D08. Federal Tax Law: The Latest and Greatest CLE

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Rally 2019: The National Land Conservation Conference
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Land Trust Alliance
Together, conserving the places you love
Pine Mountain Preserve: Big win for lasting conservation

LTA Blog: https://www.landtrustalliance.org/blog/big-win-lasting-conservation

The Land Trust Alliance has long held that amendment clauses in conservation easements serve to strengthen easements and improve their enforceability. That’s why we oppose efforts by the IRS to constrain the ability of land trusts to amend easements. And now — thanks to a recent federal court decision — it’s clear that a sound amendment clause upholds conservation purposes.

In the case of Pine Mountain Preserve, LLLP v Commissioner (link is external), the United States Tax Court definitively asserted that the inclusion of an amendment clause in an easement cannot and should not be grounds for denying a deduction for an easement donation. The court said an amendment clause that specifically protects the conservation purposes "did not prevent that easement from satisfying the granted-in-perpetuity requirement" of the tax code.

Donors and land trusts can now feel confident including a sound amendment clause in a conservation easement. Be sure to review these Risk Management Pointers to reduce the risk of audit and help limit problems if there is an audit.

The Tax Court referenced legal briefs the Alliance filed. The court read and quoted from our briefs, ultimately supporting our position that well-drafted amendment clauses are consistent with an easement’s goal of perpetual conservation. We made these arguments on your behalf — and the court embraced our position. But our work is not done. The IRS continues to increase its scrutiny of conservation easements on audit. Additionally, the Pine Mountain decision left unsettled a matter concerning permitted building rights. This is a complicated issue and we are evaluating how to move forward on behalf of land trusts and their donors. There will be more to come on this issue, so stay tuned.

Case Law Summary

- Pine Mountain Preserve, LLLP v. Commissioner, 151 T.C. No. 14 (U.S.T.C. Dec. 27, 2018)(Pine Mountain I);
- State: Alabama
- Procedural Status: Case active. On appeal to 11th Circuit.
- Date: 2018
- Keywords: Amendment; 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; structures; 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 unrebuted 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 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.

- Analysis and Notes: Although it is tucked in at the end of the majority’s opinion, perhaps the most important part of the Pine Mountain I opinion is the holding that the easements’ amendment provisions, which are identical or similar to amendment provisions in thousands of other easements, are consistent with the perpetuity requirements of § 170(h). In 2017, the Land Trust Alliance submitted amicus briefs in this case as well as two others before the Tax Court, in order to counter the IRS’ aggressive arguments about amendment provisions. Following the arguments set forth in these amicus briefs, as well as the rationale of Simmons, the Pine Mountain I majority found that easement holders can be assumed to remain faithful to the conservation purposes upon which their 501(c)(3) tax exemption rests. Pine Mountain I thus represents a solid victory for the land trust community on this issue and will hopefully put an end to the IRS’ pursuit of this line of attack. However, while decisively offering a win on the amendment provision issue, the opinion opens up a host of new complications in its holdings concerning the building areas and permitted rights.

Drafting Pointers for Risk Balancing in Conservation Easement Modifications

Keep Your Amendment Clause

The Alliance has long held that a modification clause in conservation easements strengthen easements and improves enforceability. A modification clause, which may include amendment, consent, waiver and other discretionary approvals, enhances the “protected in perpetuity” standard and improves the chances of perpetual easement protection. This clause (or clauses), along with well-crafted guiding principles, helps conservation organizations properly address unforeseen circumstances.

Due to a federal court decision in 2018, it is clear that a sound amendment clause upholds conservation purposes. In the case of Pine Mountain Preserve, LLP v. Commissioner, the U.S. Tax Court definitively asserted that the inclusion of an amendment clause in an easement cannot and should not be grounds for denying a deduction for an easement donation. Be sure to review these Risk Management Pointers to reduce the risk of audit and help limit problems if there is an audit.

Visit the Alliance blog to learn more about this big win and how the Alliance, working with many tax and conservation experts, helped secure it. Donors and land trusts can now feel confident including a sound amendment clause in a conservation easement. Land trusts may wish to review the Amendment Principles in the 2017 Amending Conservation Easements: Evolving Practices and Legal Principles and ensure any amendment clause reflects the Amendment Principles. The Alliance specifically recommends an amendment clause “to allow amendments that are consistent with the overall purposes of the easement, subject to the requirements of applicable laws.” Practice 11H1 of Land Trust Standards and Practices requires land trusts holding easements to have a written policy on amendments that is consistent with the Amendment Principles.

Eight Elements for Conservation Easement Modification

Land trusts may wish to consider including the following elements for a well-drafted amendment clause. Review them with the board and outside legal counsel:

1. Perpetual duration of the easement and intent to protect conservation purposes in perpetuity.
2. Recognition that change happens over the course of time to which the land trust and the landowner may need to respond.
3. Full disclosure that nothing requires Grantor or Grantee to modify the easement deed. Vest sole discretion for all determinations in the Grantee (avoid use of Grantor consent or agreement).
4. Sole discretion for all determinations retained by the Grantee.
5. Incorporate the concepts embodied in all of the Amendment Principles.
6. Conforms to all of Grantee’s policies in effect at the time of the amendment.
7. Any extinguishment, with the exception of de minimis corrections, requires approval as dictated by state law. Easements for which the donor obtained a federal income tax deduction must comply with the U.S. Tax Code.
Avoiding an Audit

If your donors or donor attorneys fear an IRS audit, consider recommending these steps:
1. Have a moderate and fully substantiated appraisal.
2. Fully substantiate the entire transaction.
3. Draft to demonstrate that conservation protections are paramount, not business interests.
4. Tie all decisions to protection of the conservation purposes.

Pointers for Balancing Risk on Conservation Easement Modification

Eight Elements to Consider Pending a Tax Court Decision

The Land Trust Alliance has long held that a modification clause in conservation easements strengthen easements and improve enforceability. A modification clause, which may include amendment, consent, waiver and other discretionary approvals, enhances the "protected in perpetuity" standard and improves the chances of perpetual easement protection. This clause (or clauses) along with well-crafted guiding principles helps conservation organizations properly address unforeseen circumstances. The following Pointers reflect Land Trust Standards and Practices and can help land trusts and donors avoid IRS challenges while retaining the tools necessary for perpetuity.

IRS Audit Scrutiny

In recent years, the IRS increased its scrutiny of conservation easements and continues to do so on audit. While the IRS has attempted to deny deductions based on the presence of an amendment or modification clause, no court opinion to date has upheld that position, nor has the IRS issued any rulings prohibiting modifications or amendments. These Pointers provide interim guidance while the land trust community continues to wait for the Tax Court to formally opine on the issue. In a summary judgment opinion, one tax court judge ruled that an amendment clause is valid so long as it does not “endanger qualification under section 170(h).” Land trusts must report all modifications annually on Form 990.

If your donors or their advisors fear an IRS audit, there are many actions they can take to reduce audit risk of the overall easement transaction. These include ensuring the appraisal is moderate and fully substantiated, having fully substantiated documentation of the entire easement transaction and, finally, including an amendment clause with the elements below that specifically uphold perpetuity and comply with Section 170(h).

If you do remove your standard amendment clause, then, at a minimum, document in writing, signed by all parties for the land trust’s permanent records, that the deviation from the practice of having an amendment clause does not indicate a presumption against any amendment.

Background

The following Eight Elements of Conservation Easement Modification provide a framework for analysis to assist drafters and land trust personnel in crafting an amendment clause that upholds perpetuity and survives scrutiny by the IRS. In the land trust’s discretion, these elements can be included in one or many clauses.

- The Alliance recommends including a clause or clauses to allow modifications that are consistent with the overall purposes of the easement, subject to the requirements of applicable laws. Doing so clarifies up front for all parties the limited circumstances under which the parties may modify a conservation easement.
- Land Trust Standards and Practices (2017) requires land trusts holding easements to have a written

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1 IRS Form 990 instructions for Schedule D reporting of easement modifications state: “For purposes of this Schedule D reporting requirement, an easement is modified when its terms are amended or altered in any manner. For example, if the deed of easement is amended to increase the amount of land subject to the easement or to add, alter, or remove restrictions regarding the use of the property subject to the easement, the easement is modified......Use of a synonym for any of these terms doesn’t avoid the application of the reporting requirement. For example, calling an action a ‘swap’ or a ‘boundary line adjustment’ doesn’t mean the action isn’t also a modification, transfer, or extinguishment.” See the full instructions at https://www.irs.gov/pub/irs-pdf/i990sd.pdf.
policy on amendments that articulates the principles for and limitations on amendments, consistent with the concepts embodied in the Amendment Principles (Practice 11H1). To date, tax court decisions have only ruled against clauses at explicitly provided for removal of land from the easement.

- Drafters should review the Amendment Principles in the 2017 Amending Conservation Easements: Evolving Practices and Legal Principles (the Amendment Report) and ensure any amendment clause reflects the concepts embodied in these seven principles (the Amendment Principles):
  
  a. Clearly serve the public interest and be consistent with the land trust's mission
  b. Comply with all applicable federal, state and local laws
  c. Not jeopardize the land trust's tax-exempt status or status as a charitable organization under federal or state law
  d. Not result in private inurement or confer impermissible private benefit
  e. Be consistent with the conservation purpose(s) and intent of the easement
  f. Be consistent with the documented intent of the grantor and any direct funding source
  g. Have a net beneficial or neutral effect on the relevant conservation values protected by the easement

Drafting Pointers

Eight Elements for Conservation Easement Modification

Land trusts may wish to consider including the following elements, worded as developed by your attorney, staff and board and informed by your state law, policies and experiences. Use these Elements as a checklist to ensure that the concepts occur somewhere in your conservation easement. Following each element are italicized annotations providing the legal basis or the rationale for inclusion.

1. Perpetual duration of the easement and intent to protect conservation purposes in perpetuity.
   - This element is about upholding conservation permanence, which the IRS wants to see emphasized. The word "perpetuity" appears twice in Tax Code Section 170(h). See also 9-2016 Summary Judgment order in Sells v. Commissioner, U.S. Tax Court Docket Nos. 6267-12, 6801-12, 6835-12, 6836-12, 6837-12, 6838-12, 19246-12 and 13553-13.
   - The IRS Conservation Easement Audit Techniques Guide (revised January 24, 2018) also addresses the need to emphasize perpetuity: “The restriction on the use of the real property must be enforceable in perpetuity, meaning that it lasts forever and binds all future owners. An easement deed will fail the perpetuity requirements of § 170(h)(2)(C) and (h)(5)(A) if it allows any amendment or modification that could adversely affect the perpetual duration of the deed restriction.” While perpetuity applies to the entire document, the Tax Court has specifically stated that it wants to see perpetuity acknowledged in any modification clause.

2. Recognition that change happens over the course of time to which the land trust and the landowner may need to respond.
   - Thus, an acknowledgment of some kind that natural conditions, landscape changes, consistent uses, agricultural and silvicultural economic conditions, cultural conditions, technologies and many other factors may change, requiring the land trust to use its sole discretion to evaluate whether modification is necessary and is consistent with the purposes of the easement.
   - This explains the basis for the legitimacy and logic of amendments and discretionary waivers and approvals. Word the clause to allow the land trust discretion as uses evolve, if consistent with the conservation purposes and values. Agricultural and silvicultural easements may need to address changes in underlying practices that respond to market conditions, while still protecting in perpetuity all conservation purposes and values. An essential boilerplate clause to balance this point is the prohibition on use of economic hardship to defeat conservation restrictions.

3. Full disclosure that nothing requires Grantor or Grantee to modify the easement deed.
   - This element is in response to IRS briefs in various cases, such as Belk, Balsaam, Sells, Kumar and Pine Mountain. This element addresses the IRS requirement that a land trust must retain all decision-making control and act exclusively in the public interest.

4. Sole discretion for all determinations retained by the Grantee.
• Avoid words such as "freely amend" or "not unreasonably withheld" and "Grantor and Grantee agree," which cause concern for the IRS. Also avoid explicit Grantor rights to require any amendment or modification. Again, this is to avoid challenge by the IRS based on word choices that cause the Service concern about abuse.

5. Incorporate the concepts embodied in all of the Amendment Principles.
   • These principles are consistent with the Treasury Regulations, Tax Code and case law.
   • Several of these basic principles overlap, but every concept embodied in a principle should be part of the easement language somewhere in the deed. Drafters can include the concepts in many ways and while it is not necessary to include all of the concepts in the modification clause, it may be logical and prudent to have them in one place.
   • Drafters can include the concepts in the Amendment Principles in many ways and need not explicitly repeat the Principles. Drafters can avoid references to off-record documents by merely including the underlying concept. For example, a drafter can incorporate funders’ intent in the easement’s conservation purposes.

6. Conforms to all of Grantee’s policies in effect at the time of the amendment.
   • The Amendment Report addresses land trust policies on modification.

7. Any extinguishment, with the exception of de minimis corrections, requires approval as dictated by state law. Easements for which the donor obtained a federal income tax deduction must comply with the U.S. Tax Code.
   • IRC §170(h) and the Treasury Regulations §1.170A-14 apply, requiring that the donor must grant an easement in perpetuity, and the deed must protect the conservation purpose in perpetuity. This element is often included in a separate extinguishment clause.

8. Approval, waiver, discretion and consent provisions. The treatment of this essential tool for perpetual stewardship is the subject of some debate about whether to include it in a conservation easement. Some have concerns that the IRS will attack its use. Others balance the risks in favor of including a clause in order to set forth the limits of the use of these tools as many land trusts have done with amendments.
   • The Amendment Report addresses approvals, waivers and consents. The standards for amendment and discretion are similar, but because land trusts exercise administrative discretion for temporary uses, structures or one-time events that are lesser in scope and scale than amendments, some of the standards are different. Similarly, sufficient overlap exists to reasonably encompass approvals, waivers and consents within the modification clause if a land trust so chooses.
   • This could also be a standalone clause, and many land trusts elect to treat this element in a separate section.
   • If you include this clause, you may wish to state explicitly, both in the easement and in the document granting the approval, waiver, consent or other discretionary act, that it is revocable in the land trust’s sole discretion based on consistency with the conservation purposes or any other measurable standard as stated in your template.
   • Practice 11F2 of Land Trust Standards and Practices requires a land trust to establish written procedures to guide its decision-making if using discretionary approvals or if conservation easement deeds contain such clauses.

Other Elements to Consider with Counsel

Land trusts might consider including these additional elements in the conservation easement or in the amendment policy. Consider which elements are appropriate for your area, program, risks, funders and other stakeholders.

• The Grantor compensates the Grantee for actual and reasonable expenses (including staff costs) associated with processing the amendment. Require a stewardship contribution in accordance with the policies of the Grantee at the time the parties sign and record the amendment.
• No amendment is effective unless documented in writing, executed by the Grantee and the Grantor (and any third-party interest holders), notarized and recorded according to the real estate laws of your state.
• Consider whether holders of any mortgages or other liens should subordinate their interests to any
substantive modification. Foreclosure of unsubordinated liens may extinguish that modification and potentially jeopardize easement enforcement. Understand your state law regarding the standard for extinguishment by prior right or prejudice; have land trust counsel carefully explain and evaluate your subordination requirement policy and also individual subordinations in light of the facts of each modification. If you are reducing building or division rights or otherwise further restricting Grantor rights or expanding Grantee rights, then consider the prudence of subordination to avoid disputes that are expensive and time consuming. As a practical matter, having the subordination may deter lenders and others with economic motivations from claiming that a modification has a junior priority to a lien being foreclosed.

- Advise the Grantor to obtain their own tax counsel, and confirm with the landowner that the Grantee is not responsible for any tax advice or consequences of any nature or type, and that the Grantee gives no assurances, no representations and no guarantees.
- Require an updated baseline if the on-the-ground conditions change because of the modification.
- Consider whether the amendment requires analysis and documentation from outside experts regarding conservation values, property attributes or valuation, and whether the Grantor should pay for this. The IRS often looks for this third-party independent evaluation and documentation.

General Suggestions
- Draft defensively.
- Strive for a reasonable balance; you can’t anticipate or define everything.
- Clearly express the intentions of all parties to the easement to guide courts on interpretation.
- Avoid jargon, abbreviations, colloquialisms, terms of art or technical terms.
- Beware of common law that may construe easement language against conservation.
- Understand the politics of your jurisdiction and its influence on the judiciary.
- Include a clause that directs judges to interpret the conservation easement fully in favor of conservation in all situations, not just ambiguities, and consistent with state conservation easement enabling act.
- Avoid conflict between clauses, and make explicit all assumptions.
- Explicitly address all conservation values and protected attributes.

Example Clause - For Illustration Purposes Only
The Land Trust Alliance is not engaged in rendering legal, accounting or other professional counsel or advice. This example merely illustrates the above elements of a possible modification clause. The IRS has not approved nor endorsed this clause, nor does it take into account all state law issues and local land trust considerations. For this reason, it is imperative that you work with your own legal advisors to craft a clause that makes sense for your organization. The Elements should assist you to construct your own tailored modification clause.

Example Clause
Many ways exist to address IRS concerns, state law, Land Trust Standards and Practices, the Amendment Principles, risk balancing and the land trust’s individual policy. The example below comes from three conservation attorneys spanning the country.

24. Amendment and Grantee’s Discretionary Approval

24.1 Background. Grantor and Grantee have determined, in good faith, to articulate herein the limitations of any permissible modifications hereto. Grantor and Grantee recognize that natural conditions, landscapes, uses and technologies change over time, including (select appropriate: agricultural and silvicultural economic conditions, open space, scenic, other consistent with the particular easement) practices. Grantee and Grantor recognize that unforeseen or changed future circumstances may arise which makes it beneficial or necessary to take certain action in order to ensure the continued protection of the Conservation Values (Purposes) of the Protected Property and to guaranty the perpetual nature of this Conservation Easement. Additionally proposed activities may require the exercise of discretion by Grantee, as further described below. This Section therefore ensures that the Grantee protects the Conservation Values (Purposes) of the Protected Property in perpetuity.
24.2 Purpose. To this end, if approved by the Grantee in its sole discretion, Grantor and Grantee have the right to modify this Easement. Grantee may exercise its discretion in accordance with the provisions and limitations of this Section. Grantee has no obligation to agree to any modification of this Easement. No modification shall adversely affect the perpetual duration of this Easement or the perpetual protection of its Purposes.

24.3 Amendment Requirements. Grantee shall not consent to any amendment of this Easement unless Grantor submits a written request for amendment pursuant to Grantee’s existing amendment policy and such amendment otherwise qualifies under Grantee’s policy then in effect respecting conservation easement amendments. The effect of such amendment shall be at least neutral with respect to or enhances the Conservation Values, shall be consistent with the Conservation Values of this Easement, shall comply with I.R.C. Section 170(h) and any regulations promulgated pursuant to such section, and all applicable federal, state and local laws, shall be consistent with Grantee’s public mission, shall not jeopardize the land trust’s tax-exempt status or status as a charitable organization under federal or state law, and shall not result in private inurement or confer impermissible private benefit. Grantor and Grantee may amend this Easement to be more restrictive to comply with the provisions of I.R.C. Section 2031(c). Grantee may require subordination of any mortgage as a condition of permitting any substantive amendment to this Easement.

24.4 General. Notwithstanding the foregoing, Grantee and Grantor shall have no power or right to agree to any activity, use or structure that would (i) result in the extinguishment in full of this Easement; (ii) adversely affect the perpetual nature of this Easement; (iii) adversely affect the qualification of this Easement or the status of Grantee under any applicable laws, including IRC Sections 170(h) and 501(c)(3) and the laws of the State of xxxx; or (iv) result in either impermissible private benefit or inurement to any party. For purposes of this Section, the terms impermissible private benefit and inurement shall have the same meanings ascribed to them in IRC Section 501(c)(3) and associated Treasury Regulations. Any modification that results in a partial extinguishment with the exception of corrections and clarifications of boundary disputes, legal descriptions and internal use demarcations, and any other de minimis modification, shall follow any applicable state laws regarding approvals.

24.5 Discretionary Acts. Grantee may consent to activities, structures or uses, issue waivers or licenses or otherwise exercise discretion regarding which the Easement is silent or ambiguous, under the conditions and circumstances set forth below. Because of unforeseen or changed circumstances, if an activity, structure or use that is not expressly permitted under this Easement is deemed beneficial or necessary by Grantor, Grantor may request, and Grantee may in its sole discretion grant, permission for such activity, structure or use without resorting to the formalities of Grantee’s amendment policy and process, subject to the following limitations. Such request for Grantee’s consent shall be made in writing and shall describe the proposed activity or use in sufficient detail to allow Grantee to evaluate the consistency of the proposed activity with the preservation and protection of the Conservation Values. Grantee may grant its consent only if it determines, in its sole discretion, that (x) the performance of such activity is, in fact, beneficial or necessary; and (xi) such activity (A) shall not result in private inurement or confer impermissible private benefit, (B) results in an at least neutral result with respect to or enhances the Conservation Values of this Easement, and (C) does not violate the terms of this Easement. Grantor shall not engage in the proposed activity or use unless and until Grantor receives Grantee’s approval in writing.

24.6 Costs. If Grantor is the party requesting an amendment of, or discretionary approval pursuant to, this Easement, Grantor shall be responsible for all reasonable and customary fees and costs related to Grantee’s evaluation of said request and an amendment’s execution, including reasonable attorney’s fees and costs, staff, contractor, legal, expert, consultant fees and costs incurred by Grantee, and any costs associated with any updated Baseline Documentation Report prepared pursuant to the provisions of this Section.

24.7 Updated Baseline Documentation. In the event Grantor and Grantee agree to an amendment or discretionary approval pursuant to this Section that results in alterations to the land, then the Baseline Documentation Report shall be supplemented appropriately to reflect the modification scope, scale and
intensity. The supplement shall be acknowledged by Grantor and Grantee as memorializing the condition of the Property as of the date of the amendment or discretionary approval.

24.8 Recording. Grantor and the Grantee shall execute any amendment approved after following the procedures in this section, subject to review by xxxx if applicable in the subject state, as necessary, and shall be recorded in the xxxx Registry of Deeds.

24.9 Form. Any modification that Grantee determines in its sole discretion to be beneficial or necessary, shall be in the form of either (i) an amendment, in the case of a permanent modification of this Easement, including but not by way of limitation, a clerical or technical correction or modification of a reserved right; or (ii) a discretionary approval, waiver or consent in the case of a temporary activity or impact relating to the maintenance or management of the Protected Property which does not require a permanent modification of the Easement. All amendments and discretionary actions shall be subject to this Section. Nothing in this Section, however, shall require Grantor or Grantee to consult or negotiate regarding, or to agree to any amendment or discretionary approval, consent or waiver.

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Building Area Configurations

**Interior and Included**
(All part of defined Protected Property)

**Exterior and Included**
(All part of defined Protected Property)

**Interior and Excluded**
(Building Area NOT part of defined Protected Property)

**Exterior and Excluded**
(Building Area NOT part of defined Protected Property)
This plan is conceptual only and is not represented as an engineered plan.

Credits: 2013/14 imagery from MassGIS Imagery map service.

LEGEND

Base Plan Orthophotograph

Sally Smith's Property

Document Name: 01074 ortho
Pointers for Balancing Risk on Conservation Easement Permitted Structures Following the Full Tax Court Decision in *Pine Mountain Preserve v. Commissioner*

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 case summary 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* decision. The Land Trust Alliance has taken steps to address this situation on behalf of its members, but we do not yet have a favorable resolution, and it may take some time to reverse or limit the erroneous building rights aspect of the decision. While we press our case in the courts, please evaluate your easement template with your land trust attorney in light of the issues and options below.

**Summary**

The background and details underpinning the drafting pointers below follows in the next pages. The Risk Spectrum on page 9 lays out the various approaches across a spectrum from lower risk to higher risk to non-deductibility of the easement. Whatever approach you select in consultation with your attorney and the landowner, explicitly emphasize and document that the exercise of permitted rights are at least not inconsistent with the conservation purposes. Here is a summary of the drafting pointers:

1. **Avoid any specific boundary adjustment, building area relocation or land substitution provision in your conservation easements.**
2. **Avoid inconsistent or excessive permitted structures.**
3. **Address errors or problems by a post-conservation boundary adjustment or relocation.**
4. **Consider alternative included building areas.**
5. **Consider fixing the location of major structures and surface alterations.**
6. **Consider slightly larger or multiple small building areas to add flexibility.**
7. **Cluster building areas regardless of exclusion or inclusion in the easement.**
8. **Protect intact blocks of undeveloped land, not interstitial areas between developed lots.**
9. **Combine conservation purposes and holder’s sole discretion as the approval standard.**
10. **Assess the additional risk from partially floating included building areas.**
11. **Consider documenting how the potential zones do not affect the conservation purposes.**
12. **Consider the risks of excluding or including building areas.**

**Background to Pine Mountain**

Three earlier cases led to the Tax Court’s decision in *Pine Mountain*. These cases dealt with similar issues, starting with the 2013 *Belk* 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, and 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.”

The Fourth Circuit 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 must be made within five years of the easement’s original grant date; and (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.¹ 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 within the exterior perimeter boundaries of, and thus geographically surrounded by, the

¹ For consistency throughout this document, “excluded” building areas are those completely removed from the definition of an easement’s protected property description; “included” building areas remain a part of the protected property but subject to looser restrictions. An “exterior” building area is one that is sited outside the geographic boundaries of the protected property; an “interior” building area is wholly sited within the perimeter of the protected property. Using these terms, the Homesite Parcels in Bosque Canyon were excluded and interior, while the building areas in Pine Mountain were included and interior.
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protected property. The adjustment provision prohibited any material adverse effect on any of the conservation purposes and 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 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 2005 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 properties. Moreover, because the potential boundary adjustments were to areas that were fully within the protected property’s geographic exterior boundaries, the Fifth Circuit distinguished the situation from the Fourth Circuit’s decision in Belk. In a dissenting opinion, one Fifth Circuit judge failed to see any material distinction between adjustments to the exterior perimeter boundaries and those made to the interior boundaries.

What Pine Mountain Says
Together, Belk, Balsam Mountain and Bosque Canyon frame the Tax Court’s decision in Pine Mountain. A brief overview of how the Tax Court regarded the building areas and the other permitted rights will assist drafters. The Tax Court articulated five major holdings, as follows:
(1) Contrary to the Fifth Circuit in Bosque Canyon, 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 interior boundaries (as in Bosque Canyon).
(2) Similarly, based on the facts of Pine Mountain, the Tax 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 excluded and included building areas.
(3) Following these principles, the Tax Court rejected the deductibility of the 2006 easement because it did not fix the initial location of the six building areas.
(4) In a direct comparison to and repudiation of the Fifth Circuit in Bosque Canyon, the Tax Court rejected the deductibility of the 2005 easement because the land trust could permit a change in the 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 easement from constituting a “qualified real property interest” under IRC §170(h)(2).

Key Drafting Pointers
The Pine Mountain decision is very likely to be appealed to the 11th Circuit, and additional
cases are likely to refine these issues further in Tax Court and in the appeals courts. The Alliance will be filing amicus briefs on behalf of its members in these cases. The process is lengthy, quite possibly years. If your donors or their advisers fear an IRS audit, they can reduce audit risk of the overall easement transaction by ensuring the appraisal 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 at least not inconsistent with the stated conservation purposes.

The following pointers provide a checklist for analysis to assist drafters and land trust personnel in crafting permitted building rights that uphold perpetuity and survive scrutiny by the IRS. 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.

1. **Avoid any specific boundary adjustment, building area relocation or land substitution provision in your conservation easements.**
   - Despite numerous limitations on a substitution provision in the easement, the IRS is likely to challenge it, and the Tax Court is likely to disallow the deduction based on *Belk*.
   - Fixed exclusions, fixed building areas and nondeductible easement overlaid on fixed exclusions probably are lower risk.

2. **Avoid inconsistent or excessive permitted structures.**
   - The *Pine Mountain* majority opinion emphasizes the numerous permitted rights allowed in the 2005 and 2006 easements as a significant aggravating factor in why the easements did not merit charitable deductions. For example, the Tax Court likened the right to allow numerous residential buildings outside the building areas to allowing “extra acres of holes in the cheese.” 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* 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 the inconsistent rights argument. Although the vast majority of land trusts already appropriately limit the scope of landowner rights, use extra caution now.
   - Limit permitted structures in whatever ways are appropriate to protect the conservation purposes and to minimize or eliminate the opportunity for adverse impact to the conservation purposes.

3. **Address errors or problems by a post-conservation boundary adjustment or relocation.**
   - 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* decision did not upset this holding. The easement’s general amendment and termination provisions apply to any adjustment proposal.
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- Still, by insisting that the parties fix a building area in a specific location from the outset, the Tax Court’s decision will increase the likelihood of amendment requests as landowners and easement holders discover that a different configuration or location would be more suitable from an ecological or practical perspective.
- 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. With the exception of de minimis adjustments or clear errors, treat any such amendment as a partial extinguishment. As such, it requires court approval as dictated by state law and Treasury Regulation §1.170A-14(g)(6) (assuming the donor claimed an income tax deduction).

4. **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 floating or adjustability aspect to the building areas.
   - Alternatively, the easement could restrict uses allowed only within a building envelope to one building envelope at any given time. These strategies arguably have no floating or adjustability aspect to the building areas but provide flexibility.

5. **Consider slightly larger or multiple small building areas to add flexibility.**
   - The Tax Court steers easement drafters toward establishing larger or multiple building areas in which all or most structures reside, discouraging floating or adjustable building areas, or building zones within which the landowner may later select a site.
   - 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.

6. **Consider fixing the location of major structures and surface alterations.**
   - A cautious reading of Pine Mountain is that the Tax Court is uneasy with any major structures or surface alterations that could be sited or relocated anywhere within the protected property, regardless of whether they are within or outside any building area.
   - Drafters might consider specifying locations for all additional structures permitted by the easement outside building areas. Proceed cautiously if the easement permits additional structures in any unspecified location, and be sure to specify other meaningful limits on scope and scale.
   - When addressing mineral extraction pads and infrastructure and recreation, 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. Another potential option to consider is 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 mineral rights with a separate surface use agreement.
7. **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) Ex. 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 Homesite Parcels 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 protection of the conservation purposes in the location of permitted rights.
   - In contrast, the fact that the building areas in the *Pine Mountain* 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* 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 courts will view the easement as achieving conservation goals. According to the *Pine Mountain* majority, it does not matter whether these “holes” are included building areas or excluded parcels, or whether the areas affect the interior or exterior boundaries of the protected property.
   - If building areas are not clustered, document in the baseline how the location of permitted building areas and the improvements allowed in the building areas support and protect the conservation values. 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 would then document how the separate locations and the improvements within each building area are necessary for agricultural operations.

8. **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 Home Sites that the Fifth Circuit noted, the protected properties in the two *Bosque Canyon* easements were relatively simple geometric shapes with straight boundaries. In contrast, the *Pine Mountain* protected properties appear to fill the interstices between the developed areas and is itself fragmented. In particular, the 2006 *Pine Mountain* 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.
   - The motivation discernible in the delineation of the protected property in a conservation easement should be conservation purposes and not business goals.

9. **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 approval provisions that pressure 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 consistency with conservation purposes of any approval. Such language can support the taxpayer’s claimed deduction.

10. Assess the additional risk from partially floating included building areas.

➢ Since Belk, a fully floating or partially floating excluded building area (even if subject to holder approval) has been risky. Pine Mountain appears to increase the risk to a fully or partially floating included building area. 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 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 holding in Pine Mountain appears to directly overturn these nonbinding PLRs, as well as conflict with a specific example in the Treasury Regulations, see Example 4, §1.170A-14(f).

11. Consider documenting how the potential zones do not affect the conservation purposes.

➢ After Pine Mountain, any degree of a floating building area carries higher risk. One way to lower such risk might be for the parties to document in advance of executing the easement why the degree of allowed float is consistent with the conservation purposes. The easement could reference or perhaps even include a “consistency report” as an exhibit. The level of formality and substance of this report could range from a land trust project manager’s one- or two-page analysis to a third-party consultant’s lengthy documentation. The more substantial the documentation, the higher the preparation costs, and landowners should contribute to or fully pay for these costs. It would also help if the appraisal demonstrates that any eventual location of the partially floating building area would have no effect on the fair market value of the easement.

➢ Whether such documentation avoids an IRS challenge is unknown, but a thoughtfully reasoned and methodically presented analysis could distinguish the facts sufficiently from those in Pine Mountain.

12. Consider the risks of excluding or including building areas.

➢ Even without the challenges presented by the Pine Mountain decision, there are significant pros and cons of including or excluding building areas from the protected property in the conservation easement. Some land trusts prefer the stewardship simplicity of excluded building areas. Other land trusts always include building areas in order 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. Additionally, stewardship is likely to encounter difficulties with either choice when landowners want to change locations or build outside exclusions or envelopes.

➢ Drafters will want to discuss the implications and organizational preferences inherent in any choices. The Pine Mountain decision seemingly removes the ability to allow building areas to partially or fully float.
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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 Sylvia Bates, Director of Standards and Educational Services, at 603-708-1073.

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.

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<td>Holder's discretion limited by developed parcel.</td>
<td>Additional reserved rights are clustered.</td>
<td>Holder has sole discretion over undeveloped land.</td>
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<td>Proceeds property composed of areas not balanced.</td>
<td>Interstitial areas between developed areas.</td>
<td>Expressly adjustable conservation easement boundary.</td>
<td>Large intact blocks of protected property composed of reserved rights.</td>
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<td>Expressly adjustable building area.</td>
<td>Floating included building area.</td>
<td>Unpermitted major and minor structures.</td>
<td>Floating included building area.</td>
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<td>Unpermitted minor structures not limited in location.</td>
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<td>Floating included building area.</td>
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So where does this leave us? A risk spectrum approach...
State and Local Taxes (SALT)
Treasury Issues Final Regulations on Charitable Contributions and State and Local Tax Credits June 11, 2019

Washington – The U.S. Department of the Treasury today issued final rules and additional guidance on the federal income tax treatment of payments made under state and local tax credit programs. The regulations prevent charitable contributions made in exchange for state tax credits from circumventing the new limitation on state and local tax deductions.

The Tax Cuts and Jobs Act of 2017 (TCJA) limits the amount of state and local taxes (SALT) an individual can deduct to $10,000 a year. Without the regulations taxpayers would be able to use state tax credit programs to circumvent the TCJA limit.

The regulation is based on a longstanding principle of tax law: When a taxpayer receives a valuable benefit in return for a donation to charity, the taxpayer can deduct only the net value of the donation as a charitable contribution. The rule applies that principle, known as the quid pro quo principle, to state tax benefits provided to a donor in return for contributions.

For instance, if a state grants a 70 percent state tax credit pursuant to a state tax credit program, and an itemizing taxpayer contributes $1,000 pursuant to that program, the taxpayer receives a $700 state tax credit. The taxpayer must reduce the $1,000 contribution deduction by the $700 state tax credit, leaving a federal charitable contribution deduction of $300.

The regulations provide exceptions for dollar-for-dollar state tax deductions and for tax credits of no more than 15 percent of the amount transferred. Thus, a taxpayer who receives a state tax deduction of $1,000 for a contribution of $1,000 is not required to reduce the federal income tax deduction to take into account the state tax deduction; and a taxpayer who makes a $1,000 contribution is not required to reduce the $1,000 federal income tax deduction if the state or local tax credit received or expected to be received is no more than $150.

The final regulations are effective August 11, 2019, but apply to contributions made after August 27, 2018.

In response to comments on the proposed regulations regarding potential negative impacts, Treasury and the IRS are also issued a notice providing a safe harbor that, subject to certain limitations (including the SALT cap), allows individual taxpayers who itemize deductions to treat payments made in exchange for tax credits as payments of state or local taxes for federal income tax purposes. Eligible taxpayers can use the safe harbor to determine their SALT deduction for their 2018 return and can file an amended return if they have already filed.

Effective date: These regulations are effective August 12, 2019.
Applicability dates: For dates of applicability, see § 1.170A-1(h)(3)(viii) and § 1.642(c)-3(g)(2).
The Regs under Code Sec. 170 apply to amounts paid or property transferred by a taxpayer after Aug. 27, 2018. (Reg § 1.170A-1(h)(3)(viii), see: "(viii)Effective/applicability date. This paragraph (h)(3) applies to amounts paid or property transferred by a taxpayer after August 27, 2018.")
The Regs under Code Sec. 642 apply to payments of gross income after Aug. 27, 2018. (Reg § 1.642(c)-3(g)(2) see: "(g)Payments resulting in state or local tax benefits - (2) Effective/ applicability date. Paragraph (g)(1) of this section applies to payments of gross income after August 27, 2018.").

A group of House Democrats is inching closer to a proposal to provide relief from the $10000 cap on the state and local tax deduction: **H.R. 4274 Would Repeal SALT Deduction Limitation** Sponsor: Rep. Gottheimer, Josh [D-NJ-5] (Introduced 09/10/2019), Referred to Ways and Means 09/10/2019 To amend the Internal Revenue Code of 1986 to repeal the limitation on the deduction for certain taxes, including State and local property and income taxes, to limit the step-up in basis allowed in the case of property acquired from a decedent, and to deem a sale on any contribution of property to a private foundation.

**Four states also have sued the federal government** to overturn the provision (Connecticut, Maryland, New Jersey, and New York).
MAKE SURE YOU REMEMBER THESE POINTS (BTW WHO IS RESPONSIBLE FOR GETTING THESE RIGHT?? IF THEY ARE NOT DONE RIGHT, WHO LOSES??)

1. Requests for approval of certain activities – deemed approval is no good – must be deemed denial (Hoffman). Include language confirming Grantor can come back and ask again. PERPETUITY CASE

2. Proceeds clause – easement holder gets first dibs at its proportionate percentage of the proceeds; no netting out of value of improvements; no “first pay all expenses associated with…” (PBBM) PROCEEDS CLAUSE CASE

3. Follow the reg and the proportionate share calculations precisely (deduction denied because one important word in the easement was wrong; Carroll) PROCEEDS

4. What does this rule (first dibs) mean for mortgage subordinations? PROCEEDS

5. Once encumbered always encumbered – no “swapping out” and unencumbering once-eased land and substituting and encumbering other “conservation land” (Belk) PERPETUITY

6. Consistent with #5, no moving building areas from an approved site to a different location on the eased property (very much like “once encumbered always encumbered”) (Pine Mountain) PERPETUITY

7. Related to #6, make sure to include language in the easement and in the Baseline explaining why building in the areas chosen for future building sites will not have an adverse impact on the conservation values. PERPETUITY

8. Related to #7, amending to relocate might be ok – extreme due diligence and see #11, below. PERPETUITY
9. Lack of *timely* mortgage subordination (old news, many cases) PROCEEDS

10. Lack of *correct* mortgage subordination (see #2; old news, many cases) PROCEEDS

11. *Any* amendment clause? (IRS) Rigorous and limiting amendment clause ok? *(Pine Mountain)* Issue not settled PERPETUITY

12. “Mutual consent” to terminate/extinguish, but not court approval – no deduction PERPETUITY

13. Failure to meet “conservation purposes” test – not frequent audit issue

14. “Inconsistent use” – not frequent audit issue but watch out for this

15. Failure to timely record (lots of cases, 5-0 against taxpayer who tries to claim a deduction in a year before the easement is recorded; note best practices here: timely delivery to registry and receipt of date-stamped copy confirming timely delivery)

16. Incomplete or non-compliant substantiation (lots of different cases)
   
   a. Incomplete Form 8283
   
   b. Incorrect valuation date
   
   c. Failure to follow “contiguous property” and “enhancement” rules (note that these rules can involve parsing the partnership attribution rules); who determines which of the valuation rules is/are relevant in any given appraisal? [TIP: create a map]
   
   d. Not correct methodology to determine “fair market value”
   
   e. What if the claimed valuation bothers you?
   
   f. Absence of “gift letter” or “contemporaneous written acknowledgement”) – *any* charitable gift, including a check to your alma mater or place of worship [Section 170(f)(8) – “no deduction shall be allowed unless the taxpayer substantiates the contribution….”]

17. This is by no means intended to be an exhaustive list

18. This is by no means intended to be an exhaustive list (*sic*) or legal advice

19. Oh, right, if you get past “deductibility” then you can anticipate a fight about valuation
AND WHAT TO DO ABOUT THEM

1. Goal: if the deduction is reviewed by the IRS, we want the package to go into the IRS out box, so Grantor should file with Grantor’s tax return:
   a. Complete Form 8283
   b. Comprehensive “Supplemental Statement”
   c. Qualified appraisal report
   d. Copy of recorded deed of correct easement (include in appraisal)
   e. Baseline Documentation Report (not required to file but recommended)
   f. “Gift letter/contemporaneous written acknowledgement” (not required to file but recommended)

2. What about recorded conservation easements that are non-compliant (i.e., “deemed approval”; net out value attributable to improvements)
   a. No really good solution
   b. Least bad solution is not a good solution, but…..

3. IRS’ audit “strategy”
4. “Taxpayer” audit strategy

FINAL NOTE

Remember, run the title early and then follow that up with whatever due diligence is necessary.