inform prospective donors considering building rights of both decisions.
   - Pros and cons remain of including or excluding building areas and if those should be interior or exterior to the protected property. Some land trusts prefer the stewardship simplicity of excluded exterior building areas. Other land trusts always include building areas within the easement to prevent division of the land and to maintain some degree of control over those areas, especially when sited in the interior of the protected property.
   - Stewardship staff is likely to encounter difficulties with either choice when landowners want to change locations or build outside exclusions or outside of included building areas. The increased potential for litigation over conserved land with no building rights of any kind is an important consideration in this assessment should future owners petition courts to impose building rights.
   - You may want to consider creating two easements—a deductible easement that excludes the building areas and a nondeductible easement, or deed restriction, that

Pointers for Balancing Risk on Permitted Structures

restricts only the building areas. The nondeductible easement or restriction may restrict some development within the building areas and should prevent the sale of the building areas separately from the other protected property. The main easement should explicitly prohibit separate sale as well to effectively prevent such a separate sale.

- Ideally, any existing structures should be located entirely within a well-defined, fixed building area, which includes all amenities, all utilities and all access. Short of this ideal, it is best to minimize as much as possible these permitted rights outside of envelopes.
- Drafters will want to discuss the implications and organizational preferences inherent in any choice. Land trusts will want to provide general information to the landowner and their attorney to assist them in evaluating the risk to any deduction.
- Land trusts may wish to create a reference list of options available with their preferences and associated costs as they continue to conserve land using deductible easements.

7. *Consider slightly larger or multiple small building areas to add flexibility.*
    - Permitting partially floating included interior building areas within which the landowner may later select a site increases the risk of a tax audit challenge, but thoroughly documenting this choice, as described below, may mitigate that risk to some extent.
    - Size the building area appropriately to the circumstances. Somewhat expanded or multiple building areas may reduce the need for future adjustments. Drafters cannot fully eliminate the future need to address violations, errors and changed zoning laws and siting requirements so drafters must anticipate the future need for adaptation by including a well-drafted amendment clause in all conservation easements.
8. *Consider alternative included building areas.*
    - If a landowner cannot decide between competing building areas, and to avoid a large partially floating building area, consider whether it makes sense for the easement to establish two or more alternative and fixed included building areas. In the future, the landowner selects one of these building areas, and the other(s) automatically extinguish. This strategy arguably has no float or adjustment to the building areas.
    - Selection of this approach requires the land trust to document how all alternative building areas are equally consistent with the conservation purposes, are appraised as financially neutral or identical and retain conservation restrictions in all building areas.
    - Alternatively, the easement could restrict uses allowed only within a building area to one building area at any given time. These strategies arguably have no floating or adjustability aspect to the building areas but provide flexibility.
9. *Fix the location of any major structures and surface alterations outside of building areas.*
    - Consider specific explicit locations for all structures permitted by the easement. Proceed cautiously if the easement permits additional new structures in any unspecified location, especially residential and residential amenities but also including agricultural, forestry and public recreation structures. Be sure to specify explicit limits on the scope and scale of all structures and surface alterations. Identify and limit existing structures.
    - When addressing mineral extraction pads and infrastructure, recreational, silvicultural, agricultural, habitat or other dispersed structures, consider fixed areas or fixed exclusions. Alternatively, consider substantial limits on scope and scale if the permitted rights remain dispersed.

Pointers for Balancing Risk on Permitted Structures

- Another potential option is to consider a group of fixed areas that may be used one at a time in succession but only after the prior area is reclaimed with all structures removed, the use stopped and the area extinguished.
- Address the development of pre-existing severed subsurface mineral rights with a separate surface use agreement that minimizes impacts to conservation purposes during exploration and production and requires full surface reclamation after subsurface mineral extraction activity ceases.

10. *Cluster building areas regardless of exclusion or inclusion in the easement.*
    - Clustering of buildings and other structures is usually good conservation practice. Clustering is also expressly identified as a positive factor in an example in the Regulations (see §1.170A-14(f) Example 4). Recently, the courts have highlighted the degree of clustering (or lack thereof) as a factor in whether an easement will qualify for a tax deduction. For instance, the relative clustering of the homesites was a big factor in the Fifth Circuit's decision to uphold the deduction in *Bosque Canyon*.
    - If clustering is not possible, then carefully document in the baseline why it is not possible, and how the location of permitted building areas and the improvements allowed in the building areas support and protect the conservation purposes and contain effective perpetual conservation restrictions. For example, an agricultural conservation easement might locate a building area for agricultural improvements and structures in two or more different areas of the property. The baseline documentation must show how the separate locations and the improvements within each building area are necessary for and supportive of agricultural purposes. The same analysis applies to forestry and public access.
    - The fact that the building areas in the *Pine Mountain Preserve* and *Carter* easements could at least in theory be sited or relocated anywhere on the protected property was a major flaw in the Tax Court's view. Moreover, the dissent in *Bosque Canyon* and the Tax Court in *Pine Mountain Preserve* and *Carter* repeatedly used a "Swiss cheese" analogy to describe a conservation easement that allows excluded or included building areas. Using this analogy, the more holes, and the more scattered those holes, and then the ability to create more holes by moving them, the less likely that the IRS will view the easement as achieving conservation goals. The 11th Circuit clearly reversed the Tax Court on this point in *Pine Mountain Preserve* and referred to building areas as included ingredients, as opposed to carved-out holes in cheese, citing flecks of pepper in Pepper Jack cheese, instead of holes in Swiss cheese..
11. *Document how the building areas support the conservation purposes and perpetual restrictions.*
    - One way to lower such risk might be for the parties to document in advance of executing the easement why the building area is consistent with the conservation purposes. Also, it is important to address the IRS's and Tax Court's mistaken belief that the conservation easement does not restrict the inconsistent uses of building areas by documenting the explicit restrictions imposed inside any building area. Fully document everything as to consistency with conservation purposes and as to imposition of conservation restrictions across the entirety of the conserved land *including any building areas and any isolated building rights.*

Pointers for Balancing Risk on Permitted Structures

- The easement could reference a "consistency report" as an exhibit or as part of the baseline documentation. The level of formality and substance of this report could range from a short analysis by land trust staff to lengthy documentation by a third-party consultant. The more substantial the documentation, the higher the preparation costs, and landowners should contribute to or fully pay for these costs. It may also help if the appraisal demonstrates that any eventual location of the partially floating building area, and indeed any building area, would have no effect on the fair market value of the easement. Avoid fully floating building areas.
- Whether such documentation avoids an IRS challenge is unknown, but a thoughtfully reasoned and methodically presented analysis could distinguish the facts sufficiently from the easements challenged by the IRS in *Pine Mountain Preserve* and in *Carter*. Third-party documentation may convince an IRS auditor that the land trust thoroughly evaluated the placement of future structures.

12. *Protect intact blocks of undeveloped land, not interstitial areas between developed lots.*
    - As the Fifth Circuit stated in *Bosque Canyon*, "a picture is worth more than 10,000 words." In addition to the clustering of homesites acknowledged by the Fifth Circuit, the protected properties in the two *Bosque Canyon* easements were relatively simple geometric shapes with straight boundaries. In contrast, the *Pine Mountain Preserve* protected property was fragmented, protecting the gaps between the developed areas. In particular, the 2006 *Pine Mountain Preserve* easement protects 499 acres overall, but the protected property is comprised of eight noncontiguous parcels, many of which have irregular boundaries and long thin strips.
    - Public-benefit, qualified conservation purposes should be the clearly stated and documented primary motivation of any conservation easement. Private business or land development goals should be secondary.
13. *Combine conservation purposes and holder's sole discretion as the approval standard.*
    - A key theme in the court opinions discussed above is whether easement holders should be trusted to make pro-conservation decisions with respect to building areas and other rights. Courts appear to disfavor prior approval provisions that the courts may perceive as pressuring holders to approve landowner requests. The most common of these are approval formulations that require the holder to be "reasonable" or, conversely, that the holder's approval "shall not be unreasonably withheld." Land trusts should avoid these reasonableness standards and insist on sole discretion based on whether a requested activity is consistent with the conservation purposes. Be sure to state both the sole discretion review and the consistency with conservation purposes of any approval. Such language can support the taxpayer's claimed deduction.
    - This strategy alone, however, was insufficient in *Carter* to demonstrate consistency with perpetuity to the court. The court cited the 11 fully floating residential building rights. The court did not comment on the numerous fully floating ancillary residential and recreational structures, but presumably this plethora of unsited building rights added to the court's disqualification of the deduction.
14. *Address errors or problems by a post-conservation easement minor boundary adjustment or relocation of building areas, if necessary, consistent with the land trust's amendment policy.*
    - The suggested easement drafting strategies in this Pointer that strictly limit building areas in an attempt to comply with these recent, ambiguous Tax Court decisions

increase the likelihood of amendment requests, as landowners and land trusts may discover that a different configuration or location would be more suitable from an ecological, local zoning or other perspective.

- Land trust policies may require the land trust to deny or modify such requests and this may lead to protracted or expensive disputes with landowners. Land trusts should ensure that they have sufficient defense reserves and have a full insurance portfolio, including Terrafirma, general liability and directors and officers coverage.
- Of course, treat any amendment that removes land from the protected property with an abundance of caution, as discussed on pages 34-36 of *Amending Conservation Easements: Evolving Practices and Legal Principles*. Except for *de minimis* adjustments or clear errors, treat any such amendment as a partial extinguishment. As such, it may require court approval as dictated by state law and Treasury Regulation §1.170A-14(g)(6).

The Risk Spectrum appears on the next page.

QUESTIONS?

Please call or write to Leslie Ratley-Beach, Conservation Defense Director, at 802-262-6051 or Diana Norris, Associate Director of Conservation Defense, at 202-816-0221.

DISCLAIMER

The Land Trust Alliance designed this material to provide accurate, authoritative information about the subject matter covered, with the understanding that the Land Trust Alliance is not engaged in rendering legal, accounting, tax or other professional counsel. If a land trust or individual requires legal advice or other expert assistance, they should seek the services of competent professionals. The Land Trust Alliance is solely responsible for the content of this series.

Last revised 10-27-20

Pointers for Balancing Risk on Permitted Structures

The risk spectrum.

The uncertainties and nuances of the building areas and permitted rights issues in *Pine Mountain Preserve, Carter* and the related cases, cause concern about what provisions will disqualify a conservation easement charitable deduction. No one can predict what the IRS might consider disqualifying, thus land trusts and landowners should consider using a risk analysis. Acceptable risk depends on the landowner's risk tolerance, the amount of deduction at stake, land trust stewardship preferences and mission and the particular attributes of the protected property. This spectrum is subject to change.

Lower Risk	Medium Risk	Higher Risk	No Deduction
No major structures or surface alterations permitted.			Expressly floating or adjustable building area.
Fixed building area with all major structures and only minor limited structures outside building area.	Partially floating sites located within a fixed included larger building area.	Floating included building area, even with express limitations and approval.	Fully or partially floating excluded building area.
	Alternative fixed included building area.		Fully floating included building area.
Fixed overlay nondeductible easement on a fixed exclusion.			
Building areas, structures and permitted alterations limited in location, number and size.	Unsited minor structures or alterations limited in number or size.	Unsited minor structures or alterations not limited in number or size.	Unsited minor and major structures not limited in number and size.
Clustered building areas and additional permitted rights.	Dispersed permitted rights with substantial limits on scope and scale and significant restrictions on sensitive areas.	Dispersed unlimited building areas or unlimited permitted structures and alterations.	Expressly adjustable conservation easement boundary.
Protected property composed of large intact blocks of undeveloped land.		Protected property composed of interstitial areas between developed parcels.	So many dispersed building rights that conservation is secondary to development.
Holder has sole discretion over all approval rights.		Holder's discretion limited by reasonableness or other standard.	No standard or no holder approval required in some way.

II. Issues surrounding the retention of donor rights to surface mine for the extraction of minerals.

The IRS Office of Chief Counsel issued Internal Revenue Service Memorandum No. 202236010 on September 27, 2022 (the "Mining Memo"). In the Mining Memo the IRS reiterates its position and conclusion that a conservation easement will not be deductible (or generate Virginia Land Preservation Tax Credits as a result) if the easement allows the donor to use a surface mining method to extract subsurface minerals with or without the holder's approval. The advice is not applicable in the case of severed mineral rights which are the subject of a different analysis and are not the topic of this seminar.

For a conservation easement to qualify under IRC Section 170(h), the donor cannot retain a qualified mineral interest if at any time there can be extraction or removal of minerals by surface mining – IRC Section 170(h)(5)(B)(i). The only exception is contained in IRC Section 170(h)(5)(B)(ii) which deals with severed mineral rights. Importantly, the Mining Memo expressly eliminates the limited exception contained in Treasury Reg. Section 1.140A-14(g)(4)(i) with regard to easements granted after December 31, 1997. That regulation contained an exception for extraction of materials with limited, localized impact on the real property that are not irremediably destructive of significant conservation interests.

The IRC does not have a specific definition of "Mineral" for purposes of the 170(h)(5) analysis. I do not know what definition a Virginia court might use for "Mineral" in this instance but I did find a definition of "Mineral" in the Virginia Code found in title 42.5 – Mines, Minerals, and Energy - Virginia Code Section 45.2-1101 defines mineral as follows "Mineral" means clay, stone, sand, gravel, metalliferous or nonmetalliferous ore, or any other solid material or substance of commercial value excavated in solid form from a natural deposit on or in the earth, exclusive of coal and any mineral that occurs naturally in liquid or gaseous form.

The issues and the IRS document cited above are covered in more depth in the following pages

Internal Revenue Service Memorandum No. 202236010

Office of Chief Counsel
Internal Revenue Service
Memorandum

Number: **202236010**
Release Date: 9/9/2022

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POSTU-105674-20

UILC: 170.00-00

date: September 27, 2021

to: Keith L. Gorman
General Attorney
(Large Business & International)

from: Bridget E. Tombul
Branch Chief, Branch 2
(Income Tax & Accounting)

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subject: Retained Surface-Mining Rights in Conservation Easement Deeds

This Chief Counsel Advice responds to your request for assistance. This advice may not be used or cited as precedent.

ISSUE

Does a conservation easement satisfy the requirements of section 170(h) of the Code if the donor of the easement retains a qualified mineral interest, the ownership of the surface estate and mineral interest has never been separated, and under the terms of the deed the donor can use a surface-mining method to extract the subsurface minerals with the donee's approval?

CONCLUSION

No. If the donor of a conservation easement owns both the surface estate and a qualified mineral interest that has never been separated from the surface estate, and the deed retains any possibility of surface mining to extract the subsurface minerals, the conservation easement does not satisfy the requirements of section 170(h) even if the donee would have to approve the surface-mining method, because the contribution is not treated as made exclusively for conservation purposes under section 170(h)(5).

LAW AND ANALYSIS

Section 170(f)(3)(A) generally precludes a charitable contribution deduction for a gift of a partial interest in property. Section 170(f)(3)(B)(iii), however, provides an exception for a qualified conservation contribution. Section 170(h)(1) defines a qualified conservation contribution as a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes.

Under section 170(h)(5)(A), a conservation easement is not treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity. Under section 170(h)(5)(B)(i), if the donor retains a qualified mineral interest, the conservation easement is generally not treated as exclusively for conservation purposes if at any time there may be extraction or removal of minerals by any surface-mining method. The only exception to this rule is in section 170(h)(5)(B)(ii), which states that if the ownership of the surface estate and mineral interests has been and remains separated, and the probability of surface mining occurring on the property is so remote as to be negligible, then the contribution may be treated as exclusively for conservation purposes.

Section 1.170A-14(g)(4)(i) clarifies the rules regarding the retention of qualified mineral interests in conservation contributions and whether those retained interests preclude a charitable contribution deduction. Section 1.170A-14(g)(4)(i) restates the general statutory rule that no deduction is allowed if there is a retention by any person of a qualified mineral interest and the minerals may be extracted or removed by any surface-mining method. Section 1.170A-14(g)(4)(i) also states that the requirement that the conservation purposes be protected in perpetuity is not satisfied in the case of a qualified mineral interest gift if any method of mining that is inconsistent with the particular conservation purposes of a contribution is permitted at any time. Finally, section 1.170A-14(g)(4)(i) provides that a deduction under § 1.170A-14 will not be denied in the case of certain methods of mining that may have limited, localized impact on the real property and are not irremediably destructive of significant conservation interests. However, as stated above, surface mining is specifically prohibited. Therefore, surface mining is not a mining method that is allowable if it has limited, localized impact on the real property and is not irremediably destructive of significant conservation interests.

Section 1.170A-14(g)(4)(ii)(A) provides an exception to the prohibition on surface mining for contributions made after July 18, 1984, but this regulation section pre-dates, and is different than, the statutory exception in current section 170(h)(5)(B)(ii). Section 1.170A-14(g)(4)(ii)(A) does not apply to conservation easements donated after the applicability date of section 170(h)(5)(B)(ii) as amended, i.e., conservation easements granted after December 31, 1997.

In Great Northern Nekoosa Corp. v. U.S., 38 Fed. Cl. 645, 649-50 (1997), the taxpayer contributed two conservation easements but retained the right to surface-mine

subsurface minerals. The government filed a motion for partial summary judgment claiming the contribution was not deductible because the taxpayer's contribution was not exclusively for conservation purposes due to the retained surface-mining rights. Id. at 654. The taxpayer argued that the deduction was allowed, based on the third sentence in Treas. Reg. §1.170A-14(g)(4)(i), which provides an exception to the disallowance rule where the impact of the mining has a limited, localized impact but is not irremediably destructive of significant conservation interests. Id. at 658. The court dismissed this argument, stating that the taxpayer's interpretation of the regulation was contrary to the regulation as a whole and the statute itself, both of which prohibit surface mining. Id. at 659. In addition, the court noted that the taxpayer's argument would conflict with, and subvert, the fundamental conservation purposes of the statute. Id. The court in Great Northern Nekoosa Corp. cited the law as it existed in 1981, which did not provide for an exception for the prohibition on surface mining.[1] However, the court's analysis is relevant here because the change in law, which added the only exception to the prohibition on surface mining, does not apply in situations where the ownership of the surface estate and the mineral interest has never been separated.

Under section 170(h)(5) and section 1.170A-14(g)(4)(i), unless the exception in section 170(h)(5)(B)(ii) applies, a contribution is not treated as made exclusively for conservation purposes if there is an owner of a qualified mineral interest and the deed permits the owner of that interest to extract or remove those minerals by a surface-mining method. Here, the ownership of the surface estate and mineral interest has never been separated. As such, the exception under section 170(h)(5)(B)(ii) does not apply. The contribution is not treated as made exclusively for conservation purposes because, with the donee's approval, the deed allows surface mining of the donor's subsurface minerals. A donee's approval does not rectify the problem, because if the approval is granted, surface mining can occur. Because the contribution is not treated as made exclusively for conservation purposes, it is not a qualified conservation contribution. Therefore, because the gift is a less than the donor's entire interest and is not a qualified conservation contribution, a charitable contribution deduction is not allowed under section 170(f)(3)(B)(iii).

If you have any questions, please contact Richard C. Gano IV at (202) 317-7011.

[1] Congress added section 170(h)(5)(B)(ii) in 1984. See Pub. L. No. 98-369, § 1035(a), 98 Stat. 494, 1042 (1984). Congress subsequently amended section 170(h)(5)(B)(ii) in 1997. See Pub. L. No. 105-34, § 508(d), 111 Stat. 788, 860 (1997).

Land Trust Alliance Practical Pointers Pamphlet on Reserved Surface Mining Rights

Land Trust Alliance
Together, conserving the places you love

Practical Pointer

Easement donation disqualification for reserved rights of surface mining methods

Recent advice from the IRS Office of Chief Counsel reiterates the IRS's position on perpetual conservation easements on land where the landowner retains the rights to extract minerals using *surface* mining methods. The IRS announced its position that a landowner's retention of rights to use surface mining methods of their *unsevered* mineral interests would disqualify the easement donation as a charitable deduction. This position could significantly impact conservation easements on working lands allowing agricultural "borrow pits" and the removal or extraction by surface mining methods of gravel, sand or other surface mining materials to build or maintain roads on the protected property.

Office of Chief Counsel Internal Revenue Service Memorandum, 202236010 (9/9/2022) states:

- If the easement deed permits the landowner as owner of an unsevered mineral interest to extract or remove minerals by a surface mining method then the conservation easement does not satisfy the requirements of section 170(h) because the contribution is not treated as "made exclusively for conservation purposes."
- Donee approval of a surface mining method does not rectify the problem.
- Treas. Reg. §1.170A-14(g)(4)(i), which provides an exception to the disallowance rule where the impact of the mining has a limited, localized impact but is not irremediably destructive of significant conservation interest does not apply to surface mining methods of unsevered mineral interests.
- The only exception to the IRS rule would be if the mineral rights were severed from the surface estate and the likelihood of using surface mining methods to extract minerals passes the "remoteness test" (with the possibility of the mineral rights being exercised being so remote as to be negligible, as required by I.R.C. section 170(h)(5)(B)(ii)).

The IRS's Memorandum bases its analysis on the Great Northern Nekoosa Corp. v. United States, 38 Fed. Cl. 645 (Fed.Cl.1997), a case in which the court held that the grantor of the easement retained a "qualified mineral interest" pursuant to §170(h)(6) because sand and gravel were "subsurface minerals." Therefore, the easement was not "exclusively for conservation purposes," under §170(h)(5)(A) and (B), and the grantor's charitable deduction was denied in its entirety.

According to the court, the so-called "limited and localized" exception under Treas. Reg. §1.170A-14(g)(4)(i) was incongruous with the statute. The statute prohibits "extraction or removal of minerals by any surface mining method." §170(h)(5). The regulations, in contrast, provide a limited exception for mining that has a "limited, localized impact on the real property but that are not irremediably destructive of significant conservation interests." The court did not factor into its determination elements such as pre-existing uses, state law definitions of minerals, or the size and scale of the surface extraction.

Despite the holding of *Great Northern Nekoosa*, many deductible easements in the ensuing years did continue to include a reserve right for limited and localized sand and gravel extraction, and the IRS did not seem interested in challenging deductions on that ground. However, the recent IRS Memorandum may signal a renewed focus on this issue, and heightened risk of a denied deduction.

Practical and legal considerations

Land trusts that address removal or extraction of materials such as gravel, sand, or hard rocks by surface mining methods in their templates or that are working with a specific donor interested in such removal or extraction may wish to reassess. Talk with the landowner and explain the risks without giving tax or legal advice. The decision about what to include in the easement as to extraction and removal will be determined by how much risk the donor is willing to take that their deduction might be audited and disallowed on this basis. Without more guidance from the IRS, land trusts and landowners must evaluate the risks and options in the context of these practical and legal considerations:

- *The definition of subsurface minerals and surface mining under state real property and federal tax law*. The IRS's Memorandum refers to "surface-mining methods" and "subsurface minerals" but does not define those terms creating confusion about what uses and substances might fall into these categories. The interaction between state real property and federal tax law definitions of minerals and/or surface mining is unclear. For example, what happens if the right to remove or extract is of substances not classified as minerals under state law? What constitutes a prohibited "surface mining method"?
    - The court in *Great Northern Nekoosa* did not look to state real property law definitions of these terms. Instead, it looked to the federal tax code and regulations and ultimately applied an ordinary meaning analysis to "minerals," but the IRS's analysis may conflict with the ordinary meaning of critical definitions under state laws.
    - Are there ways to draft conservation easements to allow de minimis removal of surface materials by methods that should not be considered surface mining? For example, state law may not regulate small-scale gravel pits, especially if the materials produced are not sold commercially or transported off the property. Those activities are not considered regulated "surface mining" under state law. Could a conservation easement state that sand and gravel produced as by-products of permitted activities shall not be considered surface mining, and the by-products can be removed from the property?
- *The interplay between the conservation purposes and surface mining*. How will the IRS treat a surface mining method of subsurface minerals which supports a protected conservation value? Can the conservation easement, for example, allow gravel extraction to maintain agricultural roads on an agricultural conservation easement conducted pursuant to a clearly delineated governmental conservation policy and that creates a significant public benefit?
- *Surface mining method as a pre-existing use*. Can the continuation of surface mining of subsurface minerals as historically practiced on farms and ranches meet the pre-existing use language of Treas. Reg. §1.170A-14e3 ("A donor may continue a pre-existing use of the property that does not conflict with the conservation purposes of the gift.")? Or does the

explicit prohibition against surface-mining methods in the statute take precedence over the more general language of 14e3?
    - The pre-existing use exception in the regulation likely would fail a contest with the statute's surfacing mining prohibition if the *Great Nekoosa* rationale is used. The court said the *limited and localized* exception in the regulation contradicted the statute and the statute prevails over regulations. The *pre-existing use* regulation would, most likely, have the same problem.
- *The size of the area, scope or scale for surface mining*. Would small-sized individual "Maintenance Areas" where materials are gathered and not necessarily mined, with a capped percentage of the eased property and a remediation requirement be treated differently by the IRS than a large-scale commercial aggregate operation?

Land trusts, attorneys and landowners cannot know in advance how the IRS would respond to these queries so uncertainty and risk exist. The following risk spectrum may assist you in your analysis.

Risk Spectrum

The uncertainties associated with what the IRS might consider for disqualifying reserved rights to engage in surface mining methods, the holding in *Great Northern Nekoosa Corp.* and the IRS Memorandum cause concern about drafting tax-deductible conservation easements. Factors to consider are the landowner's risk tolerance for potential audit and disqualification of the easements for deduction, the amount of deduction at stake, land trust stewardship preferences, land trust missions and the particular attributes of the protected properties.

LOWER RISK APPROACHES

- Prohibit extraction of unsevered mineral interests by any surface mining method
- Meet the severance requirements found in §1.170A-14(g)(4)(ii) (A) and (B) (severance needed to occur pre-1976) and pass the remoteness test of I.R.C. section 170(h)(5)(B)(ii)
- Exclude extraction site from the conservation easement protected property. Consider restricting that site with a nondeductible easement or restrictive covenant that is tied to the deductible easement to prevent division of the property (but see risks with commercial operations below)

HIGHER RISK APPROACHES

- Allow continuation of pre-existing use that does not conflict with the conservation purposes of the gift e.g., use of gravel from an already-existing small pit to fill potholes on agricultural or forest management roads.
- Allow surface mining methods with explicit provisions in the easement addressing scale and scope of surface mineral extraction and use to assure scale and scope of removal pose no

adverse impact to the conservation purposes. Tie to managing the resources and to complement land conservation goals but in a manner that will not adversely impact the deductible easement to avoid an IRS claim of an inconsistent use.

- Allow private, noncommercial surface operations. State that surface minerals may be produced as a by-product of other permitted reserved rights such as excavations of foundations for permitted residences, barns, or other structures, or development of ponds and wetlands for wildlife habitat enhancement.
- Exclude a perimeter lot with historic commercial surface extraction. Commercial surface operations present serious and substantial risks. The excluded lot might be controlled by a restrictive covenant that runs to the benefit of the conservation easement, which is a real property interest. There is a benefitted property which should make the covenant enforceable. The covenant could provide for restoration and revegetation with native species, building restrictions, a restriction on selling the land separate from the conservation easement protected property, and a promise to add the land into the conservation easement after restoration.

HIGHEST RISK APPROACHES→NO DEDUCTION

- Allow surface mining methods with holder approval
- Allow surface mining methods with the application of the limited and localized exception
- Allow surface mining methods for future use such as reserving the right to engage in development of new gravel or sand sources for commercial sale for off-site uses, or uses on the property that do not complement protection of conservation goals.
- Allow interior commercial gravel extraction or any other extraction for commercial use.

Contact us:

- Leslie Ratley-Beach (802) 262-6051 | lrbeach@lta.org
- Diana Norris (202) 816-0221 | dnorris@lta.org

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DISCLAIMER: The Land Trust Alliance designed this material to provide accurate, authoritative information about the subject matter covered with the understanding that the Alliance is not engaged in rendering legal, accounting or other professional counsel. If a land trust or individual requires legal advice or other expert assistance, they should seek the services of competent professionals. The Alliance is solely responsible for the content of this series.

III. Limited in time ability to amend easements to avoid flaws related to extinguishment and boundary line adjustments pursuant to IRS Notice 2023-30

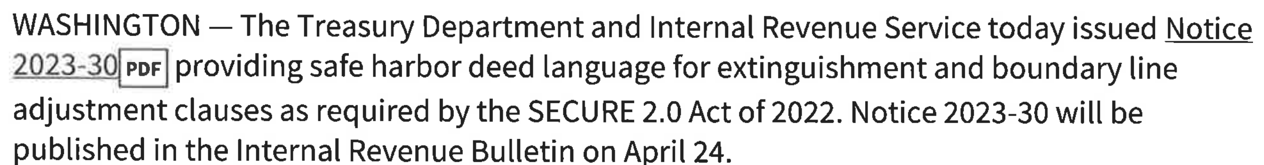
Congress passed the SECURE 2.0 Act on December 29, 2022. The act required the IRS to prepare and issue a process for conservation easement donors to amend their conservation easement so substitute safe harbor language for extinguishment clauses and boundary line adjustment clauses in their original easements which may have caused the easement as originally written to fail to qualify for the Federal income tax deduction under IRC Section 170(h) (or generate Virginia Land Preservation Tax Credits as a result). The Treasury Department and the IRS issued Notice 2023-30 on April 24, 2023. To be effective, the amendment must be both executed by the donor as well as the holder and be recorded in the appropriate Circuit Court Clerk's Office by July 24, 2023 or the opportunity is lost.

The issues and the IRS document cited above are covered in more depth in the following pages.

United States Treasury Department and Internal Revenue Service Notice 2023-30

Treasury, IRS issue safe harbor deed language for extinguishment and boundary line adjustment clauses

IR-2023-73, April 10, 2023



WASHINGTON — The Treasury Department and Internal Revenue Service today issued Notice 2023-30 PDF providing safe harbor deed language for extinguishment and boundary line adjustment clauses as required by the SECURE 2.0 Act of 2022. Notice 2023-30 will be published in the Internal Revenue Bulletin on April 24.

Section 605(d)(2) of the SECURE 2.0 Act provides donors the opportunity to amend certain conservation easement deeds to substitute the safe harbor language for the corresponding language in the original deed. Taxpayers will have until July 24, 2023, to record their safe harbor deed amendments.

This safe harbor notice addresses only corrections to extinguishment and/or boundary line adjustment clauses in accordance with the SECURE 2.0 Act. This safe harbor notice does not address any other deed amendments. Donors are not required to amend their deeds to include the safe harbor language in the notice.

Section 605(d)(2) of the SECURE 2.0 Act applies only if the amendment is effective as of the date of the recording of the original easement deed. Notice 2023-30 provides that if a donor substitutes the safe harbor deed language for the corresponding language in the original eligible easement deed, and the amended deed is signed by the donor and donee and recorded on or before July 24, 2023, the amended eligible easement deed will be treated as effective for purposes of § 170, § 605(d)(2) of the SECURE 2.0 Act and Notice 2023-30 as of the date the eligible easement deed was originally recorded, regardless of whether the amended eligible easement deed is effective retroactively under relevant state law.

Part III – Administrative, Procedural, and Miscellaneous

Conservation Easements -- Safe Harbor Deed Language for Extinguishment and Boundary Line Adjustment Clauses

Notice 2023-30

SECTION 1. OVERVIEW

.01 This notice sets forth the safe harbor deed language for extinguishment and boundary line adjustment clauses required by § 605(d)(1) of the SECURE 2.0 Act of 2022 (SECURE 2.0 Act), enacted as Division T of the Consolidated Appropriations Act, 2023, Public Law 117-328, 136 Stat. 4459 (December 29, 2022). This notice also describes the process donors may use to amend an original eligible easement deed to substitute the safe harbor language for the corresponding language in the original deed, as provided by § 605(d)(2) of the SECURE 2.0 Act.

.02 This safe harbor notice addresses only amendments to extinguishment and boundary line adjustment clauses in accordance with § 605(d) of the SECURE 2.0 Act. This safe harbor notice does not address any other deed amendments. Donors are not required to make the amendments described in this notice.

SECTION 2. BACKGROUND

.01 Section 170(a) of the Internal Revenue Code (Code) provides, subject to certain limitations and requirements, a deduction for any charitable contribution, as defined in

§ 170(c), payment of which is made within the taxable year.[1] Section 170(f)(3)(A) denies a deduction under § 170 in the case of a contribution of a partial interest in property, except as provided in § 170(f)(3)(B). Section 170(f)(3)(B)(iii) provides an exception to the deduction denial in the case of a qualified conservation contribution as defined in § 170(h).

.02 Under § 170(h)(1), the term qualified conservation contribution means a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. For this purpose, a qualified real property interest is defined in § 170(h)(2)(C) to include a restriction (granted in perpetuity) on the use that may be made of the real property. Under § 1.170A-14(b)(2), a perpetual conservation restriction includes an easement or other interest in real property that under state law has attributes similar to an easement. Section 170(h)(3) defines the term qualified organization (donee organization). Section 170(h)(4) defines the term conservation purpose, which must be protected in perpetuity for the qualified conservation contribution to be treated as exclusively for conservation purposes pursuant to § 170(h)(5).

.03 Section 1.170A-14 provides further guidance on qualified conservation contributions. Section 1.170A-14(g) requires that such a restriction be enforceable in perpetuity. Section 1.170A-14(g)(6)(i) provides a rule pertaining to extinguishment. It provides that if a subsequent unexpected change in the conditions surrounding the property that is the subject of a perpetual conservation restriction makes it impossible or impractical to continue to use the property for conservation purposes, the conservation

[1] Unless otherwise specified, all "section" and "§" references are to the Internal Revenue Code or the Income Tax Regulations (26 CFR Part 1).

purpose can nonetheless be treated as protected in perpetuity if (1) the restrictions are extinguished by judicial proceeding and (2) all of the donee's proceeds (determined under § 1.170A-14(g)(6)(ii)) from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original contribution.

.04 Section 1.170A-14(g)(6)(ii) provides that, for a deduction to be allowed under § 170(a), at the time of the gift, the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift bears to the value of the property as a whole at that time. That proportionate value of the donee's property rights must remain constant. Accordingly, under § 1.170A-14(g)(6)(ii), if a change in conditions gives rise to the extinguishment of a perpetual conservation restriction under § 1.170A-14(g)(6)(i), the donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction.

.05 Neither the Code nor the regulations specifically address boundary line adjustments. Under § 170(h)(2)(C), however, the restriction the donor grants on the use of the real property subject to the conservation easement must be made in perpetuity. See also § 170(h)(5)(A).

.06 The SECURE 2.0 Act was signed into law on December 29, 2022. Section 605(d)(1) of the SECURE 2.0 Act directs the Secretary of the Treasury or her delegate (Secretary) to publish safe harbor deed language for extinguishment clauses and boundary line adjustment clauses within 120 days after the date of the enactment of the SECURE 2.0 Act (that 120th day is April 28, 2023). Section 605(d)(2) of the SECURE 2.0 Act provides that, beginning on the date the safe harbor language is published by the Secretary, donors have a 90-day period in which to amend an original eligible easement deed to substitute the safe harbor language for the corresponding language in the original deed. Since this notice is published in the Internal Revenue Bulletin on April 24, 2023, the 90th day is July 22, 2023. Because that date is a Saturday, § 7503 extends the date until Monday, July 24, 2023. The amended deed must be signed by the donor and donee and recorded by July 24, 2023, and the amendment must be treated as effective as of the date of the recording of the original easement deed.

.07 Section 3 of this notice describes the process donors may use to amend an eligible easement deed to substitute the safe harbor language for the corresponding language in the original eligible easement deed, and which easement deeds are eligible to be amended, as provided by § 605(d)(2) of the SECURE 2.0 Act. Section 4 of this notice sets forth safe harbor deed language for extinguishment and boundary line adjustment clauses as required by § 605(d)(1) of the SECURE 2.0 Act.

SECTION 3. PROCEDURE TO AMEND ELIGIBLE EASEMENT DEEDS

.01 In general. In accordance with § 605(d)(2) of the SECURE 2.0 Act, to amend an original eligible easement deed to substitute the safe harbor language in section 4.01 or 4.02 of this notice for the corresponding language in the original deed—

(1) The amended deed must be signed by the donor and donee and recorded

on or before July 24, 2023; and

(2) The amendment must be treated as effective as of the date of the recording of the original easement deed. See section 3.03 of this notice.

.02 Exceptions. The term eligible easement deed does not include an easement deed relating to any contribution—

(1) Which is part of a reportable transaction (as defined in § 6707A(c)(1)), or is described in Notice 2017-10, 2017-4 I.R.B. 544;

(2) Which, by reason of § 170(h)(7), is not treated as a qualified conservation contribution;

(3) If a deduction under § 170 has been disallowed by the Secretary and the donor is contesting such disallowance in a case that is docketed in a Federal court on a date before the date the amended deed is recorded by the donor; or

(4) If a claimed deduction for such contribution under § 170 resulted in an underpayment to which a penalty under § 6662 or § 6663 applies and either—

(i) The penalty has been finally determined administratively; or

(ii) If the penalty is challenged in court, the judicial proceeding with respect to such penalty has been concluded by a decision or judgment which has become final.

.03 Effect of correction. If a donor substitutes the safe harbor language in sections 4.01 or 4.02 (or sections 4.01 *and* 4.02) of this notice for the corresponding language in the original eligible easement deed and the amended deed is signed by the donor and donee and recorded on or before July 24, 2023, the amended eligible easement deed will be treated as effective for purposes of § 170, § 605(d)(2) of the SECURE 2.0 Act, and section 3.01(2) of this notice as of the date the eligible

easement deed was originally recorded, regardless of whether the amended eligible easement deed is effective retroactively under relevant state law.

SECTION 4. SAFE HARBOR DEED LANGUAGE

.01 Extinguishment clause. The safe harbor deed language for extinguishment clauses is:

> *Pursuant to Notice 2023-30, Donor and Donee agree that, if a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation of the perpetual conservation restriction renders impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if (1) the restrictions are extinguished by judicial proceeding and (2) all of Donee's portion of the proceeds (as determined below) from a subsequent sale or exchange of the property are used by the Donee in a manner consistent with the conservation purposes of the original contribution.*
>
> *Determination of Proceeds. Donor and Donee agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in Donee, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction, at the time of the gift, bears to the fair market value of the property as a whole at that time. The proportionate value of Donee's property rights remains constant such that if a subsequent sale, exchange, or involuntary conversion of the subject property occurs, Donee is entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction.*

.02 Boundary line adjustments clause. The safe harbor boundary line adjustment clause is:

> *Pursuant to Notice 2023-30, Donor and Donee agree that boundary line adjustments to the real property subject to the restrictions may be made only pursuant to a judicial proceeding to resolve a bona fide dispute regarding a*

boundary line's location.

.03 Similar terms with the same meaning. In substituting deed language, the donor may use the precise terms used in sections 4.01 and 4.02 of this notice, or the donor may use terms that have the same meaning as the terms in sections 4.01 and 4.02. For example, if the original deed uses the terms "Grantor" and "Grantee" instead of "Donor" and "Donee," the donor can use either "Grantor" and "Grantee" or "Donor" and "Donee" because these terms have the same meaning. Also, for example, if the original deed uses the term "easement" or "servitude" instead of "restriction," the donor may use any of those terms, provided the term refers to a qualified real property interest within the meaning of § 170(h)(2)(C) and § 1.170A-14(b)(2).

SECTION 5. DRAFTING AND CONTACT INFORMATION

The principal authors of this notice are Elizabeth Boone and Hannah Kim of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Ms. Boone at (202) 317-5100, or Ms. Kim at (202) 317-7003 (not toll-free numbers).

Land Trust Alliance Advisory regarding Charitable Conservation Easement Program Integrity Act

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DOCUMENT FEATURED

Important Advisory: Charitable Conservation Easement Program Integrity Act Advisory

Posted January 11 Updated April 11

SOURCE

Land Trust Alliance

ABOUT THIS DOCUMENT

UPDATED April 11, 2023 after release of safe harbor language from IRS. This Advisory summarizes the most important elements of the Charitable Conservation Easement Program Integrity Act for land trusts The Advisory details the legislation which not only effectively disallows deductions for abusive syndicated conservation easement transactions but it also provides a time-limited "cure" provision allowing taxpayers to amend easements by adopting IRS safe harbor language addressing extinguishment and boundary line adjustment provisions only.

Please check back frequently for updates to this Advisory or additional information about the Integrity Act's safe harbor provisions.

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The U.S. Congress passed the Charitable Conservation Easement Program Integrity Act as part of the year-end "omnibus" spending bill, and it was signed into law on December 29, 2022. This legislation effectively shuts down a tax avoidance scheme that took advantage of the federal conservation easement tax incentive. (For more details on abusive syndicated conservation easement transactions and the legislative efforts to curtail them, see the **Alliance's blog**).

The Act provides taxpayers the opportunity to correct certain "defects" in an easement deed within 90 days of the publication by the IRS of safe harbor language. On April 10, 2023, the IRS notified the public that it will publish safe harbor language effective as of April 24, 2023 for purposes of calculating the 90 day window.

1. **Notice 2023-30**

IRS Notice 2023-30 sets forth the safe harbor deed language for extinguishment and boundary line adjustment clauses required by § 605(d)(1) of the SECURE 2.0 Act of 2022 (the Integrity Act). The window to amend and record will start on April 24 and close on July 24. The Notice reiterates the provisions of the Integrity Act and gives limited additional details.

The IRS safe harbor deed language for extinguishment clauses is:

Pursuant to Notice 2023-30, Donor and Donee agree that, if a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation of the perpetual conservation restriction renders impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if (1) the restrictions are extinguished by judicial proceeding and (2) all of Donee's portion of the proceeds (as determined below) from a subsequent sale or exchange of the property are used by the Donee in a manner consistent with the conservation purposes of the original contribution.

***Determination of Proceeds**. Donor and Donee agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in Donee, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction, at the time of the gift, bears to the fair market value of the property as a whole at that time. The proportionate value of Donee's property rights remains constant such that if a subsequent sale, exchange, or involuntary conversion of the subject property occurs, Donee is entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction.*

The IRS safe harbor deed language for boundary line adjustment clauses is:

Pursuant to Notice 2023-30, Donor and Donee agree that boundary line adjustments to the real property subject to the restrictions may be made only pursuant to a judicial proceeding to resolve a bona fide dispute regarding a boundary line's location.

Considerations and comments regarding evaluating safe harbor language:

» Donors are not required to make the amendments described in the Notice but the intention of the substitute language is to safeguard the deduction from audit due to "faulty" extinguishment and/or boundary line adjustment language.

» In substituting deed language, the donor may use the precise terms or may use terms that have the same meaning as the terms such as "Grantor" and "Grantee" instead of "Donor" and "Donee." No other allowable deviations are indicated.

» The safe harbor language for the extinguishment clause closely tracks Treas. Reg. section 1.170A-14(g)(6)(ii) and has been supported by Tax Court and some federal appellate courts.

» The safe harbor language for the boundary line adjustments clause is very limiting and restrictive. This narrow position could be an open question in court.

» Now that the language and instructions have been released, we recommend you review:

- State law to determine the treatment of amendments and deed reformation and what is required.
  Please note the bolded language: "if a donor substitutes the safe harbor deed language for the corresponding language in the original eligible easement deed, and the amended deed is signed by the donor and donee and recorded on or before July 24, 2023, the amended eligible easement deed will be treated as effective for purposes of § 170, § 605(d)(2) of the SECURE 2.0 Act and Notice 2023-30 as of the date the eligible easement deed was originally recorded, **regardless of whether the amended eligible easement deed is effective retroactively under relevant state law.**"
- Your land trust's amendment policy.
- **Practice 11H1 on amendments.**
- The Alliance's "**Amending Conservation Easements: Evolving Practices and Legal Principles 2017**" publication.

Related to the safe harbors, there are two key components of the Charitable Conservation Easement Program Integrity Act found in Section 605 (page 935) of the **funding bill**.

1. The Act disallows a charitable deduction for a qualified conservation contribution if the deduction claimed exceeds 2.5 times the sum of each partner's relevant basis in the contributing partnership, unless one of the following two exceptions is met:

a. The contribution meets a three-year holding period test.

b. Substantially all of the contributing partnership is owned by members of a family.

Notes on provision 1:

» This provision does not implicitly approve donations of easements valued up to 2.5 times basis; as such, claims below the 2.5 times threshold can continue to be audited and challenged by the IRS.

» If the 2.5 times threshold is exceeded, the entire deduction is disallowed.

» This provision is prospective, so it is effective for contributions made after the date of enactment of this Act, which is Dec. 29, 2022.

» This provision does not apply to any qualified conservation contribution whose conservation purpose is the preservation of any building that is a certified historic structure.

The validity of a conservation easement continues to be determined under state law; the Act only addresses the donor's

» charitable donation.

» All Land Trust Alliance member land trusts adopt and commit to implement ***Land Trust Standards and Practices***, the ethical and technical guidelines for the responsible operation of a land trust. Those guidelines require that all Alliance member land trusts refuse to knowingly participate in tax shelter transactions. (See the Alliance's **Advisory: Tax Shelter Abuse of Conservation Donations**.)

2. The Act provides taxpayers the opportunity to correct certain "defects" in an easement deed:

a. Within 120 days after the date of the enactment of the Act, the Secretary of the Treasury is to publish safe harbor deed language for extinguishment clauses and boundary line adjustments.

b. During the 90-day period beginning on the date of publication of the safe harbor deed language, a donor may amend an easement deed to substitute the safe harbor language for the corresponding language in the original deed if the following two conditions are met:

i. The amended deed is signed by the donor and donee and recorded within such 90-day period.

ii. Such amendment is treated as effective as of the date of the recording of the original easement deed.

» The ability to cure does not apply to an easement donation in the following instances:

- It is part of a reportable transaction.
- It meets the description of IRS Notice 2017–10.
- It is not treated as a qualified conservation contribution pursuant to the new IRC section 170(h)(7) detailed in Provision 1 above.
- It is being contested in a federal court before the date the amended deed is recorded.
- Penalties have been finally determined administratively for an underpayment, or the penalty is challenged in court, the judicial proceeding with respect to such penalty has been concluded by a decision or judgment which has become final.

» The ability to cure only applies to extinguishment and boundary line adjustments provisions; no other deed language flagged by the IRS is able to be corrected under the Act.

» The ability to cure is intended to "reform the deed" making the amendment effective as of the date of the recording of the original easement deed.