



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

### Summary

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

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

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

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

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

## Pointers for Balancing Risk on Permitted Structures

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

### Drafting Pointers Summary

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

### Background to *Pine Mountain* and *Carter*

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

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

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

## Pointers for Balancing Risk on Permitted Structures

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

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

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

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

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

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

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

## Pointers for Balancing Risk on Permitted Structures

[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.<sup>3</sup> In *Bosque Canyon*, the Tax Court disallowed deductions for two easements because of a provision allowing for adjustments to the boundaries of 47 five-acre “Homesite Parcels” that were clustered in an area inside of the exterior perimeter boundary of the protected property. The adjustment provision prohibited any material adverse effect on any of the conservation purposes and prohibited any increase in size of a Homesite Parcel.

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

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

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

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

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

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

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

## Pointers for Balancing Risk on Permitted Structures

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

- (2) Similarly, in *Pine Mountain Preserve*, the Tax Court found that because the permitted structures within and outside of the building areas were so extensive and did not have sufficient restrictions, there was no substantive distinction between excluded and included building areas.
- (3) Following these principles, the Tax Court rejected the deductibility of the 2006 *Pine Mountain Preserve* easement because it did not fix the initial location of the six building areas. This was also the case for the 11 fully floating building areas in *Carter*.
- (4) In a direct comparison to and repudiation of the Fifth Circuit in *Bosque Canyon*, the Tax Court rejected the deductibility of the 2005 *Pine Mountain Preserve* easement because the express modification provision allowed the land trust to approve a change in the location of the interior included building areas.
- (5) The totality of the other permitted structures and surface alterations (including roads and ponds, utilities and so forth) within and outside the building areas also prevented the 2005 *Pine Mountain Preserve* easement from constituting a “qualified real property interest” under IRC §170(h)(2). This was also the case in *Carter*, although the opinion did not delve into this issue.
- (6) The court in the *Carter* case took the next step of holding that fully floating building areas are inconsistent with perpetuity under §170(h)(2)(C). Furthermore, the *Carter* opinion causes additional uncertainty by using conflicting language about whether the opinion is limited to fully floating building areas or encompasses all building areas of any kind. As a result, land trusts will want to advise landowners of the risks of included building areas at least until the appeals conclude.

### The Appeals

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

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

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

## Pointers for Balancing Risk on Permitted Structures

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

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

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

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

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

## Pointers for Balancing Risk on Permitted Structures

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

## Pointers for Balancing Risk on Permitted Structures

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

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



## Pointers for Balancing Risk on Permitted Structures

- restricts only the building areas. The nondeductible easement or restriction may restrict some development within the building areas and should prevent the sale of the building areas separately from the other protected property. The main easement should explicitly prohibit separate sale as well to effectively prevent such a separate sale.
- Ideally, any existing structures should be located entirely within a well-defined, fixed building area, which includes all amenities, all utilities and all access. Short of this ideal, it is best to minimize as much as possible these permitted rights outside of envelopes.
  - Drafters will want to discuss the implications and organizational preferences inherent in any choice. Land trusts will want to provide general information to the landowner and their attorney to assist them in evaluating the risk to any deduction.
  - Land trusts may wish to create a reference list of options available with their preferences and associated costs as they continue to conserve land using deductible easements.
7. *Consider slightly larger or multiple small building areas to add flexibility.*
- Permitting partially floating included interior building areas within which the landowner may later select a site increases the risk of a tax audit challenge, but thoroughly documenting this choice, as described below, may mitigate that risk to some extent.
  - Size the building area appropriately to the circumstances. Somewhat expanded or multiple building areas may reduce the need for future adjustments. Drafters cannot fully eliminate the future need to address violations, errors and changed zoning laws and siting requirements so drafters must anticipate the future need for adaptation by including a [well-drafted amendment clause](#) in all conservation easements.
8. *Consider alternative included building areas.*
- If a landowner cannot decide between competing building areas, and to avoid a large partially floating building area, consider whether it makes sense for the easement to establish two or more alternative and fixed included building areas. In the future, the landowner selects one of these building areas, and the other(s) automatically extinguish. This strategy arguably has no float or adjustment to the building areas.
  - Selection of this approach requires the land trust to document how all alternative building areas are equally consistent with the conservation purposes, are appraised as financially neutral or identical and retain conservation restrictions in all building areas.
  - Alternatively, the easement could restrict uses allowed only within a building area to one building area at any given time. These strategies arguably have no floating or adjustability aspect to the building areas but provide flexibility.
9. *Fix the location of any major structures and surface alterations outside of building areas.*
- Consider specific explicit locations for all structures permitted by the easement. Proceed cautiously if the easement permits additional new structures in any unspecified location, especially residential and residential amenities but also including agricultural, forestry and public recreation structures. Be sure to specify explicit limits on the scope and scale of all structures and surface alterations. Identify and limit existing structures.
  - When addressing mineral extraction pads and infrastructure, recreational, silvicultural, agricultural, habitat or other dispersed structures, consider fixed areas or fixed exclusions. Alternatively, consider substantial limits on scope and scale if the permitted rights remain dispersed.

## Pointers for Balancing Risk on Permitted Structures

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

### 10. Cluster building areas regardless of exclusion or inclusion in the easement.

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

### 11. Document how the building areas support the conservation purposes and perpetual restrictions.

- One way to lower such risk might be for the parties to document in advance of executing the easement why the building area is consistent with the conservation purposes. Also, it is important to address the IRS's and Tax Court's mistaken belief that the conservation easement does not restrict the inconsistent uses of building areas by documenting the explicit restrictions imposed inside any building area. Fully document everything as to consistency with conservation purposes and as to imposition of conservation restrictions across the entirety of the conserved land *including any building areas and any isolated building rights*.

## Pointers for Balancing Risk on Permitted Structures

- The easement could reference a “consistency report” as an exhibit or as part of the baseline documentation. The level of formality and substance of this report could range from a short analysis by land trust staff to lengthy documentation by a third-party consultant. The more substantial the documentation, the higher the preparation costs, and landowners should contribute to or fully pay for these costs. It may also help if the appraisal demonstrates that any eventual location of the partially floating building area, and indeed any building area, would have no effect on the fair market value of the easement. Avoid fully floating building areas.
  - Whether such documentation avoids an IRS challenge is unknown, but a thoughtfully reasoned and methodically presented analysis could distinguish the facts sufficiently from the easements challenged by the IRS in *Pine Mountain Preserve* and in *Carter*. Third-party documentation may convince an IRS auditor that the land trust thoroughly evaluated the placement of future structures.
12. *Protect intact blocks of undeveloped land, not interstitial areas between developed lots.*
- As the Fifth Circuit stated in *Bosque Canyon*, “a picture is worth more than 10,000 words.” In addition to the clustering of homesites acknowledged by the Fifth Circuit, the protected properties in the two *Bosque Canyon* easements were relatively simple geometric shapes with straight boundaries. In contrast, the *Pine Mountain Preserve* protected property was fragmented, protecting the gaps between the developed areas. In particular, the 2006 *Pine Mountain Preserve* easement protects 499 acres overall, but the protected property is comprised of eight noncontiguous parcels, many of which have irregular boundaries and long thin strips.
  - Public-benefit, qualified conservation purposes should be the clearly stated and documented primary motivation of any conservation easement. Private business or land development goals should be secondary.
13. *Combine conservation purposes and holder’s sole discretion as the approval standard.*
- A key theme in the court opinions discussed above is whether easement holders should be trusted to make pro-conservation decisions with respect to building areas and other rights. Courts appear to disfavor prior approval provisions that the courts may perceive as pressuring holders to approve landowner requests. The most common of these are approval formulations that require the holder to be “reasonable” or, conversely, that the holder’s approval “shall not be unreasonably withheld.” Land trusts should avoid these reasonableness standards and insist on sole discretion based on whether a requested activity is consistent with the conservation purposes. Be sure to state both the sole discretion review and the consistency with conservation purposes of any approval. Such language can support the taxpayer’s claimed deduction.
  - This strategy alone, however, was insufficient in *Carter* to demonstrate consistency with perpetuity to the court. The court cited the 11 fully floating residential building rights. The court did not comment on the numerous fully floating ancillary residential and recreational structures, but presumably this plethora of unsited building rights added to the court’s disqualification of the deduction.
14. *Address errors or problems by a post-conservation easement minor boundary adjustment or relocation of building areas, if necessary, consistent with the land trust’s amendment policy.*
- The suggested easement drafting strategies in this Pointer that strictly limit building areas in an attempt to comply with these recent, ambiguous Tax Court decisions

## Pointers for Balancing Risk on Permitted Structures

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

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

**The Risk Spectrum appears on the next page.**

### QUESTIONS?

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

### DISCLAIMER

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## Pointers for Balancing Risk on Permitted Structures

### The risk spectrum.

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

#### **Lower Risk**

No major structures or surface alterations permitted.

Fixed building area with all major structures and only minor limited structures outside building area.

Fixed overlay nondeductible easement on a fixed exclusion.

Building areas, structures and permitted alterations limited in location, number and size.

Clustered building areas and additional permitted rights.

Protected property composed of large intact blocks of undeveloped land.

Holder has sole discretion over all approval rights.

#### **Medium Risk**

Partially floating sites located within a fixed included larger building area.

Alternative fixed included building area.

Unsitd minor structures or alterations limited in number or size.

Dispersed permitted rights with substantial limits on scope and scale and significant restrictions on sensitive areas.

#### **Higher Risk**

Floating included building area, even with express limitations and approval.

Unsitd minor structures or alterations not limited in number or size.

Dispersed unlimited building areas or unlimited permitted structures and alterations.

Protected property composed of interstitial areas between developed parcels.

Holder’s discretion limited by reasonableness or other standard.

#### **No Deduction**

Expressly floating or adjustable building area.

Fully or partially floating excluded building area.

Fully floating included building area.

Unsitd minor and major structures not limited in number and size.

Expressly adjustable conservation easement boundary.

So many dispersed building rights that conservation is secondary to development.

No standard or no holder approval required in some way.