

# INCENTIVES FOR CONSERVATION EASEMENTS: THE CHARITABLE DEDUCTION OR A BETTER WAY

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## I

### INTRODUCTION

The Internal Revenue Code allows a charitable income-tax deduction for a “qualified conservation contribution,”<sup>1</sup> known, more colloquially, as a conservation easement. To be eligible for the deduction, the easement must be “granted in perpetuity” to a “qualified organization, exclusively for conservation purposes.”<sup>2</sup> The 1980 change in the tax law to codify this deduction is generally recognized as being the factor largely responsible for the tremendous growth in the donation of conservation easements.<sup>3</sup> The Land Trust Alliance, an umbrella organization for land trusts, (like other defenders of the tax deduction) has pointed to the millions of acres now protected by conservation easements as evidence of the tax-expenditure program’s enormous success.<sup>4</sup> What is striking, however, is that supporters make no mention of the program’s cost.

This article presents a discussion of tax-policy concerns relating to the charitable deduction for conservation easement donations. The deduction is unique in a number of ways. First, since 1969, the Internal Revenue Code has generally denied the deduction for a gift of a partial property interest.<sup>5</sup> The conflict of interest between charity and other owners raises a concern that the charitable deduction would not reflect the ultimate charitable benefit. The

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1. I.R.C. § 170(f)(3)(B)(iii) (2006); *id.* § 170(h)(1).

2. *Id.* § 170(h)(1)(B)–(C). *See id.* § 170(h)(3) (defining “qualified organization”).

3. *See, e.g.,* Zachary Bray, *Reconciling Development and Natural Beauty: The Promise and Dilemma of Conservation Easements*, 33 HARV. ENVTL. L. REV. 119, 135 (2010); Nancy A. McLaughlin, *Increasing the Tax Incentives for Conservation Easement Donations—A Responsible Approach*, 31 ECOLOGY L.Q. 1, 22 (2004).

4. *Land Trust Alliance President Testifies at Finance Hearing on Land Conservation Tax Breaks*, 2005 TAX NOTES TODAY 110-49, June 9, 2005, at 2 (“Since Congress enabled tax deductions for those donations, land trusts have protected more than 9 million acres of important wildlife habitat, farms, ranches, and forests with this tool.”). The Land Trust Alliance describes itself as the strategist and representative of over 1700 land trusts nationwide. *Leadership in Land Conservation*, LAND TRUST ALLIANCE, <http://www.landtrustalliance.org/about> (last visited Dec. 31, 2010).

5. I.R.C. § 170(f)(3)(A).

deduction for conservation easements is the principal exception to this rule<sup>6</sup> despite the significant potential for abuse and the distinct possibility that the public benefit may be less than anticipated. Moreover, the few other exceptions are either narrower or more carefully circumscribed.

Second, since 2006, the limitation on the deduction for a qualified conservation contribution is, at least temporarily,<sup>7</sup> uniquely high. In contrast to the deduction for other appreciated property, which is limited to thirty percent of the so-called contribution base,<sup>8</sup> the deduction limit for a qualified conservation contribution is generally fifty percent of the contribution base.<sup>9</sup> In the case of certain contributions from persons earning more than fifty percent of their gross income from farming or ranching, the limit is increased to one hundred percent.<sup>10</sup> Further, instead of the normal carryover of five years for unused contributions, the carryover for these contributions is extended to fifteen years.<sup>11</sup> In addition, the taxable value of land for estate-tax purposes can be reduced by as much as \$500,000 for up to forty percent of the value of land subject to a conservation easement, in addition to any value reduction from the effect of the easement itself.<sup>12</sup> These provisions are extraordinary. It is unlikely many would believe that this charitable purpose should be elevated above all others.

Although I have previously written on the charitable deduction,<sup>13</sup> I am not an expert on conservation easements. I have been invited to participate in this symposium, and at earlier conferences at the Lincoln Institute<sup>14</sup> and the Harvard

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6. See *id.* § 170(f)(3)(B)(iii) (providing exception for a “qualified conservation contribution”).

7. The liberalization of the deductions limit expired at the end of 2009 pursuant to I.R.C. § 170(b)(1)(E)(vi), but was extended through December 31, 2011 in the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, § 723, 124 Stat. 3296, 3316.

8. I.R.C. § 170(b)(1)(C).

9. *Id.* § 170(b)(1)(E)(i). This provision was added as part of the Pension Protection Act of 2006, Pub. L. No. 109-280, §1206(a), 120 Stat. 780, 1068.

10. I.R.C. § 170(b)(1)(E)(iv).

11. *Id.* § 170(b)(1)(E)(ii).

12. *Id.* § 2031(c). Senate Finance Committee Chair Max Baucus introduced legislation, H.R. 4853, 111th Cong. §306 (2010), that would greatly expand this provision to allow estate reduction by as much as fifty percent of the land value up to \$5,000,000. *Baucus Amendment Would Extend Tax Cut*, 2010 TAX NOTES TODAY 233-82, Dec. 6, 2010, at 37. This provision, however, was not included in the final version of the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, Pub. L. No. 111-312, 124 Stat. 3296.

13. See Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-In Gains*, 56 TAX L. REV. 1 (2002).

14. Conservation Easements Policy Seminar, Lincoln Institute of Land Policy, Lincoln House, Cambridge, Mass. (Feb. 18, 2005). For a brief overview of this conference, see <https://www.lincolninst.edu/education/education-coursedetail.asp?id=254> (last visited Mar. 8, 2011).

Law School,<sup>15</sup> because reporters at the *Philadelphia Inquirer*<sup>16</sup> discovered testimony I had delivered on behalf of the Treasury back in 1979 and 1980.<sup>17</sup> My testimony had raised serious concerns about allowing the charitable deduction for conservation easement contributions.

The Treasury was troubled by the possibility of overvaluation of conservation easements and the difficulty of accurately valuing such partial interests in land. The Treasury believed that the proposed legislation failed to provide a sufficiently precise definition of conservation purposes and thus did not insure that deductible contributions would be confined to those providing some benefit to the general public. The Treasury was also concerned because the proposed legislation did not guarantee that the perpetual easements would be enforced over the long term. The professional tax staffs of the Joint Committee on Taxation and the Senate Finance Committee expressed similar reservations in 2005,<sup>18</sup> indicating that the problems the Treasury had identified in 1979 and 1980 remain. To summarize:

1. Unlike gifts of cash or marketable securities, the amount of the deduction for a conservation easement donation depends upon an appraisal. The uniqueness of each encumbered property, the variability in easement restrictions, and the paucity of cash easement sales make it highly unlikely that the value of a conservation easement can be derived from sales of comparable easements.<sup>19</sup>
2. The charitable deduction should be measured by either the loss in value to the donor or the benefit to charity, whichever is less. The diminution in the donor's assets would often suffice. The assumption that the detriment to the donor is equivalent to the value to charity—which would seem to follow in the case of a cash gift—is not necessarily true, however, in the case of a conservation easement donation. This would seem particularly true because the donee is not free to transfer or terminate the easement, especially if there is no independent certification of the public benefit.
3. When a charity holds only a partial interest in property, there is a significant risk that the property will be used in a way that is harmful to the charitable interest. This is of particular concern in the conservation easement context because the scope of the

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15. The 8th Annual Conference on Litigating Takings and Other Constitutional Challenges to Land Use and Environmental Regulations, Georgetown University Law Center CLE/Environmental Law and Policy Institute, Harvard Law School, Cambridge, Mass. (Oct. 27, 2005). For a brief overview of this conference, see [http://www.law.georgetown.edu/gelpl/about\\_GELPI/Conf05.pdf](http://www.law.georgetown.edu/gelpl/about_GELPI/Conf05.pdf).

16. Craig R. McCoy & Linda K. Harris, *Saving Treasures that Benefit Few; As Federal Law Helps Protect Private Property, the Public Often Gets Little*, PHILA. INQUIRER, Feb. 24, 2002, at A1, available at [http://articles.philly.com/2002-02-24/news/25333700\\_1\\_federal-tax-tax-deduction-tax-revenue](http://articles.philly.com/2002-02-24/news/25333700_1_federal-tax-tax-deduction-tax-revenue).

17. *Miscellaneous Tax Bills: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways & Means*, 96th Cong. 11 (1979) (statement of Daniel Halperin, Deputy Assistant Sec'y, Treasury Dep't) (in reference to H.R. 4611); *Minor Tax Bills: Hearing Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways & Means*, 96th Cong. 165 (1980) (statement of Daniel Halperin, Deputy Assistant Sec'y, Treasury Dep't) (in reference to H.R. 7318).

18. STAFF OF THE JOINT COMM. ON TAXATION, 110TH CONG., *OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES*, JCS-2-05, at 277–87 (2005), available at <http://www.jct.gov/s-2-05.pdf>; *Finance Committee Issues Report on the Nature Conservancy*, 2005 TAX NOTES TODAY 109-11, June 8, 2005.

19. See, e.g., *Trout Ranch v. Comm'r*, T.C. Memo. 2010-283 (2010) (rejecting taxpayer's argument that conservation easement at issue should be valued for purposes of a deduction based on the sale prices of other conservation easements because such easements were not comparable).

easement restrictions will often not be easily determinable and because the holder may have neither the necessary resources for nor the interest in enforcement.

Therefore, the revenue loss from the charitable deductions for easement donations might well be far more than the public benefit provided. Particularly at a time of severe revenue constraints, a huge disparity between the tax benefits (primarily for the wealthiest) and the public benefit is unacceptable.

We need a new approach: one that would require a governmental entity or a land trust meeting certain minimum standards to certify the public benefit of the transfer. Given the potential for abuse of the tax deduction, preferably Congress should substitute direct government grants to facilitate the acquisition of conservation easements.<sup>20</sup> If this approach is not politically viable, it would be wise to place a dollar limit on the amount of the annual revenue loss by replacing the deduction with a limited amount of tax credits, to be allocated among eligible beneficiaries by an expert government agency. At the very least, such an agency or a beneficiary meeting specified standards should be required to certify the public charitable benefit.

Although it may appear quite radical, my proposal is actually consistent with the direction of the tax law. First, this proposal merely recognizes the conservation easement gift's unique status as an unlimited exception to the restrictions on gifts of partial interests, despite circumstances where the abuses inherent in such gifts are particularly likely to be prevalent. Moreover, the proposal is consistent with steps that have been taken to restrict deductions for partial-interest gifts in other contexts and to limit overvaluation of charitable contributions. Thus, a general modification of the charitable deduction is not a prerequisite to a new approach to conservation easements.

Second, although once quite rare, dollar limits on the annual cost of tax expenditures and involvement of other agencies are becoming increasingly common. In these circumstances, reliance is appropriately placed on an expert agency to allocate a limited amount of government aid to the acquisition of conservation easements. In short, given the likely disparity between the revenue loss from the charitable deduction for conservation easement donations and the benefit to the public from the easements, change is appropriate.

## II

### PARTIAL INTERESTS IN PROPERTY

#### A. In General—1969 Tax Reform Act

The risk that the donor benefit from a charitable deduction will exceed the public benefit from the donation is greatly increased when the charity receives

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20. See Dominic P. Parker, *Conservation Easements: A Closer Look at Federal Tax Policy*, PERC POLICY SERIES, Oct. 2005, at 20–22, <http://www.perc.org/pdf/ps34.pdf> (discussing potential benefits of replacing federal tax-code funding with “federal competitive grants requiring trusts to raise matching funds from private sources and local governments”).

only a partial property interest. A partial interest is unique in that the future behavior of the donor or a subsequent transferee determines the contributed property's charitable value. For example, if I were to give my daughter an income interest in a trust fund, with a remainder interest to Harvard, I could have the funds invested in an oil well, which will be dry in ten or fifteen years. In that case, my daughter's income would be substantial, but Harvard would receive nothing. Despite the appearance of a contribution and the receipt of a deduction, I would have given nothing of value to charity for the public benefit. This ability to structure partial-interest donations to favor private interests over the charitable beneficiary led Congress to amend the Internal Revenue Code to prohibit charitable deductions for most partial-interest gifts.<sup>21</sup>

That 1969 reform focused on gifts in trust. Reflecting the heightened concern that prior rules allowed a "taxpayer to receive a charitable contribution deduction for a gift to charity of a remainder interest in trust which was substantially in excess of the amount that the charity might eventually receive,"<sup>22</sup> Congress generally limited the deduction to a charitable-remainder annuity trust or a charitable-remainder unitrust.<sup>23</sup> The Joint Committee on Taxation noted that the limitations "remove the flexibility of the prior provisions whereby it was possible to favor the income beneficiary over the remainder beneficiary by means of manipulating the trust's investments."<sup>24</sup> To prevent similar abuse, Congress disallowed a deduction for a partial interest not in trust except in very limited circumstances—an undivided interest in property and a remainder interest in a personal residence or farm.<sup>25</sup>

#### B. Remainder Interest in a Residence

The Senate Finance Committee proposed a deduction for gifts of all remainder interests in real property, citing as an example a gift of a personal residence.<sup>26</sup> The 1969 Conference Committee subsequently narrowed the Senate Finance Committee's proposed rule to allow deductibility only for a remainder interest in a personal residence or farm.<sup>27</sup>

Charitable gifts of remainder interests in a personal residence were probably common types of transfers that, according to the Joint Committee, "Congress did not believe . . . presented the kind of abuse that it was appropriate to

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21. Pub. L. No. 91-172, § 201(a)(1), 83 Stat. 487, 556–57 (1969).

22. STAFF OF THE JOINT COMM. ON TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969 83 (Comm. Print 1970).

23. I.R.C. § 170(f)(2)(A) (2006).

24. STAFF OF THE JOINT COMM. ON TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, at 84.

25. I.R.C. § 170(f)(3).

26. S. REP. NO. 91-552, at 89 (1969).

27. H.R. REP. NO. 91-782, at 294 (1969) (Conf. Rep.). The special treatment of "farmers" is not unusual and will not be examined here.

curtail.”<sup>28</sup> Perhaps Congress believed it was unlikely the remainder beneficiaries would be unduly disadvantaged because there was a negligible risk that a donor who continued to live in a residence would allow it to deteriorate. Still, Congress imposed strict standards to forestall overvaluation of remainder-interest gifts.<sup>29</sup> This narrow, carefully circumscribed exception to the denial of a deduction for charitable partial-interest gifts is relevant in examining the need for further restrictions on deductions for conservation easement transfers.

### C. Undivided Interests

In 1969, Congress also allowed a deduction for contributions of an undivided interest in property, perhaps on the assumption that, because the charity’s interest was the same as that of other undivided-interest holders, the value to the charity *must be* the applicable percentage of the entire value. In 2006, however, Congress realized that the charity would not necessarily receive what it was entitled to. For example, museums often did not exercise their right to possess a work of art for the applicable portion of the year, permitting the donor to retain full possession.<sup>30</sup> Therefore, in 2006, Congress substantially restricted the deduction for an undivided-interest gift, denying the deduction if the charity did not have substantial physical possession of the property or would not obtain full ownership within ten years of the initial gift. Further, the fair market value at the time of the original transfer determines the value of any subsequent donation unless the value has declined.<sup>31</sup> These limitations are relevant to the consideration of conservation easements, which seem far more likely to be abused. With an undivided interest in property such as a work of art, the only question is whether, in deference to the donor, the charity will fail to enforce its rights. The charity’s rights are clear, and enforcement is straightforward. With conservation easements, on the other hand, the scope of the restrictions will often be uncertain, and enforcement is decidedly more problematic.

### D. Conservation Easements

The Internal Revenue Code made no mention of conservation easements in 1969. Although land trusts have existed since the late nineteenth century,<sup>32</sup> easements for conservation purposes were rarely seen until the 1930s; and, prior

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28. STAFF OF THE JOINT COMM. ON TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969, at 84.

29. *Id.*; see I.R.C. § 170(f)(4) (providing for valuation of remainder interest in real property).

30. See James B. Lyon, *Reflections on Deductibility of Contributions of Items of Tangible Personal Property to Museums*, 2007 TAX NOTES TODAY 32-45, Feb. 15, 2007, at 7.

31. I.R.C. § 170(o).

32. For a brief history of land trusts in the United States, beginning with the first land trust, the Trustees of Public Reservations (formed in Massachusetts in 1891), see RICHARD BREWER, CONSERVANCY: THE LAND TRUST MOVEMENT IN AMERICA 13-40 (2003). According to Brewer, although the first national land trust, The Nature Conservancy, was founded in 1946, the land trust movement did not begin until 1981.

to the Tax Reform Act of 1969, little was written about them. Thus, it was perhaps unimportant to the nascent conservation movement that the 1969 reforms appeared to deny a deduction for conservation easements. Nevertheless, Congress had some last-minute regrets. The 1969 Conference report described an uncodified exception for certain *easements*, which were to be considered the gift of an undivided interest in property.<sup>33</sup> This seems strange because the rationale for the undivided-interest exception—namely that the charity’s interest was identical to that of the other partial owners—was clearly inapplicable.

This purported exception may have reflected Congress’s intent to preserve the charitable deduction the Internal Revenue Service (IRS) had recognized for conservation easements five years earlier.<sup>34</sup> In a 1964 Revenue Ruling, the IRS ruled that a taxpayer who placed a restrictive easement on property adjacent to a federal highway, limiting the use and development of the land to preserve a scenic view, was entitled to a charitable income-tax deduction equal to the easement’s fair market value.<sup>35</sup> In 1965, the IRS issued a news release indicating that charitable deductions could be claimed for gifts of “scenic easements” to qualified recipients.<sup>36</sup> Apparently in reliance on the conference report, the IRS continued to recognize these exceptions despite the passage of the 1969 Act.<sup>37</sup>

In the mid-1970s, interest in conservation easements increased. By the 1980s, the use of conservation easements was becoming widespread.<sup>38</sup> In these circumstances, it would have seemed unwise to continue to rely on an unsupported statement in the legislative history to justify a deduction. Presumably in response, Congress enacted the Tax Reform Act of 1976,<sup>39</sup> temporarily codifying the deductibility of conservation easement donations. No reason was given for the addition of the easement provisions to the 1976 Act, and the Act’s legislative history includes no testimony or debate by interested parties or legislators concerning conservation easement provisions.<sup>40</sup> In 1980, Congress made the conservation easement provisions permanent.<sup>41</sup>

In sum, Congress has provided a broad, unfettered exception to the rule disallowing deductions for partial-interest gifts for conservation easement donations; but, as the Treasury testimony noted, it has failed to pay sufficient attention to whether there is protection from the serious problems that led to

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33. H.R. REP. NO. 91-782, at 292 (1969) (“The conferences on the part of both Houses intend that a gift of an open space easement in gross is to be considered a gift of an undivided interest in property where the easement is in perpetuity.”).

34. See, e.g., Rev. Rul. 64-205, 1964-2 C.B. 62.

35. *Id.*

36. I.R.S. News Release IR-65-784 (Nov. 15, 1965).

37. See S. REP. NO. 96-1007, at 8–9 (1980).

38. BREWER, *supra* note 32, at 148.

39. Pub. L. No. 94-455, § 2124(e), 90 Stat. 1520 (1976).

40. Stephen J. Small, *An Obscure Tax Provision*, in PROTECTING THE LAND: CONSERVATION EASEMENTS PAST, PRESENT, AND FUTURE 55, 56–57 (Julie Ann Gustanski & Roderick H. Squires eds., 2000).

41. Pub. L. No. 96-541, § 6, 94 Stat. 3204 (1980).

these deductions' prohibition. This failure is highlighted by the recent severe restrictions on gifts of undivided interests. There are substantial questions whether the charitable deduction for conservation easements reflects the charity's benefit from the gift,<sup>42</sup> in part because the definition of public benefit is imprecise and because there rarely is direct evidence of the value to the public. Further, it is not clear that the intended conservation benefit, such as it is, will be secured. Restrictions on the use of the property in an easement can be murky and difficult to interpret. Even if they are not, the current regulations provide inadequate assurance that holders will enforce the perpetual conservation easements according to their terms.

#### E. Enforcement

"The real work with conservation easements begins after the signature ink is dry. Even the best written easements are only as good as the holder's resolve and capacity over the long term to monitor, enforce, and defend them."<sup>43</sup> Unfortunately, the current Treasury regulations do not provide adequate assurance that easements will be enforced. The Treasury regulations do require the organization receiving a conservation easement to be a publicly supported charity that has "a commitment to protect the conservation purposes of the donation, and . . . the resources to enforce the restrictions."<sup>44</sup> But this can be a mirage. The commitment can be shown merely by including the appropriate language in the organization's articles of incorporation, and the organization "need not set aside funds to enforce the restrictions."<sup>45</sup> The regulations also fail to specify what an organization must do following the gift to demonstrate that it has the requisite commitment and resources.

Recognizing this problem, in 2005, the Senate Finance Committee staff recommended that the IRS issue guidance establishing the conditions necessary for compliance with the monitoring obligation, which might include a stewardship fund, periodic monitoring reports, and a centralized directory of easements.<sup>46</sup> As suggested, the annual information return filed with the IRS now requires the organization to state whether it has a written policy regarding the periodic monitoring, inspection, handling of violations, and enforcement of easements, and asks for data as to the time and money devoted to this purpose.<sup>47</sup> But the IRS has not indicated what enforcement activity is required.<sup>48</sup>

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42. See *infra* Part III.

43. JEFF PIDOT, REINVENTING CONSERVATION EASEMENTS, A CRITICAL EXAMINATION AND IDEAS FOR REFORM 18 (Lincoln Inst. of Land Policy 2005).

44. Treas. Reg. § 1.170A-14(c)(1) (as amended in 2009).

45. *Id.*

46. STAFF OF S. COMM. ON FINANCE, 109TH CONG., 1 REP. OF STAFF INVESTIGATION OF THE NATURE CONSERVANCY, at Executive Summary 11 (Comm. Print 2005).

47. Schedule D to Form 990, the Annual Return of an Organization Exempt From Income Tax. Schedule D is required for all easement holders, which must disclose this status in Question 7 of Form 990, Part IV. See STAFF OF S. COMM. ON FINANCE, 109TH CONG., 1 REP. OF STAFF INVESTIGATION OF THE NATURE CONSERVANCY, at Executive Summary 11 (recommending that the IRS modify Form



Of course, the failure to enforce the easement would in most cases have no impact on the donor's deduction. Thus, to strengthen the obligation to enforce, the Senate Finance Committee staff also recommended in 2005 that "the IRS consider revoking the tax exempt status of a conservation organization that regularly and continuously fails to monitor and enforce conservation easements."<sup>49</sup> Most significantly, the staff recommended that "the law should permit the IRS to impose excise taxes on officers and directors for failure to adopt and enforce policies to assure the organization satisfies its monitoring and enforcement obligations."<sup>50</sup> This is a sensible idea that would put real teeth in the enforcement obligation. It deserves to be considered by Congress.

In any event, it is not enough that the holder care about protecting the easement; it must have the resources to do so. "Many land trusts are newly created, underfunded, and in a weak position to commit to this kind of permanent stewardship."<sup>51</sup> Therefore, the donee should be required to certify that it has selected the easement consistent with its mission and that it has both the resources to manage and enforce the restriction and a commitment to do so. Further, as the Senate staff suggested, funds should be set aside for monitoring, defending, and enforcing the easement. The Land Trust Alliance has taken substantial steps to achieve this goal as part of its accreditation process.<sup>52</sup>

Ideally, the Internal Revenue Code should require that tax-deductible easements be held solely by organizations that meet rigorous uniform standards.<sup>53</sup> Moreover, because it is obviously easier to set aside adequate funds if one expects a problem with a relatively small percentage of a large number of easements, eligibility should be restricted to organizations that hold a substantial number of easement grants and have sufficient staff to monitor and enforce compliance. To assure that funds will be available for enforcement, the donor should be required either to contribute such funds or to demonstrate that the organization has adequate resources. These steps would increase the

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990 "to require conservation organizations to provide information regarding its ongoing monitoring and enforcement policies and practices").

48. *But see generally* I.R.S. Priv. Ltr. Rul. 201048045 (Dec. 3, 2010) (denying tax-exempt status for failure to demonstrate ability to enforce easement); I.R.S. Priv. Ltr. Rul. 201109030 (Mar. 4, 2011) (denying exempt status for accepting nonqualifying property and for failure to monitor and enforce easements); I.R.S. Priv. Ltr. Rul. 201110020 (Mar. 11, 2011) (denying exempt status *inter alia* for failure to ensure that accepted easements serve a conservation purpose or to demonstrate its commitment to protect the easements it accepts).

49. STAFF OF S. COMM. ON FINANCE, 109TH CONG., 1 REP. OF STAFF INVESTIGATION OF THE NATURE CONSERVANCY, at Executive Summary 10.

50. *Id.*

51. PIDOT, *supra* note 43.

52. *See Land Trust Standards and Practices*, LAND TRUST ALLIANCE, 8–9, 12 (2004) (Standard 8: Evaluating and Selecting Conservation Projects; and Standard 11: Conservation and Easement Stewardship), <http://www.landtrustalliance.org/training/sp/lt-standards-practices07.pdf>. These standards must be adopted as part of the Alliance's accreditation process. *See also Accreditation Requirements*, LAND TRUST ALLIANCE, <http://www.landtrustaccreditation.org/getting-accredited/are-you-ready> (last visited Mar. 31, 2011).

53. PIDOT, *supra* note 43, at 21.

likelihood that the public benefit from an easement donation will be in accord with the terms of the gift.

### III

#### DETERMINING THE BENEFIT TO CHARITY

##### A. Valuation In General

Even if the gift is enforced according to its terms, however, it is not necessarily the case that the public benefit flowing from an easement donation will match the tax revenue lost from the deduction. If the public benefit is not commensurate with the revenue loss, one of the traditional rationales for allowing tax deductions for charitable donations—namely that charitable activities serve as a substitute for government services—will not be satisfied.<sup>54</sup> When a contributor donates cash, the amount contributed (which ordinarily determines the tax deduction) would, apart from the costs of fundraising,<sup>55</sup> be identical to the benefit to charity. Gifts of property raise greater concern for two reasons. First, unlike cash, the value of property may be misstated. It can be difficult to determine the value of a donated item,<sup>56</sup> and there is a strong incentive for a donor to overstate the value of her donation in order to claim a larger deduction and thus decrease her taxable income. Second, the value of the property in the charity's hands may be less than its fair market value. Both concerns arise in the context of conservation easement donations, and it is instructive that Congress has attempted to address these concerns with respect to other forms of charitable contributions.

For example, in the case of tangible personal property, which can be difficult to value, section 170(e) of the Internal Revenue Code mitigates the valuation

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54. Rob Atkinson, *Altruism in Nonprofit Organizations*, 31 B.C. L. REV. 501, 606 n.292 (1990); Evelyn Brody, *Of Sovereignty and Subsidy: Conceptualizing the Charity Tax Exemption*, 23 J. CORP. L. 585, 590 (1998) (“Under the subsidy theory, tax exemption functions as an inducement to charities to undertake specific activities or to engage in behavior a certain way. For example, under the classic conception of this ‘quid-pro-quo’ approach, the state bestows tax exemption in recognition of charities’ lessening the burdens of government.”); *id.* at 590 n.23 (discussing legislative history supporting this rationale); see C. Eugene Steuerle & Martin A. Sullivan, *Toward More Simple and Effective Giving: Reforming the Tax Rules for Charitable Contributions and Charitable Organizations*, 12 AM. J. TAX POL’Y 399, 404 (1995) (stating that among other justifications for the charitable deduction “is the belief that the philanthropic sector represents a third sector that sometimes can meet needs better or more efficiently than the government or the individual acting on his or her own behalf”).

55. Excessive fundraising costs call into question the efficiency of charitable organizations. The discussion in the text might suggest we should seek a mechanism to exclude from donors’ tax deductions the portion of each donation attributable to fundraising costs. This is an issue affecting all charitable organizations and will not be pursued here.

56. William A. Drennan, *Charitable Donations of Intellectual Property: The Case for Retaining the Fair Market Value Tax Deduction*, 2004 UTAH L. REV. 1045, 1084 n.173 (2004); see Erin Thompson, *The Relationship Between Tax Deductions and the Market for Unprovenanced Antiquities*, 33 COLUM. J.L. & ARTS 241, 243–45 (2010) (discussing the difficulty of assessing the fair market value of art and the IRS’s appraisal verification procedures). Thompson notes that, in 2007, the IRS Art Advisory Panel accepted only thirty-six percent of the appraisals it reviewed without changes. *Id.* at 245.

problem by limiting the charitable deduction to basis, usually cost, unless the receiving charity uses the property in a manner consistent with its exempt charitable purpose.<sup>57</sup> When it applies, this provision eliminates the valuation issue. It also deters such gifts, thereby reducing the misalignment between the deduction and the value to charity that occurs when a deduction fails to account for the costs the charity incurs in disposing of the property. But this provision does not apply to gifts of real property like conservation easements and, in any event, would not apply when the receiving charity uses the property in a manner consistent with its exempt charitable purpose.

Moreover, limiting the deduction to cost, though important in preventing overvaluation, would not prevent the deduction from exceeding the property value if value is below the original cost. The latter would generally be true when the property, such as a household or clothing item, was originally purchased for personal use. In such cases, there are additional restrictions that focus on the value to the charity. To ensure there is some value to the charity from the donation of a household or clothing item, a taxpayer may not claim a deduction for such item that is not in “good used condition or better,” unless the item is worth more than \$500 and the taxpayer provides a qualified appraisal to that effect.<sup>58</sup>

Among donations of tangible personal property, used automobile contributions, in particular, have raised questions about the proportionality of charitable tax deductions. The IRS previously allowed donors to deduct the so-called blue-book value of a car even though donors would not likely be able to sell the car for that amount unless they advertised heavily and sold the car in a private transaction.<sup>59</sup> Concerns about taxpayers’ inflating the value of donated used cars<sup>60</sup> led Congress to amend the Internal Revenue Code in 2004 to generally limit deductions of used-car donations above \$500 to the gross proceeds of the charity’s subsequent sale.<sup>61</sup> Charities, however, often partner with for-profit entities that act as the charity’s agent. The agent will bear the cost of taking possession and selling the vehicle and, perhaps, for advertising the program. These costs plus the agent’s fee are subtracted from the amount paid to the charity, which suggests the charity could receive considerably less

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57. I.R.C. § 170(e)(1)(B)(i) (2006).

58. *Id.* § 170(f)(16).

59. Rev. Rul. 2002-67, 2002-2 C.B. 813.

60. See Wendy C. Gerzog, *From the Greedy to the Needy*, 87 OR. L. REV. 1133, 1145 (2008) (“The strict rules regarding the donation of vehicles are a response to the excessive and dubious deductions that donors were taking, echoing the aggressive advertising of the donee charities. . . . The benefit[] to the donor in terms of a tax deduction sometimes exceeds any benefit to the charity.”); U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-04-73, VEHICLE DONATIONS: BENEFITS TO CHARITIES AND DONORS, BUT LIMITED PROGRAM OVERSIGHT (2003), available at [www.gao.gov/htext/d0473.html](http://www.gao.gov/htext/d0473.html) (finding that in a majority of cases examined, charities received five percent or less of deduction claimed).

61. I.R.C. § 170(f)(12); I.R.S. Notice 2005-44, 2005-1 C.B. 1287.

than the selling price.<sup>62</sup> Thus, although the 2004 legislation ameliorates some valuation problems by linking deductions to the sale price of donated automobiles,<sup>63</sup> it does not entirely ensure that each deduction's revenue cost matches the benefit to the recipient charity.

Despite its limitations, the decision to focus on the charitable value in the case of used automobile donations (as opposed to the asserted "loss" to the donor based upon the price that some hypothetical buyer might be willing to pay for the car) is important. In 2004, Congress similarly based the tax deduction for gifts of copyrights, patents, and other intellectual property largely on the amount of the income actually received by the donee.<sup>64</sup> These changes illustrate the inappropriateness of focusing primarily on the decline in the value of the donor's property or assets. The cost to the government, namely the revenue loss from the charitable deduction, should never exceed the actual benefit to charity.

## B. Valuing Easement Donations

Congress's concern with overvaluation of charitable contributions and its focus on the value to the recipient show that modification of the rules applicable to conservation easement donations is appropriate. The rules for conservation easement gifts provide inadequate assurance that the amount of the charitable deduction will be properly determined. Easements are often hard to appraise and easy to overvalue. For a conservation easement, for which comparable sales (purchases of similar easements on closely similar properties) would be rare, the focus is on the decline in the property value for the donor due to the imposition of the restriction. But not only is this decline difficult to measure, the approach itself is also faulty. As a consequence, the donor is often able to take a higher federal tax deduction than is justifiable.

The IRS regulations provide that, in the absence of comparable sales, a donor must generally look to the difference between the value of the property before the restriction and the value of the property subject to the easement.<sup>65</sup> This is extremely difficult to determine because it is heavily fact specific. For example, it would be necessary to determine what the zoning regulations are, whether they are likely to change, and what sort of development was commercially feasible prior to the restrictions, as well as other issues. That there is no standard form of easement exacerbates these difficulties, as does the IRS's

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62. See generally GAO Report, *supra* note 60; Rev. Rul. 2002-67, 2002-2 C.B. 873; I.R.S. Pub. 4302, *A Charity's Guide to Car Donations* (2004), reprinted in 2010 TAX NOTES TODAY 92-27, May 13, 2010.

63. See Richard J. Kovach, *New Rulemaking Approaches to Improve Federal Tax Administration Through Use of Precisional Substitutions that Avoid Valuation Uncertainties*, 6 HOUS. BUS. & TAX L.J. 79, 83 (2005) (arguing that tax code's limit on vehicle donations be expanded to additional asset categories).

64. I.R.C. § 170(m). See *id.* § 170(e)(1)(B)(iii) (allowing deduction for donor's basis without regard to donee's income); H.R. REP. NO. 108-548, pt. 1, at 352-53 (2004).

65. Treas. Reg. § 1.170A-14(h)(3)(i) (as amended in 2009).

lack of the resources required to wade through long documents—drafted by hundreds of different attorneys—in order to determine exactly what restrictions are in place and whether the easements satisfy the various requirements under section 170(h) and the Treasury Regulations. The use of standardized language as a condition for a tax deduction has thus been recommended.<sup>66</sup> This should be seriously considered.

Another problem with conservation easement donations is that the donor may actually benefit from use restrictions. The regulations recognize that an easement restricting neighboring development could increase the value of nearby properties. Thus, the donor must take into account the effect the easement may have on the value of other property owned by the donor or a related party and reduce the charitable deduction accordingly.<sup>67</sup> Because reciprocal easements by owners of adjoining property could increase the value of the whole area, however, the donor should also be required to account for any increase in value of other property, owned by the donor or a related party, due to corresponding restrictions placed by owners of nearby properties. This may prove impossible, making the donor's loss even more difficult to quantify.

More importantly, this is the wrong question. As the restrictions on gifts of intellectual property and used automobiles demonstrate, the diminution in value to the donor is an inappropriate starting point in measuring the benefit to the public. The focus should be on actual benefit to the public, and the taxpayer should be required to present evidence as to this amount. Otherwise, there is no assurance that the charitable benefit will match the revenue loss.

The decline in value to the holder, however, should be the *maximum* deduction. When it is clear that there will be no impact on the donor's enjoyment of the property in the foreseeable future, a deduction is inappropriate. Therefore, it is disturbing that, in a number of recent cases, the Tax Court has rejected the IRS's zero or negligible easement valuation, which the IRS apparently based on the idea that the value to the donor had not changed. The court reasoned that a prospective purchaser would surely take the restrictions into account. In at least one case, the court specifically noted that the government expert had confused "the post-easement value of the land to [the donor] with the fair market value of the land to a willing buyer and seller."<sup>68</sup> To the contrary, the post-gift value to the donor is highly relevant. If

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66. PIDOT, *supra* note 43, at 9–10; Nancy A. McLaughlin & W. William Weeks, *In Defense of Conservation Easements: A Response to the End of Perpetuity*, 9 WYO. L. REV. 1, 84 n.319 (2009) ("As in the charitable remainder and charitable lead trust context, to facilitate compliance, enforcement, and consistency in interpretation, the Treasury Department should develop sample conservation easement provisions that satisfy the requirements of the Internal Revenue Code § 170(h) and the Treasury Regulations interpreting that section. Such provisions could address, for example, the circumstances under which a tax-deductible conservation easement can be amended, transferred, or extinguished; the calculation and division of proceeds upon extinguishment; and the holder's use of its share of the proceeds upon extinguishment.").

67. Treas. Reg. § 1.170A-14(h)(3)(i).

68. Akers v. Comm'r, T.C. Memo. 1984-490 (1984), *aff'd*, 799 F.2d 243 (6th Cir. 1986) (quoted in Scott D. McClure, Steven E. Hollingsworth & Nicole D. Brown, *Courts to the IRS: Ease Up on*

the donor has given nothing away, the tax deduction is merely a windfall, not an incentive to contribute. The post-gift value to the donor is especially relevant in the absence of any evidence of the value that would be attributed to the easement by a responsible land trust.

### C. Establishing Public Benefit

Although the current Internal Revenue Code does require a conservation purpose,<sup>69</sup> the definition is too open ended. The standard for determining public benefit is vague, especially when there is no public access and the property has no value as a habitat for plants and animals. The preservation of open space for scenic enjoyment is particularly problematic. The regulations state that “to satisfy the requirement of scenic enjoyment by the general public, visual (rather than physical access) to or across the property by the general public is sufficient,”<sup>70</sup> which indicates that the donor might not have given up anything of value. Furthermore, that “the entire property need not be visible to the public”<sup>71</sup> leaves open the question of how much the public must be able to see. The regulations provide that “the public benefit from the donation *may be insufficient* to qualify for a deduction if only *a small portion* of the property is visible to the public.”<sup>72</sup> This language suggests to a tax lawyer that it *may* be enough to claim a deduction if the public can see only a small portion and that it is certainly sufficient if the public can see a portion that is only slightly bigger than “small.”

Discussing the vagueness of what is meant by scenic enjoyment illustrates the general problem with the public-benefit standard. In response, in 2005, the staff of the Joint Committee on Taxation (which serves both the House Ways and Means Committee and the Senate Committee on Finance) recommended that, to qualify for a deduction, a contribution must generally protect or preserve property pursuant to a clearly defined governmental conservation policy, which is now required only in the case of some donations in order to protect open space.<sup>73</sup> A clearly defined governmental conservation policy is the minimum requirement necessary to assure some public benefit. Under the current regulations, however, the government need not identify particular parcels, and the governmental policy could be quite vague.<sup>74</sup>

Ideally, the donee should be required to certify *publicly* that it views the public benefit to be at the level of the claimed deduction, which should also be publicly disclosed. Charitable organizations generally do not wish to take

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*Conservation Easement Valuations*, 124 TAX NOTES 551, 552–53, Aug. 10, 2009 (discussing a number of cases in which the IRS proposed a zero or negligible value for the easement)).

69. I.R.C. § 170(h)(4)(A).

70. Treas. Reg. § 1.170A-14(d)(4)(ii)(B).

71. *Id.*

72. *Id.* (emphasis added).

73. STAFF OF THE JOINT COMM. ON TAXATION, 110TH CONG., OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES, JCS-2-05, at 286 (2005).

74. Treas. Reg. § 1.170A-14(d)(4)(iii)(A).

responsibility for abusive deductions, viewing this as a matter to be worked out between the donor and the IRS. Nevertheless, more involvement by the charity is essential if we are to continue a special exemption from the rule prohibiting a deduction for a partial interest in property without *other* protection against the potential abuse that led to that prohibition. The Land Trust Alliance's *Standards and Practices* requires the recipient to evaluate the public benefit and to review each transaction for consistency with tax requirements. Yet, although the trust must agree that it "will not knowingly participate in projects where it has significant concerns about the tax deduction," the standards indicate that the donor is responsible for determining the value of the donation.<sup>75</sup> The recipient should instead be required to share the responsibility for valuation.

#### D. Viability of Current Approach

The prior discussion demonstrates that the concerns the Treasury expressed more than thirty years ago—namely, potential lack of enforcement, inadequacy of public benefit, and overvaluation of contributions—remain. Donors may be giving up very little, particularly because the burden on a donor depends upon the holder's monitoring and enforcing the use restrictions over the long term. In addition, an easement's benefit to the public may be much less than the purported loss to the donor.

Publicity generated by articles in the *Washington Post*<sup>76</sup> led to heightened IRS enforcement efforts,<sup>77</sup> including enhanced information-reporting requirements,<sup>78</sup> and fairly drastic proposals for legislative change from the congressional staff. Even the land-trust community acknowledged that some action was needed.

It is not surprising that the staff of the Joint Committee on Taxation recommended that deductions be disallowed entirely for easements connected to the taxpayer's residence and limited to thirty-three percent of their value in all other circumstances.<sup>79</sup> The staff reasoned that, in the case of residences, the deduction often resulted in a windfall because the owners frequently anticipated no restriction on planned use.<sup>80</sup> Thus, in light of what the staff viewed as insurmountable valuation difficulties, it was best to eliminate the

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75. *Land Trust Standards and Practices*, *supra* note 52, at 12 (Standard 10: Tax Benefits); *see also id.* at 8–9 (Standard 8: Evaluating and Selecting Conservation Projects).

76. *See, e.g.,* Joe Stephens & David B. Ottaway, *Nonprofit Sells Scenic Acreage to Allies at a Loss: Buyers Gain Tax Breaks with Few Curbs on Land Use*, WASH. POST, May 6, 2003, at A1.

77. Fred Stokeld, *IRS Focusing on Deductions for Donated Easements, Miller Says*, 49 EXEMPT ORG. TAX REV. 197, 197 (Aug. 2005); *Everson Testifies Before Senate Finance Regarding EOs*, 2005 TAX NOTES TODAY 65-46, Apr. 6, 2005, at 8–9 (testimony of Mark W. Everson, Comm'r of Internal Revenue); I.R.S. Notice 2004-41, 2004-2 C.B. 31; Janet Novack, *Feds Sue Trust Over Historic Easement Tax Breaks*, TAXING MATTERS, FORBES BLOG (June 16, 2011, 1:52 PM), <http://blogs.forbes.com/janetnovack/2011/06/16/feds-sue-trust-over-historic-easement-tax-breaks/>.

78. *See supra* note 47 and accompanying text.

79. STAFF OF THE JOINT COMM. ON TAXATION, 110TH CONG., OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES, JCS-2-05, at 286 (2005).

80. *Id.* at 284.

deduction entirely. In other cases, they viewed the problem as less severe, but still found valuation concerns significant enough to warrant limiting the deduction to thirty-three percent of the appraised amount. The staff clearly came to the same conclusion that Congress reached in 1969 with respect to gifts of partial interests—under present circumstances, the risk of tax abuse outweighs the potential benefits. Therefore, it would be best to substantially curtail the program.

Predictably, Congress did not do as the staff suggested. The land-trust community strongly opposed the proposals, which would have drastically reduced the availability of a tax deduction. Although the community agreed that it would be sensible to prohibit deductions in some extreme cases, such as easements on golf courses or backyards, their focus was on increased IRS enforcement and securing more-accurate valuations—for example, by establishing standards for appraisers and increasing the penalty for abuse.<sup>81</sup>

The Pension Protection Act of 2006<sup>82</sup> attempted to make appraisals more accurate by increasing the penalty for valuation misstatements and imposing additional penalties on appraisers,<sup>83</sup> who must also meet certain standards to be “qualified” as appraisers.<sup>84</sup> Yet, despite suggestions from the congressional staff that the deduction be restricted, the Act went in the other direction, temporarily increasing the limit on conservation easement contributions from thirty percent to fifty percent and allowing an unlimited deduction for contributions by “qualified” farmers and ranchers.<sup>85</sup>

In my view, the restrictions adopted in 2006 are insufficient and do not come close to dealing with the problem. More disclosure of conservation easements on the annual return, which the IRS is requiring, will help but will not suffice. Although the IRS has significantly increased its attention to this area, it can obviously audit only a small sample of all transactions. Even putting aside deliberate abuse, the appraisal process is so indeterminate that getting the valuation right is extraordinarily difficult.

In fact, more enforcement is the usual taxpayer response to the problem of identifying abuse. But, of course, the IRS does not get an increased budget for the task, and, in fact, no one wants an army of auditors. Not surprisingly, stepped-up enforcement efforts have led to criticism from tax lawyers.<sup>86</sup> Moreover, more enforcement here means less enforcement elsewhere.

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81. See *Land Trust Alliance President Testifies*, *supra* note 4, at 4–7.

82. Pub. L. No. 109-280, § 1219(b), 120 Stat. 780.

83. I.R.C. § 6695A (2006).

84. *Id.* § 170(f)(11)(E).

85. *Id.* § 170(b)(1)(E)(i), (iv).

86. E.g., *Internal Revenue Service Advisory Council 2009 General Report*, IRS (2010), available at <http://www.irs.gov/taxpros/article/0,,id=215543,00.html> (urging moderation of IRS audits with respect to historic preservation easements); *IRS Official Defends Audit Strategy on Conservation Easements*, 2009 TAX NOTES TODAY 185-7, Sept. 28, 2009; Scott D. McClure, Steven E. Hollingsworth & Nicole D. Brown, *Courts to IRS: Ease Up on Conservation Easement Valuations*, 124 TAX NOTES 551, Aug. 10, 2009.



Parts II and III of this paper include proposals that would help to align the charitable deduction with the public benefit. Nevertheless, a new approach is preferable.

#### IV

##### A NEW APPROACH—DIRECT EXPENDITURES

The current scheme for encouraging landowners to donate conservation easements is implemented through the income-tax system. The same conservation goals could also be addressed, however, through a direct government-spending program. A third option is to design a program in which a substantive agency, such as the Bureau of Land Management, helps to administer the tax incentives, with an annual dollar cap. A fourth option is to place a dollar limit on the annual expenditures for conservation easements, even if the IRS continues to administer the program. At the very least, an expert agency should be required to attest to the easement's public value. These different approaches offer various benefits and drawbacks.

##### A. The Superiority of Direct Expenditures

David Weisbach and Jacob Nussim have proposed a framework for deciding whether a tax-expenditure program or a direct-spending program would be more appropriate for a given policy goal.<sup>87</sup> They argue that the key is to determine how accurately a particular agency can implement a policy goal for a given cost.<sup>88</sup> Applying this framework in the context of conservation easements, we would compare the efficiency of a tax-expenditure program with that of a direct-spending program. The question then becomes: what value of land could be conserved for a given amount of either tax revenue forgone or government funds expended?

Promoting conservation easement donation through a tax-expenditure program has certain benefits. First, it takes advantage of the tax system's existing infrastructure. Individuals who donate conservation easements are already filing a tax return, and tax benefits can be distributed to the donor with minimal additional costs. The donor bears the cost of appraising the value of the easement, thus limiting the administrative burden on the IRS, at least initially.<sup>89</sup> The program is open ended, eliminating the need to prioritize or compare the merit of individual donations. In comparison to a direct-spending

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87. See generally David A. Weisbach & Jacob Nussim, *The Integration of Tax and Spending Programs*, 113 YALE L.J. 955 (2004).

88. *Id.* at 993 (“A more accurate policy better distinguishes between different individuals or different actions. It comes closer to the optimum.”).

89. The IRS monitors valuation after the fact through audits. Historically, the IRS has been much more likely to audit donors based on their estimate of the easement valuation than on any other measure of substantive compliance with § 170(h). It should be noted, however, that audits based on other requirements have appeared to increase in recent years. See C. TIMOTHY LINDSTROM, A TAX GUIDE TO CONSERVATION EASEMENTS 11 (2008).

program, which would need to evaluate and rank applications in order to allocate limited funds, it seems likely that integrating the program with the tax system would minimize administrative costs.

Of course, this comes at the cost of greater accuracy. An open-ended tax-benefit program is likely to have broad, rather than targeted, eligibility requirements. Further, because the IRS lacks the institutionalized knowledge of a more specialized agency, such as the Bureau of Land Management, it will be less capable of enforcing even these broader parameters consistently and coherently. Consequently, a tax expenditure will distribute more dollars than is likely to be appropriated, in exchange for less benefit.

Implementing a program through the tax system would provide a particular benefit when doing so will take advantage of already existing definitions, measurements, and infrastructure.<sup>90</sup> The IRS's primary institutional advantage is income measurement, which makes it a good fit for programs that have income-based eligibility requirements.<sup>91</sup> The primary measurements at issue in the conservation easement program, though, are satisfaction of the conservation-purposes tests and value of the easement. The Bureau of Land Management, with its specialized knowledge of the field, would seem to be much better equipped than the IRS to measure both. A specialized agency would also be better suited to assess other eligibility requirements, such as whether an easement's conservation purpose is "protected in perpetuity."<sup>92</sup>

Substantive agency review of applications, therefore, would likely lead to greater consistency in implementation and could help to curb valuation abuse. Also, in contrast to an open-ended tax-deduction program, a direct-spending program could be targeted in various ways. For example, a program that evaluates and ranks individual applications could give preference to easements with the greatest conservation value. The program could also be adapted to meet specific conservation goals or to allocate funds in a way that balances the benefit across geographic areas. A direct-spending program could also be more easily targeted to a specific type of land or a specific class of landowners.

For example, prior to the 2006 amendments to the conservation easement deduction, much discussion arose concerning a group of "land-rich, cash-poor" landowners who lacked a sufficient incentive to donate under the program in effect at the time.<sup>93</sup> The 2006 amendments, which allowed an unlimited deduction for contributions made by "qualified" farmers and ranchers and substantially increased deductions for other donors, appear to have been designed to reach this group.<sup>94</sup> But a deduction will always be an inadequate incentive for individuals who have little or no taxable income. If conserving farm or ranch land is a particularly important goal, it could be accomplished in a

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90. Weisbach & Nussim, *supra* note 87, at 1008.

91. *See id.* at 1001 (discussing the Earned Income Tax Credit).

92. I.R.C. § 170(h)(2)(C) (2006).

93. *See, e.g.,* McLaughlin, *supra* note 3, at 6 n.14.

94. *See* I.R.C. § 170(b)(1)(E)(iv).

more straightforward manner through a grant program than by varying deduction limitations across multiple subsections of the Internal Revenue Code.

Any government purchase of a conservation easement involves a direct expenditure and affects some agency's budget. The amount spent is known and relevant, projects can be prioritized based on merit, and the program can be targeted to accomplish specific conservation goals. On the other hand, Congress often acts as if tax benefits are a free lunch and have no effect on the deficit. Moreover, tax provisions can be more easily abused.<sup>95</sup> Because the advantages of the tax-expenditure approach are minimal in the case of conservation easement donations, the inefficiency of this approach should be recognized and direct grants used instead.

#### B. Limited Tax Credits Allocated by an Expert Agency

If the tax preference remains, Congress should impose additional conditions to approximate the direct-expenditure approach as nearly as possible. This requires some direct involvement by a public agency.

Thus, an additional option would be to design a program that is jointly implemented by the IRS and an expert agency. For example, the deduction for conservation easement contributions could be eliminated and replaced by tax credits, capped at a certain dollar amount each year. These tax credits could be allocated by application to the Bureau of Land Management. One long-standing example of this type of program, which has recently become far more common, is the Low Income Housing Tax Credit, through which state housing agencies distribute a fixed allotment of tax credits to developers of affordable housing projects.<sup>96</sup>

Two recent, additional examples of such tax-credit programs have authorized up to \$250 million in tax credits for certain gasification projects<sup>97</sup> and up to \$1.25 billion in tax credits for coal facilities.<sup>98</sup> Both amounts are allocated through a joint application to the IRS and the Department of Energy.<sup>99</sup> The Department of Energy also participates in the implementation of the Qualified

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95. See Stephen J. Small, *Proper-and-Improper Deductions for Conservation Easements, Including Developer Donations*, 105 TAX NOTES 217-224, Oct. 11, 2004.

96. I.R.C. § 42(h). This program was created under the Tax Reform Act of 1986, Pub. L. No. 99-514, § 252, 100 Stat. 2085. Annual tax expenditures for fiscal year 2010 are estimated to be \$4.7 billion for corporations and \$300 million for individuals. STAFF OF THE JOINT COMM. ON TAXATION, 111TH CONG., ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2009-2013, JCS-1-10, at 33 (Comm. Print 2010). Under the program, state agencies have wide discretion in setting criteria by which they will award credits to proposed projects.

97. I.R.S. Notice 2009-23, 2009-16 I.R.B. 802. Tax credits for the "qualifying gasification project program" under I.R.C. § 48B were authorized by section 112 of the Energy Improvement and Extension Act of 2008, Pub. L. 110-343, 122 Stat. 3765.

98. I.R.S. Notice 2009-24, 2009-16 I.R.B. 817. Tax credits for the qualifying advanced-coal-project program under I.R.C. § 48A were authorized by section 111 of the Energy Improvement and Extension Act of 2008, Pub. L. 110-343, 122 Stat. 3765.

99. Edward Kleinbard describes both of these examples in *The Congress Within a Congress: How Tax Expenditures Distort Our Budget and Our Political Process*, 36 OHIO N.U. L. REV. 1, 2 (2010).

Advanced Energy Project Credit<sup>100</sup> and the Credit for Production From Advanced Nuclear Power Facilities.<sup>101</sup> This approach may be more politically palatable than an explicit direct-spending program and would be an improvement on the current regime.

A program through which the Bureau of Land Management allocates a capped level of tax benefits to conservation easement donors would have many of the benefits listed above for direct-spending programs—including harnessing agency expertise, increasing consistency in implementation, and allowing for more-targeted distribution. A closed-ended program would also force greater prioritization of government funds for conservation easements.

As in the Low Income Housing Tax Credit example, the tax benefits could potentially be allocated to state land-use agencies to distribute, allowing for diverse priorities across regions. In other programs, state agencies allocate the tax credits available on the issuance of certain bonds bearing tax credits.<sup>102</sup> A program could also be designed that would distribute tax credits directly to land trusts, which could then use the credits to “buy” conservation easements directly from landowners. This proposal is analogous to the New Markets Tax Credit, through which the Treasury allocates a capped level of tax credits to designated Community Development Entities (CDEs). The CDEs are then able to allocate these credits to investors whose funds were used to invest in low-income communities.<sup>103</sup>

Such caps on tax expenditures are becoming more common, even if no outside agency is involved, particularly in programs for the issuance of bonds entitling the holder to tax credits.<sup>104</sup> Congress has also placed limits on the tax incentives for the purchase of alternative-fuel cars.<sup>105</sup> Thus, consistent with emerging practice, Congress should place a dollar limit on the conservation

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100. I.R.C. § 48C (allocated by Treasury in consultation with Department of Energy based on criteria described in § 48C(d)).

101. *Id.* § 45J. The Treasury allocates the annual limit after consultation with the Secretary of Energy under “necessary and appropriate” regulations. *Id.* § 45J(b)(4).

102. Qualified Energy Conservation Bonds, *id.* § 54D (allocated by Treasury to states and large local governments by population, *id.* § 54D(e)); Qualified Zone Academy Bonds, *id.* § 54E (allocated by Treasury to states in proportion to population below poverty line, *id.* § 54E(c)); Qualified School Construction Bonds, *id.* § 54F (allocated by Treasury to states and large school districts in proportion to eligibility to receive certain grants under Elementary and Secondary Education Act, *id.* § 54F(d)).

103. *Id.* § 45D(f)(2). Congress capped the total level of tax credits at \$5 billion for 2009. *Id.* § 45D(f)(1)(F) (West 2009).

104. Tax Credit to Holders of Clean Renewable Energy Bonds, *id.* § 54 (bond limitation allocated by Treasury, *id.* § 54(f)); New Clean Renewable Energy Bonds, *id.* § 54C (allocated by Treasury according to formula specified in Code, *id.* § 54C(c)(3)); Qualified Forestry Conservation Bonds, *id.* § 54B (allocated by Treasury as it deems appropriate based upon applications submitted, *id.* § 54B(d)); Qualified Gulf Opportunity Zone Bond, *id.* § 1400N(a)(2)–(3) (maximum based on dollar amount per relevant population); Recovery Zone Bonds, *id.* §§ 1400U-2, 1400U-3 (allocated by Treasury in proportion to 2008 employment decline, *id.* § 1400U-1(a)).

105. Alternative Motor Vehicle Credit, *id.* § 30B (phased out after first 60,000 cars, *id.* § 30B(f)); New Qualified Plug-in Electric Drive Motor Vehicles, *id.* § 30D (phased out after first 200,000 vehicles, *id.* § 30D(e)).

easement program even if it is administered through tax credits whether or not another agency is involved.

### C. Certification of Public Benefit

At the very least, a governmental agency should attest to the value of the conservation purpose. A long-standing example of agency involvement, which is now becoming more frequent, is the Department of Interior's certification procedure for tax credits for the rehabilitation of historic structures. No credit is allowed for any expenditure attributable to the rehabilitation of a certified historic structure or a building in a registered historic district unless the Secretary of Interior certifies that rehabilitation is "consistent with the historic character of such property or the district in which such property is located."<sup>106</sup> Further, the Work Opportunity Credit, which provides tax credits to employers who hire certain classes of difficult-to-employ individuals, restricts eligibility to individuals certified by a designated local agency.<sup>107</sup> Other programs require the participation of another agency in implementing a tax credit.<sup>108</sup> Similarly, eligibility for a charitable deduction for a conservation easement should be contingent on certification—by a public agency or, possibly, an IRS-accredited land trust<sup>109</sup>—that the public benefit from the contribution is equivalent to the claimed deduction.

## V

### CONCLUSION

In sum, the recent changes to various tax-expenditure programs—placing caps on the expenditures and requiring the participation of expert agencies—indicates that Congress is less enamored than it once was with open-ended tax expenditures administered solely by the Treasury Department. Congress has recognized both the need for annual limits on expenditures and the value of input from an expert agency. This model should be applied to conservation easements.

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106. *Id.* § 47(c)(2)(B)(iv), (C); see *Historic Preservation Certification Application*, NAT'L PARK SERV, U.S. DEP'T OF THE INTERIOR, <http://www.nps.gov/hps/TPS/tax/hpcappl.htm>.

107. I.R.C. § 51. The designated local agency would be a state employment-security agency. *Id.* § 51(d)(12)

108. Credit for Production of Low Sulfur Diesel Fuel, *id.* § 45H (no credit allowed unless certification obtained from Treasury after consultation with Administrator of Environmental Protection Agency, *id.* § 45H(e)); Electricity Produced from Certain Renewable Resources, *id.* § 45(c)(8)(B)(i) (Federal Energy Regulatory Commission required to certify the amount of "incremental hydropower production"); Credit for Carbon Dioxide Sequestration, *id.* § 45Q(d)(2) (requires consultation with Administrator of Environmental Protection Agency and Secretaries of Energy and Interior with respect to regulations for determining adequate security measures for storage of carbon dioxide).

109. See *supra* note 52 and accompanying text (referring to Land Trust Alliance's accreditation process).

It cannot be claimed that the deduction for conservation easements is merely a part of the charitable deduction and should not be singled out for special treatment. Congress recognized forty years ago that charitable deductions for partial-interest gifts can be easily abused. It crafted narrow exceptions it hoped would be less troublesome.

Furthermore, Congress recently imposed additional restrictions on undivided-interest gifts, which should be much less problematic than conservation easement donations. In the former case, the charitable interest's value is clear. The only question is whether the charity, in deference to the donor, will fail to enforce its rights. With easements, enforcement is definitely more difficult and expensive, and the scope of the restrictions will often be murky.

Finally, the evidence of the gift's value is inadequate. Valuation is based on the supposed decline in the sales price of the donor's holdings; this decline depends upon uncertain future events and the vigor of enforcement. Many donors have no intention of selling and would view area-wide restrictions as increasing the property's value. Thus, they may have given up little of value. More importantly, we have no evidence that the public benefit is equal to the estimated decline in selling price. Because the deduction for conservation easements is the broadest, most unfettered exception to the partial-interest restriction, special treatment is justified.

A comparison of the current tax-expenditure program's advantages with those of direct grants or limited credits shows that the tax-expenditure approach is clearly inferior. A direct-grant program or a tax credit with an annual ceiling would force the easement's recipient to prioritize and acquire only the most valuable easements. Of course, it would be best if an agency other than the Treasury selected the beneficiaries. To this end, we now have a number of examples of credits being allocated to local governments or private entities.

Even if the program is open-ended, Congress should require a government agency—or a large, diversified land trust meeting strict minimum standards—to certify the conservation purpose. This certification should express agreement with the valuation the donor claimed for tax purposes, which should be publicly disclosed. The easement holder should also be required to have an established monitoring program and to demonstrate its ability to enforce the easement. This suggests more-stringent eligibility requirements. The current limitation to a publicly supported charity, while well intended, is inadequate.

In short, the current system is just not acceptable. We need to find a better way.