

The Conservation Easement Tax Expenditure: In Search of Conservation Value

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INTRODUCTION

Since the mid-twentieth century, property owners in the United States have been encouraged to dedicate land for conservation.¹ In many respects, the need to conserve is great,² and, by some measures, the push for land conservation has been successful. In the past several decades, there have been dramatic increases both in the number of acres dedicated to a conservation purpose³ and in the number of private land trusts.⁴ This is due in part to a federal

1. The land conservation movement took hold in the mid-twentieth century. For recent overviews of the development of the conservation movement, see RICHARD BREWER, CONSERVANCY: THE LAND TRUST MOVEMENT IN AMERICA 32 (2003); Zachary Bray, *Reconciling Development and Natural Beauty: The Promise and Dilemma of Conservation Easements*, 34 HARV. ENVTL. L. REV. 119, 124–30 (2010). The world's largest conservancy organization, The Nature Conservancy, was founded by a small group of scientists in 1946 as the Ecologist's Union. *Our History*, THE NATURE CONSERVANCY, <http://www.nature.org/aboutus/vision/mission/history/index.htm> (last visited Nov. 17, 2011). Today, it operates in all fifty states and in over thirty countries. *About Us*, THE NATURE CONSERVANCY, <http://www.nature.org/aboutus/index.htm> (last visited Nov. 17, 2011). The Internal Revenue Service (IRS) first recognized a tax benefit for conservation easement charitable contributions in 1964. Rev. Rul. 64-205, 1964-2 C.B. 62.

2. Population growth, urban sprawl, and climate change all present land use challenges in which land conservation can play an instrumental role. See Jessica Owley, *Changing Property in a Changing World: A Call for the End of Perpetual Conservation Easements*, 30 STAN. ENVTL. L.J. 121, 124–26 (2011); Nancy A. McLaughlin, *Increasing the Tax Incentives for Conservation Easement Donations—A Responsible Approach*, 31 ECOLOGY L.Q. 1, 3 (2004).

3. See *infra* text accompanying notes 63–68.

4. Land trusts are private conservation organizations that have a primary purpose of holding and managing conservation property. The number of land trusts has increased dramatically since the 1980s. See Bray, *supra* note 1, at 129 (noting the period of “explosive growth [of land trusts] beginning in the 1980s”). Land trusts often receive funding from federal, state, and local government, as well as donations from the public. See WEST HILL FOUND. FOR NATURE, THE VALUE OF CONSERVATION EASEMENTS 6 (2002), available at <http://www.landscape.org/rhythmyx/action/conservation/easements/item20493.pdf>. Land trust organizations accept and manage conservation easement contributions and also purchase property in fee for conservation purposes. See *FAQ: Land Trusts*, LAND TRUST

conservation tax incentive that allows a property owner to take an income tax deduction for placing an easement on his or her property for conservation purposes and giving the easement to the government or a private environmental organization.⁵ In exchange for the easement, the property owner may claim a deduction equal to the conservation easement's value.⁶ At the federal level, this lucrative incentive yielded \$1.22 billion in claimed deductions in 2008 and \$2.18 billion in claimed deductions in 2007.⁷ In addition, many states offer income and property tax incentives to encourage land conservation.⁸

In general, the idea behind conservation incentives is sound: if conservation of private land is to succeed, landowners must be willing participants.⁹ Nevertheless, the federal income tax

ALLIANCE, <http://www.landtrustalliance.org/conservation/landowners/faqs-1/faq-land-trusts> (last visited Nov. 17, 2011). In order to accept deductible easement contributions, a land trust (or other conservation organization) must be "organized or operated primarily or substantially" for a conservation purpose (as defined in the Internal Revenue Code and regulations). Treas. Reg. § 1.170A-14(c)(1) (as amended in 2009). The Land Trust Alliance is the umbrella organization for the land trust industry and provides valuable information and publications about conservation and land trusts. See *About*, LAND TRUST ALLIANCE, <http://www.landtrustalliance.org/about> (last visited Nov. 17, 2011).

5. See I.R.C. § 170(h) (2006). Technically, the contribution must be given to a "qualified organization." I.R.C. § 170(h)(3). Federal tax law also provides for estate and gift tax incentives with respect to conservation easements. See I.R.C. §§ 2031(c), 2522(d). Discussion of these benefits is outside the scope of this Article; however, the impact of the proposals made in Parts II and III would have to be taken into account for estate and gift tax purposes. A number of other distinct tax benefits related to the environment are also available. See, e.g., I.R.C. § 198 (allowing expensing of environmental remediation costs); I.R.C. § 512(b)(19) (excluding otherwise taxable gain from certain sales of brownfield property by exempt organizations).

6. See Treas. Reg. § 1.170A-14(h)(3) (as amended in 2009); I.R.C. § 170(h).

7. Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2008*, STAT. OF INCOME BULL., Winter 2011, at 76, 78 (adding the numbers for "conservation easements" and "façade easements"). Note that the numbers cited do not include corporate contributions.

8. See DEBRA PENTZ, CONSERVATION RES. CTR., STATE CONSERVATION TAX CREDITS: IMPACT AND ANALYSIS (2007) (listing and comparing twelve state tax credits); Christen Linke Young, *Conservation Easement Tax Credits in Environmental Federalism*, 117 YALE L.J. POCKET PART 218, 220 (2008) ("[P]rograms in states like Colorado and South Carolina cast the widest net, granting credits to any easement donor that qualifies for the federal tax deduction."); see also COLO. REV. STAT. ANN. § 39-22-522(2) (West 2007 & Supp. 2007); S.C. CODE ANN. § 12-6-3515 (2010); VA. CODE ANN. § 58.1-512 (West 2011). Some states also provide lower property tax rates for conservation land. See, e.g., N.C. GEN. STAT. ANN. § 105-277.15 (West 2009); OR. REV. STAT. § 271.785 (West 2007).

9. Over sixty percent of land in the United States is privately owned. RUBEN N. LUBOWSKI ET AL., ECON. RESEARCH SERV., U.S. DEP'T OF AGRIC., ECONOMIC INFORMATION BULLETIN NO. 14, MAJOR USES OF LAND IN THE UNITED STATES, 2002 35 (2006). Eminent domain or voluntary purchases for conservation purposes on a massive scale are not realistic options.

deduction for conservation easements,¹⁰ though often utilized and praised, is also maligned. On the positive side, the incentive is credited with protecting millions of acres from development.¹¹ On the negative side, the incentive is disparaged as difficult to administer, prone to abuse,¹² and ill-suited to securing conservation ends.¹³ Accordingly, in recent years, a number of proposals have been made to reform the incentive.¹⁴ There are also defenders of

Land use decisions by private landowners are therefore essential to conservation goals. *See* Chris Glenn Sawyer, *Preface* to AMANDA SAUER, *THE VALUE OF CONSERVATION EASEMENTS: THE IMPORTANCE OF PROTECTING NATURE AND OPEN SPACE*, at ii (2002) (stating that “we have increasingly come to the conclusion that while some strategic acquisition of land will be required, the vast majority of land conservation must be accomplished in a manner that achieves conservation benefits for the nation but leaves the land in private ownership. Public acquisition is simply too expensive, and beyond that, maintaining these lands in private ownership is critical to cost-effective long-term stewardship and management as well as to our culture.”).

10. Technically, the conservation easement deduction is one type of “qualified conservation contribution.” I.R.C. § 170(h). The Internal Revenue Code does not use the term “conservation easement,” but rather allows a deduction for a contribution of an interest in real property for “a restriction (granted in perpetuity) on the use which may be made of the real property” where such contribution is made “exclusively for conservation purposes.” *Id.*

11. *See* THE NATURE CONSERVANCY, *CONSERVATION EASEMENTS: CONSERVING LAND, WATER AND A WAY OF LIFE* (2003), available at http://www.nature.org/aboutus/privatelandsconservation/conservationeasements/conserving_a_way_of_life.pdf (discussing the success of conservation easements in protecting wildlife habitats and open space and noting the growing popularity of conservation easements as an effective conservation tool); Bray, *supra* note 1, at 124–25 (noting that, as of 2005, state and local land trusts hold conservation easements protecting over 6.2 million acres); *see also* McLaughlin, *supra* note 2, at 1, 5–6 (stating that “[t]he tax incentives have worked remarkably well” and showing the growth in land trusts and acres under conservation protection).

12. *See infra* notes 50–58 and accompanying text.

13. John D. Echeverria, *Regulating Versus Paying Land Owners to Protect the Environment*, 26 J. LAND RESOURCES & ENVTL. L. 1, 38 (2005) (discussing how “widespread use of voluntary easements appears to threaten the viability of the regulatory tool as a matter of policy, and perhaps ultimately the legal availability of this tool.”); Julia D. Mahoney, *Perpetual Restrictions on Land and the Problem of the Future*, 88 VA. L. REV. 739, 744 (2002) (concluding that conservation easements “may further the interests of members of the present generation at the expense of future generations”).

14. *See* STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., *OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES 277–87* (Comm. Print 2005) [hereinafter JOINT COMM. ON TAXATION] (proposing elimination of the incentive in some cases and reduction in its value in others); Daniel Halperin, *Incentives for Conservation Easements: The Charitable Deduction or a Better Way*, 74 LAW & CONTEMP. PROBS. 29, 32 (2011) (advocating a new approach that “would require a governmental entity or a land trust meeting certain minimum standards to certify the public benefit of [conservation easement transactions]” and convert the deduction to a grant program); Gerald Korngold, *Solving the Contentious Issues of Private Conservation Easements: Promoting Flexibility for the Future and Engaging the Public Land Use Process*, 2007 UTAH L. REV. 1039, 1084 (2007) (discussing five principles and

the incentive.¹⁵ To the extent there is consensus, it is perhaps the narrow one that conservation is important, perhaps critically so, but the current approach to encouraging conservation is imperfect.

Frequently missing from this debate, however, is a focus on how to measure the value of conservation. “Conservation” is often described in generalities: a vague environmental goal or value, worth whatever it takes.¹⁶ To a certain extent, this is commonplace. A value, whether of conservation or otherwise, is cultural, and a matter of policy, or assertion. One either shares the value or not. But sharing the value of conservation does not, as a general matter, answer the question of what conservation means and how it should be measured.

Indeed, ever since the conservation easement tax expenditure¹⁷ became a permanent fixture in the Internal Revenue Code (“the Code”),¹⁸ the importance of conservation has largely been taken for

suggesting five related reforms related to the “perpetual nature, rigidity, and nonpublic attributes” of conservation easements). *See generally* JEFF PIDOT, REINVENTING CONSERVATION EASEMENTS: A CRITICAL EXAMINATION AND IDEAS FOR REFORM (2005), *available at* https://www.lincolnst.edu/pubs/dl/1051_Cons%20Easements%20PFR013.pdf (analyzing issues that concern conservation easements and describing potential reforms); Josh Eagle, *Notional Generosity: Explaining Charitable Donors’ High Willingness to Part with Conservation Easements*, 35 HARV. ENVTL. L. REV. 47 (2011) (suggesting that the conservation easement tax deduction might be abolished in favor of a spending program, or that conservation easements should be converted to development rights, transferable by the donee organization); Owley, *supra* note 2 (citing a need for more “holistic” conservation planning efforts and arguing for renewable term conservation easements instead of perpetual easements).

15. *See, e.g.*, Nancy A. McLaughlin & Mark Benjamin Machlis, *Protecting the Public Interest and Investment in Conservation: A Response to Professor Korngold’s Critique of Conservation Easements*, 2008 UTAH L. REV. 1561 (2008) (discussing misconceptions in criticisms of conservation easements and pointing out the potential adverse impact of several suggested reforms).

16. *See, e.g.*, PEW RESEARCH CTR. FOR PEOPLE & THE PRESS, BEYOND RED VS. BLUE: POLITICAL TYPOLOGY 14 (2011) (finding that seventy-one percent of the general public think that “this country should do whatever it takes to protect the environment”).

17. A tax expenditure is a term that describes an incentive program in which tax benefits—relative to “normal” tax treatment—are used to encourage or reward behavior. Colloquially, a tax expenditure often is referred to as “spending” through the tax code. *See, e.g.*, C. EUGENE STEUERLE, CONTEMPORARY U.S. TAX POLICY 293 (2008) (defining tax expenditures as “[s]pending programs channeled through the tax system”). *See generally* STANLEY S. SURREY & PAUL R. MCDANIEL, TAX EXPENDITURES 25–27 (1985); STANLEY S. SURREY, PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES (1973) (serving as a classic work on tax expenditures); J. Clifton Fleming Jr. & Robert J. Peroni, *Reinvigorating Tax Expenditure Analysis and Its International Dimension*, 27 VA. TAX REV. 437 (2008) (providing a recent assessment of tax expenditures).

18. Congress made the conservation easement tax expenditure a permanent part of the Code in 1980. *See infra* Part II.A (providing a synopsis of the legislative history of the

granted. But what is the value of conservation, and, in particular, what is the value of the conservation easement tax expenditure? What are the benefits? Do the costs of the program exceed the benefits? These are important questions to ask of any tax or spending program, and are especially important now in light of the wider discussion about the value of tax expenditures.¹⁹ Accordingly, it is time for an assessment of the conservation easement tax expenditure—should the program be kept, modified, or eliminated?

This Article first undertakes to provide such an assessment by considering the costs and benefits of the program. Part I of the Article finds that, although it is feasible to assess program costs, a comparable evaluation of program benefits is not possible because there is no good measure for conservation benefits. As Part I reveals, conservation value is, to a certain extent, unknown and misunderstood, making it difficult to verify the accuracy of the prevailing background assumption that the benefits of the easement program exceed the costs.

Critically, this background assumption can be traced to an overlooked aspect of the incentive; namely, that the tax benefit received by the donor is not directly related to the conservation value of the contributed easement. As discussed in Parts I and II, this is exceptional. Normally, in the charitable contribution context, a direct relationship exists between the benefit to the donor and the benefit to charity.²⁰ But with conservation easements, the tax benefit is not based on the benefit to charity (the easement's conservation value), but rather is based on the lost economic development value represented by the easement.²¹

The mismatch between the tax benefit and conservation value means that the measure for the benefit under present law is both erroneous and harmful. Because the easement value has come to be identified by taxpayers and the Internal Revenue Service ("IRS") with lost economic development value, conservation has been

program). References to "the Code" are to the Internal Revenue Code of 1986, as amended.

19. Currently, tax expenditures are a focal point of discussions about tax reform and deficit reduction. For example, one leading proposal has advocated for the elimination or substantial curtailment of many tax expenditures. See NAT'L COMM'N ON FISCAL RESPONSIBILITY AND REFORM, *THE MOMENT OF TRUTH* 15, 28–34 (2010).

20. See *infra* Part I.B.

21. See *infra* Part I.A.

undermined.²² Undue attention and resources have been placed on divining a largely fictional, subjective, and misleading number. Further, this misplaced focus has inhibited the ability to assess the effectiveness of the program and hindered the development of standards for, and an understanding of, the conservation value of easements.

Accordingly, Part II of the Article argues for an alternative measure of the tax benefit. The new measure should, in theory, be based on the conservation value of the easement. However, because conservation value is difficult to quantify, other measures should be considered. The Article weighs two: one based on a percentage of the fair market value of the entire property interest, and another based on a percentage of the donor's cost-basis in the property. While either measure should reduce waste and abuse and allow for a better focus on conservation value, on balance, using a percentage of the value of the entire property interest likely would make for a stronger incentive. Part II also argues that the charitable deduction model for conservation easements is flawed and that the deduction should be converted to a credit.

Part III of the Article then takes up the question of how reforms to the easement program, including possible conversion to a credit, should be designed. This Part argues that to better promote conservation and to minimize waste and abuse, there should be, among other reforms, different levels of tax benefits that depend upon the satisfaction of rules designed to secure conservation ends, tighter standards for conservation purposes, elimination of any tax benefit for certain types of easements, and tougher standards on land trust eligibility. Part III also avers that the role of the federal tax incentive should, as a general matter, be secondary to state and local incentives, at least in the absence of a strongly articulated federal conservation policy. In other words, absent such a policy, the federal tax incentive should be designed in such a way as to encourage the development of conservation standards and conservation decisions at a more local level.

At the end of the day, conservation is best understood as a land use issue, not a tax issue. Important conservation uses may be underrepresented in a system of property law that values development as the highest and best use of the land. Accordingly, tax and other programs to foster conservation generally make

22. See *infra* Part II.B.1.

sense. However, conservation should be more than a word evoking warm feelings and amorphous benefits. Although quantifying conservation is difficult, the conservation easement tax expenditure should be designed to pursue more than a vague notion of conservation. The expenditure should be the result of a considered policy that promotes and encourages a theory of conservation value such that, ideally, the judgment can reasonably be made that conservation is the best use of a property.

I. ASSESSING THE VALUE OF THE CONSERVATION EASEMENT TAX EXPENDITURE

What is the value of the federal conservation easement tax expenditure? Do the costs of the program exceed the benefits of conservation? Often, the question is phrased in terms of efficiency.²³ In general, a tax expenditure is efficient if benefits exceed costs and inefficient otherwise.²⁴ There are, of course, degrees of efficiency. An efficient program can be made more efficient by reducing costs and therefore increasing the ratio between benefits and costs. The greater this ratio is, the more efficient the program. Efficiency also depends upon responsiveness or causation—that is, the extent to which contributions are made because of the incentive and would not have been made otherwise.²⁵ But regardless of degrees of efficiency, at a minimum, benefits must exceed costs for a program to be considered successful.

Measuring easement program costs and conservation benefits is easy in some respects and difficult in others. The main point of the analysis here, however, is not to devise a precise estimate or even reach an unequivocal conclusion as to efficiency, but rather to

23. See McLaughlin, *supra* note 2, at 92 (stressing the importance of efficiency in deciding whether to add (at the time) additional incentives to the easement donation program); see also OFFICE OF TAX ANALYSIS, U.S. DEP'T OF THE TREASURY, A REPORT TO THE CONGRESS ON THE USE OF TAX DEDUCTIONS FOR DONATIONS OF CONSERVATION EASEMENTS 1-2 (1987) [hereinafter REPORT TO CONGRESS]. For example, if the government provides one dollar of subsidy, the expectation is that the subsidized party will produce at least one dollar of good. If the dollar's worth of subsidy produces less than one dollar's worth of good, then the subsidy is inefficient. If the dollar's worth of subsidy produces one dollar or more worth of good, then the subsidy is efficient.

24. See, e.g., Fleming & Peroni, *supra* note 17, at 444-45 (stating that the "principal purpose and justification" of tax expenditure analysis is its "role as a triggering mechanism for mandatory recasting and cost/benefit analysis").

25. McLaughlin, *supra* note 2, at 18-19.

identify what can be said about costs and benefits and what that reveals about assessing the overall value of the program.

A. Costs to the Government, Other Costs

Beginning on the cost side, one cost to consider is the amount of tax revenue lost as a result of the easement program. The IRS records the amount individual taxpayers claim as federal income tax conservation easement deductions.²⁶ For instance, in 2008, individuals claimed approximately \$1,216,043,000, or \$1.21 billion, as deductions.²⁷ In 2007, the number was \$2,176,391,000, or \$2.18 billion.²⁸ The table below shows the amounts claimed from 2003 to 2008.²⁹

The reported numbers, however, reflect the claimed value of the easements contributed, not the amount of tax revenue lost. To determine lost tax revenue, the top marginal tax rate of the donor must be multiplied by the amount deducted. If a tax rate of thirty-five percent³⁰ is assumed for all donations in years 2008 and 2007, the lost tax revenue for contributions by individuals for each year would be \$425,615,000 and \$761,737,000, respectively. The last column of the table shows lost tax revenue for each of the years

26. Because corporate contributions are not included, the total deductions are understated, perhaps significantly.

27. Liddell & Wilson, *supra* note 7, at 76. The IRS separately lists amounts for conservation easements and for façade easements. A façade easement generally is a subtype of conservation easements, in which the façade of a private property is protected from change. See I.R.C. § 170(h)(4)(C)(ii) (2006) (defining the term “certified historic structure”); see also *infra* notes 51, 58 and accompanying text (describing how façade easements are abused).

28. Liddell & Wilson, *supra* note 7, at 78; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2007*, STAT. OF INCOME BULL., Spring 2010, at 52, 53.

29. Liddell & Wilson, *supra* note 7, at 78; Liddell & Wilson, *supra* note 28, at 53; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2006*, STAT. OF INCOME BULL., Summer 2009, at 67, 68–69; Janette Wilson, *Individual Noncash Contributions, 2005*, STAT. OF INCOME BULL., Spring 2008, at 68, 69; Janette Wilson & Michael Strudler, *Individual Noncash Contributions, 2004*, STAT. OF INCOME BULL., Spring 2007, at 77, 78; Janette Wilson & Michael Strudler, *Individual Noncash Charitable Contributions, 2003*, STAT. OF INCOME BULL., Spring 2006, at 58, 58–60. Of course, the time frame for measuring and comparing the costs and benefits is important. The very nature of conservation easements and perpetual protection suggests that the benefits of the program are ongoing, so any particular snapshot of costs and benefits may be superficial.

30. The thirty-five percent rate is currently the top marginal rate of tax. Rev. Proc. 2011-12, 2011-2 I.R.B. 297. An exact estimate of revenue cost would require knowing the top tax rate of each donor claiming the deduction. Using a thirty-five percent rate here provides an estimate that is likely higher than actual revenue loss, considering that some taxpayers probably are not paying tax at the top marginal rate.

covered (again, assuming a thirty-five percent rate), for a total of \$3,573,820,000, or \$3.6 billion, over the six-year period.

TABLE 1: FEDERAL INCOME TAX CONSERVATION EASEMENT DEDUCTIONS

<u>Year</u>	<u>Conservation Easements</u>	<u>Facade Easements</u>	<u>Conservation & Facade Easements Combined</u>	<u>Total Revenue Loss</u> (assuming a 35% marginal tax rate for all donors)
2003	NA	NA	2,407 Donations	\$522,173,000
			2,179 Returns	
			\$1,491,924,000 Claimed	
2004	NA	NA	3,365 Donations	\$507,224,000
			2,971 Returns	
			\$1,449,210,000 Claimed	
2005	2,307 Donations	1,132 Donations	3,439 Donations	\$743,114,000
	2,186 Returns	1,028 Returns	3,214 Returns	
	\$1,815,814,000 Claimed	\$307,370,000 Claimed	\$2,123,184,000 Claimed	
2006	3,529 Donations	1,145 Donations	4,674 Donations	\$613,957,000
	3,402 Returns	1,143 Returns	4,545 Returns	
	\$1,489,589,000 Claimed	\$264,575,000 Claimed	\$1,754,164,000 Claimed	
2007	2,405 Donations	242 Donations	2,647 Donations	\$761,737,000
	2,231 Returns	228 Returns	2,459 Returns	
	\$1,954,122,000 Claimed	\$222,269,000 Claimed	\$2,176,391,000 Claimed	
2008	3,158 Donations	1,396 Donations	4,554 Donations	\$425,615,000
	3,095 Returns	1,180 Returns	4,275 Returns	
	\$1,177,753,000 Claimed	\$38,290,000 Claimed	\$1,216,043,000 Claimed	

Another cost to be considered is the market value lost when land is used for a conservation purpose in perpetuity, otherwise known as the lost economic development value resulting from easement

contributions.³¹ One measure of such cost is the amount claimed as deductions. Under the Code and Treasury Regulations, the amount deducted (which is deemed the fair market value)³² typically is determined using the before-and-after valuation method.³³ This means that the property is first valued before the conservation restriction and then valued after the conservation restriction. The difference between the two (usually but not necessarily a positive number)³⁴ represents the market value taken away from the property because of the restriction. In other words, under the tax law, the restriction has a negative value. Thus, the holder of the conservation restriction often is understood as the holder of the “development rights.”³⁵ Adding up the total amounts deducted from the above table, the lost economic development value from conservation easements during the period 2003 through 2008 would be equal to \$10.21 billion.

Although the amount claimed as deductions provides a starting point for determining the lost economic development value stemming from the conservation easement program, arguably it should be discounted—and perhaps by a significant percentage. This is because the lack of a sales market for conservation easements provides reason to doubt that the before-and-after

31. The lost economic development value has been termed the “market cost” of the donation. See McLaughlin, *supra* note 2, at 24 (defining market cost as “the reduction in the fair market value of the land that results from placing permanent restrictions on its development and use”).

32. Donors generally are allowed to deduct the fair market value of contributed property. I.R.C. § 170; Treas. Reg. § 1.170A-14(h)(3) (as amended in 2009).

33. Treas. Reg. § 1.170A-14(h)(3)(i) (as amended in 2009) (providing that if, as is usually the case, there is “no substantial record of market-place” easement sales available, then “the fair market value of a perpetual conservation restriction is equal to the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property after the granting of the restriction”); see also C. Timothy Lindstrom, *A Guide to the Tax Aspects of Easement Contributions*, 7 WYO. L. REV. 441, 485 (2007) (“The value of the easement for purposes of the deduction is typically the difference in the value of the easement property before the contribution and after the contribution.”).

34. The regulations make clear that an easement may enhance the value of the property. Treas. Reg. § 1.170A-14(h)(3)(ii) (as amended in 2009) (“[T]here may be instances where the grant of a conservation restriction . . . may in fact serve to enhance, rather than reduce, the value of the property.”).

35. Adrienne Lyles-Chockley, *Building Livable Places: The Importance of Landscape in Urban Land Use, Planning, and Development*, 16 BUFF. ENVTL. L.J. 95, 119 (2008) (“Private organizations may also take advantage of conservation easements (i.e., development rights), legal agreements in which a property owner restricts the type and amount of development that may take place on a particular property.”).

method produces an accurate picture of the lost development value.³⁶ As has been documented, without such a market there is no “market price” for easements.³⁷ Thus, the value of a conservation easement becomes less clearly objective and more dependent on the quality and integrity of appraisers, who are typically paid by the taxpayer-donor and not entirely independent.³⁸

To make the valuation problem worse, the incentives for the taxpayer and the donee organization align toward a higher valuation. For the taxpayer, a higher valuation means a larger deduction (and so a bigger tax benefit); for the donee organization, a higher valuation signals a more valuable easement, in that more development activity is restricted. The result is that

36. The lost economic development value, represented by the claimed fair market value of the contributed easements, should be further discounted to take into account the easement donations that would have occurred in the absence of the tax incentive. Accordingly, the lost economic development value associated with contributions that would have been made anyway should not be considered a cost of the easement program. See REPORT TO CONGRESS, *supra* note 23, at 8–9; McLaughlin, *supra* note 2, at 18 (discussing the “responsiveness” of the incentive and concluding that although many contributions are made because of the incentive, it is not clear how many are and how many are not). The same point applies on the benefit side of the equation. See LAND TRUST ALLIANCE, 2005 NATIONAL LAND TRUST CENSUS REPORT 8–9 (2006), available at <http://www.landtrustalliance.org/land-trusts/land-trust-census/2005-national-land-trust-census/2005-report.pdf> (discussing the growth of private land conservation and the factors that have played a role in that growth, public tax incentives among them).

37. See *Johnston v. Comm’r*, 74 T.C.M. (CCH) 968 (1997) (noting that “there is rarely an established market from which to derive fair market value” for contributed easements); Christopher Serkin, *Entrenching Environmentalism: Private Conservation Easements over Public Land*, 77 U. CHI. L. REV. 341, 360 (2010) (“There is no ready market for conservation easements.”).

38. Taxpayers are required to obtain an appraisal for contributions of more than \$5000 and provide a summary of the appraisal on their tax return. I.R.C. § 170(f)(11)(C) (2006). For contributions of more than \$500,000, the appraisal itself must be attached to the return. I.R.C. § 170(f)(11)(D). The appraisal must be performed by a “qualified appraiser” who has relevant education and experience. I.R.C. § 170(f)(11)(E). In 2004 and 2006 Congress enacted new legislation (in which the author was involved) intended to provide more uniformity and rigor for appraisals and appraisers. See Pension Protection Act of 2006, Pub. L. No. 109-280, § 1219(c)(1), 120 Stat. 780, 1084–85 (codified as amended at I.R.C. §§ 170(f)(11)(E), 6662, 6664, 6695A, 6696 (2009)); American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 883(a), 118 Stat. 1418, 1631–32 (codified as amended at I.R.C. § 170(f)(11)(A)–(H) (2009)). This legislation imposed a new penalty on appraisers for overvaluations, increased the penalties on taxpayers for overvaluations, and eliminated the “reasonable cause” defense for some overvaluations. I.R.C. § 6695A (2009). Before the 2006 legislation, there was no requirement that easement appraisers have expertise in what is a specialized arm of the appraisal field. Nevertheless, there is doubt that the reforms will curb the main problems. See Halperin, *supra* note 14, at 44 (concluding that “the restrictions adopted in 2006 are insufficient and do not come close to dealing with the problem.”).

even well-meaning taxpayers and donee organizations have incentives to believe bullish assumptions by an appraiser about the before value.³⁹ Further, the law provides significant flexibility to the appraiser. For example, the before value may be based on the highest and best use of the property, which is not necessarily the market price for the property, but instead may be the price for the property assuming that it would be developed.⁴⁰

This is not to say that appraisers are any more prone to engage in manipulation than other service providers, but that appraising in the absence of a market is more art than science,⁴¹ and a lot is at

39. See *Exempt Organizations: Enforcement Problems, Accomplishments, and Future Direction: Hearing Before the S. Comm. on Finance, 109th Cong.* 166 (2005) (statement of Mark W. Everson, Comm'r of IRS), available at <http://finance.senate.gov/imo/media/doc/metest040505.pdf> ("Overvaluations are difficult to identify, substantiate and litigate. Further, donors and the recipient charities do not have adverse interests that would help establish a correct valuation."); McLaughlin, *supra* note 2, at 72 ("Unless and until an audit is conducted, the IRS must rely on a one-sided assertion of value by the taxpayer who has a financial incentive to assert the highest value he thinks he can get away with.")

40. This is not to suggest that the law encourages overvaluation. The regulations require consideration of "not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property's potential highest and best use." Treas. Reg. § 1.170A-14(h)(3)(ii) (as amended in 2009). However, the before value nonetheless is based on the "highest and best use." *Id.* (alluding to "the potential fair market value represented by highest and best use"); see, e.g., *Olson v. United States*, 292 U.S. 246, 255 (1934) (noting that the highest and best use for a property is the most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future); Robert Wood, *Conservation Easements, Valuation, and Substantiation*, 37 REAL EST. TAX'N 132, 134 (2010) ("Notably, the Tax Court takes into account not only the current use of the property, but also its highest and best use."). One controversial method of valuation, subdivision development analysis, allows calculation of the before-easement value based on the price a developer, intending to subdivide it, might pay for the land. See Stephanie Stern, *Encouraging Conservation on Private Lands: A Behavioral Analysis of Financial Incentives*, 48 ARIZ. L. REV. 541, 558 (2006); see also Nancy A. McLaughlin, *Questionable Conservation Easement Donations*, 18 PROB. & PROP. 40, 45 (2004) ("The [subdivision development] analysis is intended to mimic the valuation process that would be employed by a prospective purchaser interested in acquiring the subject land for development. The appraiser first determines the total gross proceeds that would be realizable if the land were developed to its fullest extent. The gross proceeds figure is then discounted for the various factors that a prospective developer would consider, such as the risk and delay associated with obtaining any necessary approvals or zoning changes, the time it would take to sell the lots, the various costs associated with developing the property such as marketing, engineering, and infrastructure costs, and, importantly, the profit that the developer expects to make on the development. That discounted figure is then presented as the 'fair market value' of the property.")

41. It is almost boilerplate for the Tax Court to announce that valuation "is not a precise science." See, e.g., *Kiva Dunes Conservation, LLC v. Comm'r*, 97 T.C.M. (CCH) 1818 (2009); *Akers v. Comm'r*, 48 T.C.M. (CCH) 1113 (1984) ("[V]aluation is not an exact science and cannot be determined with mathematical precision. It is a subjective determination which

stake.⁴² Furthermore, although an appraisal can be challenged, such challenges are costly and may amount to dueling expert opinions. In the absence of market transactions, such duels may comprise little more than “he said, she said” type arguments—arguments that a savvy taxpayer with a well-reasoned appraisal often will win,⁴³ and which are resource intensive for the IRS to mount.⁴⁴ Accordingly, the issue of overvaluation has been at the heart of concerns about abuses in the conservation easement program.⁴⁵

Addressing the overvaluation problem should be part of any reform of the easement program.⁴⁶ But for present purposes, the

requires the exercise of our best judgment considering all the facts and circumstances of record.” (citing *Messing v. Comm’r*, 48 T.C. 502, 512 (1967)).

42. See Scott D. McClure, Steven E. Hollingworth & Nicole D. Brown, *Courts to IRS: Ease Up on Conservation Easement Valuations*, 124 TAX NOTES 551, 555 (2009) (providing a table listing twenty-five easement valuation cases and the dramatic difference in values asserted by the taxpayer and the IRS). For example, in *Kiva Dunes*, the taxpayer claimed that an easement on a golf course was worth \$30,588,325, while the IRS expert valued it at \$10,018,000. The taxpayer largely prevailed, with the Tax Court setting the value at \$28,656,004. *Kiva Dunes Conservation, LLC v. Comm’r*, 97 T.C.M. (CCH) at 1818.

43. As legal practitioners have noted, “easements are an enormously good deal[,]” especially “for the taxpayer armed with a good appraisal and, if need[] be, a credible expert[.]” Wood, *supra* note 40, at 137; see also STEPHEN J. SMALL, FEDERAL TAX LAW OF CONSERVATION EASEMENTS 1 (3d Supp. 1996–2000) (“[W]ell prepared landowners and experienced appraisers generally win against a poorly prepared IRS.”); McClure, Hollingworth & Brown, *supra* note 42, at 555 (“Taxpayers and their advisers should maximize their chances of success by ensuring that the appraisals substantiating the easement value are reasonable and well supported”); Robert Wood, *Rich “Conservation Easement” Tax Break Ends 12/31/11*, FORBES (May 4, 2011, 8:34 AM), <http://www.forbes.com/sites/robertwood/2011/05/04/rich-conservation-easement-tax-break-ends-123111/> (“[S]ome taxpayers have claimed oversized 40% to 50% deductions. The IRS has taken some of them to court but hasn’t done terribly well. These disputes often come down to dueling appraisers, and taxpayers can usually afford good ones. Conservation easements can provide attractive tax benefits to the donor and nice societal benefits too. There are details to be observed and overly rich appraisals can (and probably should) draw scrutiny. Still, with a properly planned and documented donation and a deduction that isn’t greedy, everyone wins. Get them while you can.”).

44. See, e.g., JOINT COMM. ON TAXATION, *supra* note 14, at 296 (“[V]aluation is a difficult and resource intensive issue for the IRS to identify, audit, and litigate.”).

45. See, e.g., Steven T. Miller, Comm’r, Tax Exempt and Gov’t Entities, Internal Revenue Serv., Remarks at the Spring Public Lands Conference (Mar. 28, 2006) [hereinafter Remarks of Steven T. Miller], available at http://www.irs.gov/pub/irs-tege/miller_speech_3_28_06.pdf (“[A]ppraisals of conservation easements often are based on unrealistic assumptions about the highest and best use of the land, are based on an assumption that the entire assets are already in place, are conducted without regard to current zoning law, or are conducted pursuant to inadequate professional standards.”).

46. Congress recently enacted changes directed at the valuation problem. See *supra* note 38. Some commentators acknowledge the valuation problem but are more sanguine than the author about its scope. See Eagle, *supra* note 14, at 71 (“[O]bvious and intentional overvaluation would require the complicity of the taxpayer, the qualified appraiser, and the

issue is that, to the extent the amount claimed as deductions overstates the lost development value attributable to easement contributions, such amount should be discounted to arrive at a more accurate measure of one cost of the program. Picking a discount rate here will necessarily be somewhat arbitrary.⁴⁷ Nevertheless, as the point of this exercise is more conceptual guidance than numerical precision, assuming a discount rate of ten percent (thus, assuming that all easement conservation donations are overvalued by ten percent),⁴⁸ the lost economic development value attributable to the easement program with respect to the period 2003 through 2008 would be approximately \$9.19 billion.⁴⁹

In addition to lost tax revenue and lost economic development value, other costs also should be taken into account. For example,

donee. Although the opportunity for overvaluation is a possible explanation for high willingness to part [with the easement], it seems fair to assume that the majority of fair market value estimates for donated easements are calculated in good faith.” (citations omitted)). Others argue that although the scope of valuation abuse is not certain, “it is likely that the level of abuse will increase as generous state tax incentives combine with the federal incentives to make an easement donation, coupled with an aggressive or abusive valuation, a potentially profit-making enterprise.” McLaughlin, *supra* note 2, at 86. The IRS responded to the valuation problem with an aggressive enforcement strategy, namely to assert a zero value for many easement contributions. See IRS News Release IR-2004-86 (June 30, 2004), available at <http://www.irs.gov/newsroom/article/0,,id=124485,00.html> (announcing the intent of the IRS to scrutinize easement values); McClure, Hollingworth & Brown, *supra* note 42, at 555 (noting that in nine of twenty-six easement valuation cases, the IRS asserted a zero value, but “[t]he court rejected the IRS’s zero valuation in each of those cases, assigning values ranging from \$65,860 to \$1,992,375.”); see also Halperin, *supra* note 14, at 41 (criticizing the Tax Court’s rejection of the IRS’s zero-value approach). Notwithstanding the defeats, the fact that the IRS makes zero-value arguments points to serious doubts about the underlying conservation value of the easement, and is a confession, in effect, that to admit some value of dubious easements likely opens the door to an even greater loss in court. The IRS enforcement effort nevertheless continues, to the consternation of land trusts and some members of Congress. See, e.g., Fred Stokeld, *Senators Concerned About IRS Audits of Conservation Easements in Colorado*, EXEMPT ORG. TAX TODAY, Dec. 31, 2009.

47. Note that the higher the discount rate, the lower the overall cost of the program.

48. In the author’s view, this rate is probably conservative considering that taxpayers with a well-prepared appraisal likely have a reasonable cause defense to the imposition of an overvaluation penalty. The overvaluation penalty is twenty percent of the underpayment of tax (increased to forty percent for gross valuation misstatements). I.R.C. §§ 6662(a), 6662(h) (2006). The penalty applies to negligence or disregard of the rules or regulations and to valuations that result in substantial understatements of tax or valuation misstatements. I.R.C. § 6662(b). There is a reasonable cause defense to the penalty if the taxpayer acted in good faith. I.R.C. § 6664(c)(1). The reasonable cause defense is not available, however, for gross valuation misstatements. I.R.C. § 6664(c)(2); see, e.g., 1982 East, LLC v. Comm’r, 101 T.C.M. (CCH) 1380 (2011) (upholding IRS denial of a deduction for a façade easement claim of \$6.6 million but denying imposition of a twenty percent accuracy penalty).

49. This number (\$9,189,824,400) was derived by adding the amount claimed in the fourth column of the table and multiplying by 0.9. See *supra* Table 1 and note 29.

there are administrative costs to the conservation easement program, including litigation.⁵⁰ Like loss of revenue, administrative costs are borne largely by the government (and so by taxpayers). The administrative costs from the conservation easement program likely are not insignificant, considering that in recent years the IRS has devoted considerable resources to curbing abuses. Indeed, easement valuation abuse has been listed as one of the top problems faced by the IRS.⁵¹ The current regime has generated hundreds of audits,⁵² many litigated cases,⁵³ and extensive IRS guidance,⁵⁴—demonstrating a considerable use of enforcement resources, perhaps disproportionate to other areas given the

50. See *infra* note 53.

51. I.R.S. News Release IR-2006-25 (Feb. 7, 2006) (listing façade easements as one of the top abusive tax schemes for 2006); I.R.S. News Release IR-2005-19 (Feb. 28, 2005) (listing façade easements as one of the top abusive tax schemes for 2005).

52. See Letter from Christopher Wagner, Dep't of the Treasury, to The Honorable Mark Udall (Dec. 17, 2009), in 2010 TAX NOTES TODAY 10, 10–22 (2010) (“We are currently examining 344 taxpayers for charitable donations of conservation easements For fiscal years 2005 through 2009, we closed examinations on 1,115 taxpayers.”); Fred Stokeld, *IRS Has Made Offers to Settle Conservation Easement Exams, Official Says*, 65 EXEMPT ORG. TAX REV. 1203 (2010) (noting that the IRS “had offered to settle hundreds of its audits of conservation easements in Colorado and elsewhere”).

53. See, e.g., *Comm'r v. Simmons*, 646 F.3d 6 (D.C. Cir. 2011) (affirming the Tax Court’s decision that the easement was donated for conservation purposes and that the taxpayer acquired qualified appraisals of the land); *Friedberg v. Comm'r*, 102 T.C.M. (CCH) 356 (2011); *Schrimsher v. Comm'r*, 101 T.C.M. (CCH) 1329 (2011); *DiDonato v. Comm'r*, 101 T.C.M. (CCH) 1739 (2011); *Boltar v. Comm'r*, 136 T.C. 326 (2011); *Kaufman v. Comm'r*, 136 T.C. 294 (2011); 1982 *East v. Comm'r*, 101 T.C.M. (CCH) 1380 (2011). According to an IRS official, there are approximately 240 cases currently docketed in Tax Court. E-mail from Karin Gross, Supervisory Attorney, IRS Office of the Chief, to author (Oct. 31, 2011, 5:40 PM) (on file with author). Other recent notable cases include *Glass v. Comm'r*, 124 T.C. 258 (2005), *aff’d*, 471 F.3d 698 (6th Cir. 2006) (regarding a taxpayer who claimed a charitable deduction for the contribution of two small, non-contiguous conservation easements in separate tax years on the same parcel of land with little or no discernable public benefit and without encumbering the retained property for development purposes), and *Turner v. Comm'r*, 126 T.C. 299 (2006) (finding that a developer erroneously claimed a \$342,781 conservation easement charitable deduction on a property adjacent to Mt. Vernon that was already subject to floodplain restrictions on development). See also McClure, Hollingsworth & Brown, *supra* note 42, at 555 (referring to a table of twenty-six valuation cases).

54. See I.R.S. Notice 2004-41, 2004-28 I.R.B. 3, available at <http://www.irs.gov/pub/irs-irbs/irb04-28.pdf> (warning about conservation buyer programs); I.R.S. Gen. Couns. Mem. 200738013 (Aug. 9, 2007), available at <http://www.irs.gov/pub/irs-wd/0738013.pdf> (clarifying that taxpayers may not use a percentage of the value of the underlying property as a rule of thumb in valuing the easement); I.R.S. News Release IR 2004-86 (Jun. 30, 2004), available at <http://www.irs.gov/newsroom/article/0,,id=124485,00.html> (“IRS intends to disallow improper charitable contribution deductions for transfers of easements on real property to charitable organizations and for transfers of easements in connection with purchases of real property from charitable organizations.”).

amount of revenue at stake.

Relatedly, the easement program imposes a meaningful reputational cost⁵⁵ to charitable organizations and to the cause of conservation. When conservation easements are placed on golf courses,⁵⁶ when self-dealing occurs to generate large deductions for donors,⁵⁷ and when hundreds of thousands (or millions) of dollars in deductions are claimed to protect the façade of a home from change when local law already prohibits such change,⁵⁸ the reputation of land trust alliances, conservancy organizations, and even other charitable organizations suffers. Although administrative and reputational costs are not readily quantifiable, they should nevertheless inform estimates of the cost of the conservation easement program.

Finally, there are considerable transaction costs associated with a conservation easement contribution that should not be overlooked: there is the cost of the required appraisal,⁵⁹ there are ongoing monitoring costs by the donee organization, which may include the

55. Reputational cost (if any) is a social cost, borne by the charitable sector and by the cause of conservation. See Roger Colinvaux, *Charity in the 21st Century: Trending Toward Decay*, 11 FLA. TAX REV. 1, 18–38 (2011) (discussing a recent string of scandals at leading charitable institutions, including those involving conservation easements, and their effect on the charitable sector at large).

56. *Kiva Dunes Conservation, LLC v. Comm’r*, 97 T.C.M (CCH) 1818 (2009); Remarks of Steven T. Miller, *supra* note 45, at 5 (“[T]here have been proposals to place conservation easements on small parcels of land that lie between the holes on a golf course.”).

57. See STAFF OF S. COMM. ON FIN., 109TH CONG., REP. OF STAFF INVESTIGATION OF THE NATURE CONSERVANCY 12–13 (Comm. Print 2005); I.R.S. Notice 2004-41, *supra* note 54 (describing conservation buyer programs as ones in which “the charitable organization purchases the property and places a conservation easement on the property. Then, the charitable organization sells the property subject to the easement to a buyer for a price that is substantially less than the price paid by the charitable organization for the property. As part of the sale, the buyer makes a second payment, designated as a ‘charitable contribution,’ to the charitable organization. The total of the payments from the buyer to the charitable organization fully reimburses the charitable organization for the cost of the property.”).

58. The particular problem of façade easements has been going on for years. See, e.g., Joe Stephens, *Senators Vow to End Tax Break on Easements*, WASH. POST, Dec. 18, 2004, at A03; Joe Stephens, *Tax Break Turns Into Big Business*, WASH. POST, Dec. 13, 2004, at A01; Joe Stephens, *Loophole Pays Off on Upscale Buildings*, WASH. POST, Dec. 12, 2004, at A03. Congress addressed the issue with hearings and legislation, but the response has been viewed by some as cosmetic, and abuses continue. Still, enforcement efforts persist. See Joe Stephens, *U.S. Targeting Tax Break Tied to Property Use: Façade Easements Scrutinized*, WASH. POST, July 10, 2011, at C01 (reporting on an ongoing enforcement effort by the IRS and the Department of Justice against one particular land trust, the Trust for Architectural Easements).

59. See McLaughlin, *supra* note 2, at 26 nn.92–94 (identifying these significant costs).

securing of additional contributions,⁶⁰ and there are the legal costs of drafting the easement and making the gift.

To summarize, in filling in the cost side of the equation, one should consider revenue loss, lost economic development value resulting from the use of land for conservation instead of development, the costs of administering the program, intangible costs to the reputation of charities and conservation generally, and transaction costs.⁶¹

B. Conservation Benefits

With a sense of the costs of the conservation easement tax expenditure in hand, the question then becomes one of benefits and a comparison of the two. Coming to an understanding of the conservation benefits of the easement program is harder, however, than articulating the costs. How is the conservation benefit to be defined, and how should it be measured? These are vital, but vexing, questions.

1. Standard Measures: Number of Acres and Land Trusts

The two most readily available measures of the success of the conservation easement program are the number of acres affected by conservation easements and the growth in land trusts.⁶² According to the Land Trust Alliance, “[t]otal acres conserved by state, local and national land trusts grew to 47 million as of year-end 2010—an increase of about 10 million acres since 2005 and 23 million since 2000.”⁶³ In addition, the number of acres held by local and state land trusts and protected by conservation easements increased from 2,316,064 in 2000, to 6,007,906 in 2005, to 8,833,368 in 2010,⁶⁴ accounting for fifty-five percent of all land conserved by such trusts.⁶⁵ While the number of land trusts also

60. *Id.*

61. Note that costs related to state and local tax benefits are not discussed here. *See, e.g.*, Bray, *supra* note 1, at 146 (noting the cost to state treasuries from state tax credits and property tax reductions that may result when property is reassessed at a lower value after an easement is placed on the property).

62. *See* Korngold, *supra* note 14, at 1046–48; McLaughlin, *supra* note 2, at 4–6.

63. LAND TRUST ALLIANCE, 2010 NATIONAL LAND TRUST CENSUS REPORT 5 (2011) (emphasis omitted), available at <http://www.landtrustalliance.org/land-trusts/land-trust-census/census/>.

64. *Id.* at 5.

65. *Id.* at 6.

grew significantly between 2000 and 2005,—by “32%, to 1,667”—⁶⁶ “[t]he number of active land trusts has leveled off at 1,723.”⁶⁷ Still, one of the most prominent conservancy organizations, The Nature Conservancy, “helps to protect approximately 15 million acres in the United States.”⁶⁸

By either measure, there is little doubt that the easement program has been effective in generating easement contributions.⁶⁹ The difficulty, however, is that neither the number of acres affected by conservation easements nor the number of land trusts says much, if anything, about the actual conservation benefits of the program. In other words, the program’s success in developing a conservation industry does not speak directly to the conservation value produced by the industry.

2. Easement Value Does Not Equal Conservation Value

In addition to the number of conservation acres and land trusts,

66. LAND TRUST ALLIANCE, *supra* note 36, at 5 (emphasis omitted).

67. LAND TRUST ALLIANCE, *supra* note 63, at 5 (emphasis omitted).

68. The Nature Conservancy uses both land acquisition and easement donations. *About Us: Private Lands Conservation*, THE NATURE CONSERVANCY, <http://www.nature.org/aboutus/privatelandsconservation/index.htm> (last visited Oct. 25, 2011).

69. As on the cost side, there is the question of responsiveness or causation. As explained *supra* note 36, in measuring the efficiency of the program one must identify which easements are a result of the program and which would have occurred even in the absence of the program, and then omit the latter from the cost-benefit analysis. Except for subsequent growth, Professor McLaughlin’s assessment of the responsiveness question in 2004 seems appropriate here as well: i.e., although there is not, and likely never will be, conclusive evidence of responsiveness, strong circumstantial evidence points to the conclusion that the tax incentives are responsible for some contributed easements. See McLaughlin, *supra* note 2, at 49 (“[T]he precise role played by tax incentives in motivating donations, and the level at which such incentives must be set to trigger donations are all unknown.”). Arguably, however, with the growth in state tax incentives, the increasing awareness of conservation easements as a recognized conservation tool, and the stability and competence of land trust organizations as stewards for conservation, federal tax incentives become less influential as the explanation for easement contributions over time. This raises an important point. It is sometimes said that tax incentives should be used to develop a nascent industry, and tax expenditures are often so used. But once an industry “stands up,” then the incentives may be pared back or eliminated. One of the difficulties with tax expenditures, however, is that they become tax entitlement programs, not subject to annual appropriations, and are often fiercely protected (and often expanded) by the supported industry. Indeed, and not surprisingly, the Land Trust Alliance and the land trust community generally are sophisticated advocates for the tax expenditure. See Halperin, *supra* note 14, at 44 (noting the strength of the land trust community); McLaughlin, *supra* note 2, at 6 & n.14 (stating that lobbying by the land trust community has worked to increase conservation incentives); *Accelerating the Pace of Conservation*, LAND TRUST ALLIANCE, <http://www.landtrustalliance.org/policy> (last visited Nov. 29, 2011).

there are other possible measures of conservation benefit, the most obvious of which is the amount claimed as deductions, i.e., the amount that represents the easement's market value.⁷⁰ As shown in Table 1, the amount deducted during the period 2003 through 2008 was \$10,210,916,000, or \$10.21 billion.⁷¹

However, the claimed value of easements for tax purposes is not the appropriate measure of conservation benefit. Initially, this may seem counterintuitive. After all, with other kinds of charitable contributions, the amount deducted generally *is* equal to the benefit to charity. For instance, under the general rule of the charitable contribution deduction, the donor's deduction is equal to the amount contributed—that is, the fair market value of the contribution.⁷² Thus, if a donor gives \$100 in cash, the donor gets a \$100 deduction. The charitable benefit and the deductible amount are the same—\$100.⁷³ The charity may spend the \$100 on helping the needy, on employee salaries, on purchasing a new building, or the charity may invest the money. But whatever the charity does with the \$100, the amount represents the charitable good.⁷⁴ The \$100 is in the “charitable solution,” devoted exclusively to charitable purposes, even upon dissolution.⁷⁵

The same generally is true with charitable contributions of property. If a donor contributes stock in Microsoft worth \$100, the benefit to charity is \$100 (whether the charity holds the stock for investment or sells it) and the deduction generally is also \$100.⁷⁶ If

70. Other efforts to analyze the efficiency of the program have assumed that the amount deducted is roughly equivalent to the benefits from conservation. *See* McLaughlin, *supra* note 2, at 92–94. Professor McLaughlin's efficiency analysis posits that the program “would be ‘efficient’ if the aggregate value of the easements obtained as a result of the incentives . . . exceeds the aggregate cost of the incentives in terms of foregone revenue.” *Id.* at 92.

71. *See supra* Table 1.

72. *See* I.R.C. § 170 (2006); Treas. Reg. 1.170A-1(c) (as amended in 2009).

73. *Accord* Halperin, *supra* note 14, at 38 (noting that for cash gifts the amount contributed, apart from fundraising costs, is equal to the benefit to charity). The actual tax savings of course is less (\$100 multiplied by the donor's marginal tax rate).

74. It may, and should, be questioned whether the charity's use of the \$100 is the best or most efficient use, resulting in the most charitable good; but such questions go more to governance or internal operations of the charity, as well as to the definition of “charity” under the tax law, than to questions of overall efficiency of the tax benefit.

75. Treas. Reg. § 1.501(c)(3)-1(b)(4) (as amended in 2008).

76. I.R.C. § 170. There are various limitations depending on whether the property is gain or loss property, has short-term capital gain, or is inventory property of the taxpayer. I.R.C. § 170(e). Deductions of capital gain property also may not exceed thirty percent of the taxpayer's contribution base where that taxpayer is an individual. I.R.C. § 170(b)(1)(C). The extent of deductibility also depends on whether the charity is a public charity or private

a donor contributes a painting to charity worth \$200, the benefit to charity generally also is \$200,⁷⁷ whether the charity sells it or hangs it on the wall.⁷⁸ Although there are reasons for arguing that the deduction in cases of appreciated property generally should not equal value,⁷⁹ the point here is that the benefit to charity generally is equal to the value of the property for tax purposes.⁸⁰

Why then is the amount contributed (the easement's value) *not* the measure of the charitable benefit received in the easement context? As noted above,⁸¹ an easement's value for tax purposes is a negative value. It represents the lost economic development value from the contribution. Unlike the value of other types of charitable contributions, easement value says little about the benefit to charity, or, as described here, the conservation value.⁸²

foundation. See I.R.C. § 170(b)(1)(A)–(B).

77. Transaction costs likely will mean that the net benefit to charity is less than \$200, which should be factored into the benefit calculation, and also affect the efficiency calculus for property contributions generally. Thus, the value of the property and the benefit to charity often will not be the same. Further, the charity may sell the property at well below (or above) the amount deducted. But, as a general matter, the value of the property represents the benefit to charity. Whether the deduction equals fair market value depends upon the charity's use of the property and the timing of any such sale. I.R.C. §§ 170(e)(1)(B), 170(e)(7).

78. If the charity hangs the painting on the wall, the charity has decided to consume the painting and is reaping the \$200 benefit through use of the property.

79. See JOINT COMM. ON TAXATION, *supra* note 14, at 293–307 (considering various options for reform and proposing a basis deduction for charitable contributions of appreciated property); Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-In Gains*, 56 TAX L. REV. 1 (2002) (arguing that taxation of built-in long-term capital gains should occur for contributions of appreciated property to charity).

80. Overvalued property, of course, means that the benefit to charity also is overstated. Note that the fair market value measure of the benefit to charity is not the same as the “social worth” of the contribution. For example, a contribution of a painting valued at \$200 million does not necessarily produce \$200 million worth of social good. But because there is a market for the painting and its value is known, the market value does represent the benefit received by the charity because the charity can sell the painting and use the proceeds for other things, or hang the painting on the wall. In either case, the charity has an asset worth \$200 million.

81. See *supra* Part I.A.

82. Other commentators have made this point. See Eagle, *supra* note 14, at 87 (“[T]he ‘before and after’ valuation method estimates the value of lost development rights However, the value that the public receives for this expenditure is not necessarily correlated to the value of the development rights. Rather, the public benefit is related to the ecological or aesthetic value of protecting the land from development.”); McLaughlin, *supra* note 2, at 71 (“[T]he before and after method does not in any way measure the value of those public goods. Instead, the before and after method measures only the market cost of an easement donation, or the extent to which placing permanent restrictions on the development and use of land reduces the fair market value of the land.”). However, when the disconnect between easement and conservation value is mentioned by commentators, it is mostly in passing. See,

The fact that an easement may be worth \$1 million according to the before-and-after method does not mean that there is a \$1 million benefit to charity. For example, if a \$1 million easement protected the habitat of an endangered species, clearly there is a benefit to charity from the contribution. But the \$1 million valuation reflects what is lost, not the affirmative value of endangered species protection.⁸³

This disconnect between the value of the contribution for tax purposes and the actual conservation value means that, as an initial matter, we do not know or even have a ballpark figure to use as an estimate for the value of the conservation benefit represented by conservation easements,⁸⁴ making an efficiency determination even more challenging than in the normal case.⁸⁵ In addition, the false identity of easement value and conservation benefit has meant that, to a certain extent, the overall efficiency of the easement program has been taken for granted.⁸⁶ Because the normal case of the

e.g., McLaughlin, *supra* note 2, at 71. As discussed *infra* in Part II, this Article argues that the issue is important to understanding weaknesses in the design of the conservation easement tax expenditure.

83. Conservation value is (or should be) based on the value of preserving the species at risk, and not on the fact that the property may not be developed. Thus, a property could have a high development value and a low conservation value, or vice versa—the two are not necessarily linked.

84. Indeed, in light of the uncertainty of the public benefit provided by conservation easements, Professor Daniel Halperin has concluded that “the revenue loss from the charitable deductions for easement donations might well be far *more* than the public benefit provided.” Halperin, *supra* note 14, at 32 (emphasis added).

85. For instance, normally, the overall efficiency of the charitable deduction depends more on causation or responsiveness, and less on defining the charitable benefit. To the extent that a charitable contribution is made because of the tax incentive, the incentive will be efficient in the broad sense that benefits will greatly exceed costs. For example, if a contribution of \$100 would not have been made but for the charitable deduction, then for a donor with a thirty-five percent marginal tax rate, the benefit of \$100 of charity exceeds the cost to the government of \$35. That is, the government pays \$35 to encourage the donation of \$100 to charity—an efficient result. To the extent many charitable contributions would be made absent the charitable contribution deduction, the deduction becomes less efficient. Such responsiveness questions are important in the easement context too, but before they can be assessed, some notion of the conservation benefit and overall efficiency of the program should first be developed.

86. This type of analysis has been performed in the easement context to justify the program. *See, e.g.*, PENTZ, *supra* note 8, at 19 (stating that a credit based on a percentage of an easement’s value “ensures that there is a significant public benefit for any dollars awarded as tax credits” because, for example, “when credits are valued at 50-percent of the fair market value of the donation, the public receives \$2 of land protection for every \$1 dollar offered as a tax incentive.”); McLaughlin, *supra* note 2, at 92 (illustrating efficiency by saying that if ninety landowners, each in a thirty-five percent tax bracket, donated easements because of the tax incentive, and each easement was worth \$1 million, then “the tax incentive program

charitable deduction is reflexively understood and applied to conservation easement contributions, there has not been enough focus on the conservation benefits of easements. Indeed, as argued below, the tendency to equate easement value and conservation benefit, a tendency influenced by the very design of the easement program as a charitable contribution, has led to an overemphasis on easement value by taxpayers, land trusts, and the IRS, often at the expense of conservation benefits.

3. Conservation Purpose Is Not a Useful Measure of Conservation Benefit

In order to take a charitable deduction for a conservation easement contribution, the easement must be “exclusively for conservation purposes.”⁸⁷ Thus, within the statutory scheme, the conservation benefit of the contribution is not tied to the value of the easement but to its purpose. The reason for the conservation purpose requirement is to describe easements that provide a public benefit and are therefore worthy of public encouragement. Accordingly, the conservation purpose requirement could provide a measure of conservation benefit.

As laid out in the Code and regulations, there are four qualifying conservation purposes. The first is “the preservation of land areas for outdoor recreation by, or the education of, the general public.”⁸⁸ This includes “the preservation of a water area for the use of the public for boating or fishing, or a nature or hiking trail for the use of the public.”⁸⁹ The recreation or education must be “for the substantial and regular use of the general public.”⁹⁰

The second purpose is “the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem.”⁹¹ The habitat or ecosystem must be “significant” and the life protected must “normally” live there.⁹² Land areas that have been altered by human activity qualify, as long as the life protected “continue[s] to

would be efficient because the \$90 million value of the easements . . . far exceeds the \$35 million cost of the program.”).

87. I.R.C. § 170(h)(1)(C) (2006).

88. I.R.C. § 170(h)(4)(A)(i).

89. Treas. Reg. § 1.170A-14(d)(2)(i) (as amended in 2009).

90. Treas. Reg. § 1.170A-14(d)(2)(ii) (as amended in 2009).

91. I.R.C. § 170(h)(4)(A)(ii).

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

exist there in a relatively natural state.”⁹³ Limitations on public access to the restricted property are allowed.⁹⁴

The third purpose is “the preservation of open space (including farmland and forest land) where such preservation is (i) for the scenic enjoyment of the general public, or (ii) pursuant to a clearly delineated Federal, State, or local governmental conservation policy, and will yield a significant public benefit.”⁹⁵ “Scenic enjoyment” is a broad standard evaluated based on the facts and circumstances of the contribution; eight factors to be considered are listed.⁹⁶ Visual access by the public is sufficient, and the entire property subject to the easement need not be visible.⁹⁷ The requirement of a government conservation policy may be met in several ways, including “by donations that further a specific, identified conservation project, such as the preservation of land within a state or local landmark district that is locally recognized as being significant to that district,”⁹⁸ or when the donation is made “pursuant to a formal resolution or certification by a local governmental agency established under state law specifically identifying the subject property as worthy of protection for conservation purposes.”⁹⁹ The “significant public benefit” test is a “facts and circumstances” test with eleven factors listed in the regulations as “[a]mong the factors to be considered.”¹⁰⁰

The fourth and final purpose is “the preservation of an historically important land area or a certified historic structure.”¹⁰¹ A certified historic structure is a building, structure, or land area that is listed in the National Register or a building located in a registered historic district and certified by the Secretary of the Interior as being of historic significance to the district.¹⁰² Some visual public access to the restricted property is required.¹⁰³

For present purposes, what should be apparent from this recitation of the legal requirements is that the conservation

93. *Id.*

94. Treas. Reg. § 1.170A-14(d)(3)(iii) (as amended in 2009).

95. I.R.C. § 170(h)(4)(A)(iii).

96. Treas. Reg. § 1.170A-14(d)(4)(ii)(A) (as amended in 2009).

97. Treas. Reg. § 1.170A-14(d)(4)(ii)(B) (as amended in 2009).

98. Treas. Reg. § 1.170A-14(d)(4)(iii)(A) (as amended in 2009).

99. *Id.*

100. Treas. Reg. § 1.170(A)-14(d)(4)(iv)(A) (as amended in 2009).

101. I.R.C. § 170(h)(4)(A)(iv).

102. I.R.C. § 170(h)(4)(C).

103. Treas. Reg. § 1.170A-14(d)(5)(iv) (as amended in 2009).

purpose requirement is broad, open-ended,¹⁰⁴ and provides little basis for assessing the conservation benefit of conservation easements, either in the aggregate or on an easement-by-easement basis.¹⁰⁵ For example, an easement that provides scenic benefits may be a legitimate open space easement, but the conservation value of the scenic benefits will depend upon how much scenery is protected, the location of the scenery, the extent of public access, and so on—information not provided through satisfaction of a purpose requirement. Indeed, this is in the very nature of a purpose requirement—it is not intended to measure conservation benefit but merely to provide a broad delineation (and definition) of conservation.

In general, then, the conservation purpose requirement of the easement deduction is somewhat akin to the exempt purpose

104. In the wake of highly publicized abuses of the conservation easement tax expenditure, the standards for conservation purposes have been criticized. Suggestions for improvement include extending the “significant public benefit” test for open space easements to all other conservation easements, extending the requirement for some open space easements that the easement adhere to a governmental conservation policy to all other conservation easements, and further involving government institutions in the conservation easement approval process in a manner similar to that required for the preservation of historically important land areas. See JOINT COMM. ON TAXATION, *supra* note 14, at 286 (“A significant public benefit and conservation purpose may be best demonstrated when a contribution promotes preservation or protection that is pursuant to a clearly delineated governmental conservation policy.”); see also Korngold, *supra* note 14, at 1068–69 (proposing amendments to the Code). All of these suggestions have merit; some are discussed further in *infra* Part III.

105. See, e.g., JOINT COMM. ON TAXATION, *supra* note 14, at 286 (“The present-law [conservation purpose requirements] . . . are so broad that the IRS effectively has no basis to challenge contributions claimed to have been made for such purposes.”); Halperin, *supra* note 14, at 42 (noting that the conservation purpose “definition is too open ended”); Korngold, *supra* note 14, at 1067 (describing the ambiguity in the “conservation purpose” requirement, particularly the lack of clarity in the qualification requirements for the “open space” deduction); McLaughlin, *supra* note 2, at 52 (“[W]hile the conservation purposes test does contain some objective standards, a significant number of the standards are unavoidably subjective.” (citation omitted)). To a certain extent, conservation purpose has been left to the donor and donee to determine. Although the burden to prove conservation purpose is on the taxpayer, there is clearly considerable flexibility in the requirements. Appraisers will not be focused on conservation purpose, but on lost economic development value. The best guarantee that an easement will provide conservation benefits lies in its acceptance by a conservation organization. Land trusts in theory (and probably also in practice) should not accept easements with little or no conservation value. This is an important check, which has led some to suggest mandatory accreditation for land trusts and other measures. See STAFF OF S. COMM. ON FIN., 109TH CONG., *supra* note 57, at 1152. The Land Trust Alliance has developed a voluntary accreditation program. *Getting Accredited*, LAND TRUST ACCREDITATION COMM’N, <http://www.landtrustaccreditation.org/the-process> (last visited Oct. 30, 2011) (giving an overview of the accreditation process).

requirement for tax exemption as a charitable, or section 501(c)(3), organization.¹⁰⁶ The goal is not to define conservation (or charity) with rigor, but to adopt a pluralistic approach that allows private organizations to decide within broad parameters the limits of charity and conservation.¹⁰⁷ And perhaps this is the best way to view conservation purpose—it is not a measure of efficiency for the tax incentive any more than the exempt purpose requirement of section 501(c)(3) is a measure of efficiency for tax exemption as a charity.

4. Quantifying Conservation Benefit?

There should be little doubt that conservation produces significant benefits; the challenge is quantifying the benefits. Some studies emphasize this issue, putting the language of conservation benefits into terms of investment and returns: “To protect the open space that sustains natural processes is the most important investment we can make, yielding returns that can be measured in terms of clean air and water, medicinal discoveries, flood control, artistic inspiration, fertile soils, hunting grounds, and a stable

106. See I.R.C. § 501(c)(3) (requiring that such organizations be “organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes . . .”).

107. It is worth noting here that the conservation purpose requirement itself is somewhat exceptional. For other charitable contributions of property, there is no “charitable purpose” or related use requirement. Rather, charitable deductions for property contributions generally are allowed irrespective of purpose. See I.R.C. § 170(c) (defining charitable contribution as “a contribution to or for the use of” certain organizations, without a purpose requirement). *But see* I.R.C. § 170(c)(1) (requiring that contributions to government entities be “exclusively for public purposes”). Although property-based distinctions frequently are made, such distinctions are for determining the deductible amount, not threshold eligibility. For example, the amount of the deduction is affected by whether the contributed property is gain or loss property, whether the nature of the gain is ordinary or capital, whether the property is for a use related to the exempt purposes of the donee, and, in some cases, specific types of property (e.g., intellectual property, vehicles, taxidermy, computers, fractional gifts) have special rules on the deductible amount. I.R.C. §§ 170(e), 170(f)(12), 170(f)(15)–(16), 170(m), 170(o). But for all of these, the purpose of the contribution does not affect the threshold question of whether or not the contribution is deductible. So why do conservation easements have a purpose requirement? Congress in effect was forced into a conservation purpose requirement for easement contributions because allowing a conservation easement deduction at all is an exception to the general rule that denies deductions for contributions of partial interests in property. I.R.C. § 170(f)(3). Accordingly, to make a viable exception to the partial interest rule, a purpose requirement was needed; otherwise, any partial interest contribution would be eligible. For a description of the partial interest rule, see also *infra* Part II.A.

climate.”¹⁰⁸ The benefits of protecting timberland, for example, are extensive: improved air quality (and therefore human health), flood prevention, carbon sequestration, improved water quality, recreational benefits, increased property values, and scenic benefits.¹⁰⁹ The problem lies in giving “a monetary value . . . to natural processes and benefits that are not generally recognized by economic markets[.]”¹¹⁰ Although economists have developed methods for “deriv[ing] economic value from ecosystem services,”¹¹¹ the time when “ecological services and open space benefits [are brought] into the marketplace, so that they will be incorporated into decisions affecting their future . . . appears to be a long way off.”¹¹²

In some cases, the economics are clear. For example, when a government chooses to conserve a forest for its water purification benefits rather than develop the land and incur the costs of building, operating, and maintaining a water treatment plant, many costs and benefits can be measured and assessed.¹¹³ However, a detailed assessment of the costs and benefits of possible land use is not required, and may not be feasible, in connection with the conservation easement tax expenditure. Indeed, the easement program is partly set up to avoid such studies, designed as it is to facilitate private transactions¹¹⁴ at government expense. As

108. AMANDA SAUER, *THE VALUE OF CONSERVATION EASEMENTS: THE IMPORTANCE OF PROTECTING NATURE AND OPEN SPACE 2* (2002).

109. *Id.*

110. *Id.* at 4.

111. Such methods include comparing property values of land with open space benefits to comparable land without such benefits, asking people in surveys how much they would pay for ecological benefits, and calculating the time and money spent in pursuit of conservation-related recreational opportunities. *Id.*

112. *Id.* at 5.

113. *Id.* at 5–6 (describing as one example the decision by New York City “to spend \$1.8 billion to protect 80,000 acres of its upstate watershed instead of constructing an \$8 billion water filtration plant with additional operating costs of \$300 million a year”).

114. There is some debate about whether the role of the land trust in conservation is public or private. Some argue that the conservation easement program fundamentally is private. Land trusts are viewed as private organizations, making permanent decisions about public use. This gives rise to accountability concerns: land trusts are not run by elected officials and are not accountable to the general public. See Korngold, *supra* note 14, at 1064–65; C. Timothy Lindstrom, *Conservation Easements, Common Sense and the Charitable Trust Doctrine*, 9 WYO. L. REV. 397, 401, 409–10 (2009). Others counter that because land trusts are section 501(c)(3) organizations under the Code, they are quasi-public—supported by the tax system, organized for public purposes, and subject to oversight by the IRS and state attorneys general—and, as “public” charities, land trusts are accountable to donors for their actions. See Nancy A. McLaughlin & W. William Weeks, *Hicks v. Dowd, Conservation Easements, and the*

suggested in Part III, to the extent possible, implementing a cost-benefit analysis into the conservation easement program would be a step in the right direction toward standardizing the quantification of conservation benefits so as to make assessment of conservation benefits more plausible.

5. Conclusion

If the federal government spent \$100 for \$75 to be paid to charity, the transaction would be inefficient, wasteful, and the government (and the public) would be better off without it. Sometimes called transactional efficiency,¹¹⁵ this concept can be applied broadly to an entire program and used to assess its utility. In general, with respect to the conservation easement tax expenditure, it largely has been taken for granted that the benefits of the program exceed the costs, in part because of the rarely examined assumption that an easement's value for tax purposes is roughly equivalent to its conservation benefits.¹¹⁶

However, the relationship between easement value and conservation benefits is tenuous. Further, the standard measures cited for success of the easement program (the number of acres subject to conservation easements and the growth in the number of land trusts) are not helpful measures of conservation benefits, nor is the legal requirement that easements be for one of four broad conservation purposes. In short, although an articulation of the costs of the conservation easement tax expenditure is possible and plausible, a quantifiable articulation of the benefits is elusive if not ephemeral. This is troubling, if only because the uncertainty regarding conservation benefits makes assessing the efficacy of the

Charitable Trust Doctrine: Setting the Record Straight, 10 WYO. L. REV. 73, 95–96. (2010). As discussed *infra* note 207 and accompanying text, this debate is also part of the debate about the soundness of the perpetuity requirement for deductibility. In addition, this “public-private” debate has wider ramifications than land trusts. See generally EVELYN BRODY & JOHN TYLER, HOW PUBLIC IS PRIVATE PHILANTHROPY?: SEPARATING REALITY FROM MYTH (2009) (questioning the argument that the public purposes of a charity warrant extensive public intervention). As a general matter, many, if not most, charitable organizations likely would bristle at the notion that they are anything but independent, private organizations. Indeed, the ongoing debate about the role of the IRS in nonprofit governance, and the considerable concern expressed by the charitable, “independent” sector about IRS overreach suggests that charitable organizations are viewed as mostly private. See James J. Fishman, *Stealth Preemption: The IRS's Nonprofit Corporate Governance Initiative*, 29 VA. TAX REV. 545, 549–57 (2010) (detailing state and federal regulatory regimes of charitable nonprofits).

115. See *infra* note 181.

116. See *supra* note 86 and accompanying text.

tax expenditure for conservation easements very difficult, and continuation of the tax expenditure, in part, a matter of faith or inertia.

As argued in Part II, conservation may, to a certain extent, warrant relaxing efficiency norms. Nevertheless, the efficiency analysis discussed here, and the impotence of current notions of conservation benefit, argue in favor of reforming present law to develop rules that are more likely to produce greater confidence that the conservation benefits resulting from the program justify the significant costs.

II. TOWARD A TAX BENEFIT GROUNDED IN CONSERVATION VALUE

In any reform of the conservation easement tax expenditure, the focus should be on determining the optimal level of cost for the desired conservation benefits. In some cases, it might make sense to increase the tax incentives found in present law in order to secure a particularly lucrative conservation benefit. In cases where the conservation benefits appear weak, however, costs could be reduced by decreasing the value of the tax incentive, thus eliminating waste. Key to either approach—eliminating waste or increasing benefits—is the development of rules that will provide greater confidence that the conservation benefits, even if not quantifiable, are actually realized.

The first step toward reform, however, is debunking present law's emphasis on lost economic development value as the measure for the tax benefit. As indicated in Part I, unlike other charitable contributions, the measure for the easement deduction—lost economic development value—does not bear an approximate relationship to the benefits provided by the contribution. This complicates not only the measurement of conservation benefits, but also raises questions about why lost economic development value should be the basis for determining the amount of the deduction.

A. A Brief History of the Enactment of the Easement Deduction

Historical context helps to put the development of the easement program in perspective. From the outset, the easement program was embedded within the charitable contribution deduction. Under traditional property law forms, a conservation easement generally was not a recognized property interest and so was not

enforceable.¹¹⁷ Nevertheless, as the conservation easement grew in use, a taxpayer inevitably attempted to deduct a contributed easement as a charitable contribution.¹¹⁸ The IRS ruled that a deduction was allowed for the fair market value of the conservation easement.¹¹⁹

In 1969, however, Congress introduced a rule prohibiting charitable deductions for contributions of partial interests in property.¹²⁰ A conservation easement contribution runs afoul of this rule because, typically, for such contributions, the donor fragments the property rights by creating and contributing an easement while remaining the owner of the fee. The donor's retained fee ownership means that the donor has not contributed his or her entire interest. But, because conservation easement contributions were not the intended target of the partial interest rule, language was added to the conference report that purported to allow the continued deduction of open view easements.¹²¹ This proved too flimsy a support for a broader deduction, however, and in 1976 Congress affirmatively waived the partial interest rule for conservation easement contributions on a temporary basis.¹²² In 1979, as Congress considered whether to make the tax expenditure permanent, the Deputy Assistant Secretary for Tax Policy, Daniel Halperin, testified that the Treasury Department had concerns regarding easement contributions, declaring that

the difficulties with valuing partial interests in real property may be particularly acute, especially where such interests have no impact on the donor's current enjoyment of the property. [In addition], for a taxpayer who does not have the present intention to sell or develop the property, the gift of, for example, a conservation easement, while perhaps diminishing the value of the property, does not do so until a later time [and] date; in particular, it may have no material impact on the continuing enjoyment of the property by the donor of the

117. See Korngold, *supra* note 14, at 1052. This concern was overcome through adoption in many states of the Uniform Conservation Easement Act. NAT'L CONFERENCE OF COMM'RS ON UNIFORM STATE LAWS, UNIFORM CONSERVATION EASEMENT ACT (1981).

118. Rev. Rul. 64-205, 1964-2 C.B. 62.

119. *Id.* (allowing a fair market value deduction based on the willing-buyer, willing-seller standard, but requiring a basis reduction in the retained property).

120. Tax Reform Act of 1969, Pub. L. No. 91-172, § 201, 83 Stat. 487, 556.

121. See H.R. REP. NO. 91-782, at 18 (1969) (Conf. Rep.).

122. See Act to Reform the Tax Laws of the United States, Pub. L. No. 94-455, § 214, 90 Stat. 1520, 1549 (1976).

easement.¹²³

Nonetheless, Congress made the conservation easement deduction permanent in 1980, and also introduced new requirements for the easement program.¹²⁴

B. The Problem of Value: A New Measure for the Tax Benefit Is Needed

1. Lost Economic Development Value Is Not the Right Measure for the Tax Benefit

The use of the charitable deduction framework for the easement program meant that a fair market value measure for the deduction followed as a matter of course.¹²⁵ However, the lack of a true market value for conservation easements has introduced problems not only of accurate valuation for deduction purposes—clearly a scourge of the easement program¹²⁶—but, more fundamentally, has raised questions about which of multiple values is the right one upon which to base the tax benefit. Again, to see the issue, it is helpful to consider a charitable contribution other than a conservation easement. For example, if a taxpayer donates \$100 cash to charity, the deduction is \$100 (the value of the contribution).¹²⁷ If a taxpayer donates property worth \$100, the deduction is based on the fair market value of the property and generally is also \$100.¹²⁸ In either case, the deduction is based on the contribution's value.

As a general matter, contribution value is a sensible starting point

123. *Miscellaneous Tax Bills: Hearing on H.R. 3874, 4103, 4503, 4611, 4634, and 4968 Before the Subcomm. on Select Revenue Measures of the H. Comm. on Ways and Means*, 96th Cong. 12 (1979) (statement of Daniel I. Halperin, Deputy Assistant Secretary of Tax Policy, Department of the Treasury); see also Halperin, *supra* note 14, at 31–32 (noting that the problems identified by the Treasury Department in 1979 still remain).

124. An Act to Extend Temporary Tax Provisions, and for Other Purposes, Pub. L. No. 96-541, § 6(b), 94 Stat. 3204, 3206–08 (1980). Estate and gift tax deductions also are allowed. I.R.C. §§ 2031(c), 2522(d) (2006). For an excellent and more detailed summary of the history of the deduction, see McLaughlin, *supra* note 2, at 10–17, n.20. For an overview of the partial interest rule, see Halperin, *supra* note 14, at 32–36.

125. As a general matter, treasury regulations provide that the fair market value of contributed property should be determined pursuant to a willing-buyer, willing-seller standard. Treas. Reg. § 1.170A-1(c)(2) (as amended in 2009).

126. See *supra* text accompanying notes 51–54.

127. See I.R.C. § 170.

128. Various limitations apply. See *id.*; *supra* notes 76–77 and accompanying text.

to measure the deduction, either as a matter of common sense or simple transactional efficiency, because it represents the benefit to charity. For instance, under the subsidy theory of the charitable deduction,¹²⁹ assuming that the goal is to encourage charitable giving, the question is: How much must be paid by the government to produce the desired level of giving? Here, the desired level of giving, or the benefit to charity, is the fair market value of the contributions, i.e., the cash or other property to be donated. The amount to be paid by the government, the subsidy, is a percentage of such value.¹³⁰ The value is relevant because, as a matter of transactional efficiency,¹³¹ the subsidy should not exceed 100% of the contribution value.¹³² Thus, the value of the contribution

129. Pursuant to the subsidy theory of the charitable deduction, a deduction is available because Congress decided that charitable contributions should be encouraged and subsidized. In general, under the subsidy theory, charitable contributions are a form of consumption and a personal expense and, therefore, income with respect to the contributions should not escape tax. Miranda Perry Fleischer, *Theorizing the Charitable Tax Subsidies: The Role of Distributive Justice*, 87 WASH. U. L. REV. 505, 517 (2010) (discussing the subsidy theory and noting that it is the more “common” view); John Simon, Harvey Dale, & Laura Chisolm, *The Federal Tax Treatment of Charitable Organizations*, in THE NONPROFIT SECTOR 267, 274–75 (Walter W. Powell & Richard Steinberg eds., 2006); see also JAMES J. FISHMAN & STEPHEN SCHWARZ, TAXATION OF NONPROFIT ORGANIZATIONS: CASE AND MATERIALS 652–53 (2d ed. 2008) (“Congress has justified the charitable deduction like tax exemptions generally, as an efficient alternative to government support for those nonprofit organizations providing a public benefit.”). Accordingly, the federal government pays a portion of each charitable contribution (by taxpayers who itemize deductions). See I.R.C. § 63(d). Under another view of the charitable deduction, the income measurement rationale, it is argued that a taxpayer’s income, properly construed, does not include amounts given to charity. See Simon et al., *supra*, at 273–74; William D. Andrews, *Personal Deductions in an Ideal Income Tax*, 86 HARV. L. REV. 309, 313 (1972). Charitable contributions are viewed as transfers of a consumption opportunity from the taxpayer to the charity and do not represent consumption by the taxpayer. Therefore, an accurate measurement of the taxpayer’s income does not include charitable gifts, the value of which should not be taxed. Under an income measurement approach, the proper treatment of charitable contributions of appreciated property would require realization of the appreciation; otherwise, a deduction based on the appreciated value offsets other income of the taxpayer, which may be used for private consumption. See Andrews, *supra*, at 372.

130. The amount of the subsidy depends upon the contribution amount and the taxpayer’s marginal tax rate, resulting in a larger subsidy for higher income taxpayers. For example, a contribution of \$100 by a taxpayer in the thirty-five percent tax bracket is worth \$35 (100 times 0.35), and a contribution of \$100 by a taxpayer in the twenty-eight percent tax bracket is worth \$28 (100 times 0.28). In cases where a fair market value deduction is not allowed, the deduction is based on cost recovery; that is, the taxpayer recovers their cost (basis) in the contributed property but is not allowed to deduct the appreciation in the property. I.R.C. § 170(e). Even here, the deduction may not exceed the fair market value of the property.

131. See *infra* note 181.

132. See Halperin, *supra* note 14, at 40 (noting that revenue loss “should never exceed the

necessarily is a relevant value for determining the amount of the deduction.¹³³

As an initial matter, a value-based deduction makes sense for conservation easements as well. The amount of the subsidy for conservation contributions should be a percentage of the value of the benefit to charity. Therefore, it is necessary to determine the value of the easement. The key question, however, is not whether a value-based approach to the tax benefit is reasonable, but rather which of competing values should be used to measure the tax benefit. In other words, is the fair market value approach of current law the right approach?

This question of *which* value to use normally does not arise. For the typical charitable contribution, there is one relevant value: fair market value.¹³⁴ Fair market value is appropriate for the typical contribution because it is a reasonable representation of the benefit to charity. But “fair market value” does not work in the easement context. Because fair market value, in effect, has been defined as the before-and-after value, not only is such value, to a significant degree, a fiction composed by an appraiser,¹³⁵ but more importantly, as discussed above,¹³⁶ it bears little relation to the conservation benefit of the contribution.

In short, conservation easement contributions present a problem of value not usually present. The question that normally has a standard answer—what is the value of the benefit received by the charity?—is not answered by the conventional fair market value approach. Accordingly, lost economic development value is not the right measure for the deduction, and its ongoing and largely unquestioned reign is the crux of the problem with the current design and administration of the conservation easement program.

actual benefit to charity”). Professor Halperin also explains that if “public benefit is not commensurate with the revenue loss,” one of the rationales for the charitable deduction—that charities are a substitute for government—is not satisfied. *Id.* at 38.

133. Note that under a subsidy theory for charitable contributions, the form for delivery of the subsidy as a deduction is not self-evident. A credit could work just as well, if not better. Choice of a (below the line) deduction ties the value of the subsidy to the marginal rate of the taxpayer and limits the deduction to itemizers.

134. As noted, the default regulatory standard for fair market value is based on a transactional concept, that of a willing buyer and a willing seller. Treas. Reg. § 1.170A-1(c)(2) (as amended in 2009).

135. *See supra* notes 41–44 and accompanying text.

136. *See supra* Part I.B.2.

2. Consequences of Using Lost Economic Development Value as the Measure

The principal consequence of using lost economic development value as the measure of the deduction is a basic misunderstanding and misrepresentation of the conservation benefits of the program. As discussed in Part I, there is a tendency to equate easement value with conservation benefit. Such an approach generally is sensible for other charitable contributions.¹³⁷ In truth, however, lost economic development value is not a ready measure for conservation benefit.

Further, use of lost economic development value as the measure of the deduction has driven up the costs of the program. In terms of revenue loss, many of the taxpayers most likely to donate conservation easements are unlikely to develop the property in any event and would be willing to part with the easement for much less than the current tax benefit. As argued by Professor Josh Eagle, use of lost economic development value creates a significant “subjective value spread,” representing the difference between the easement value and the subjective value to the taxpayer of the donated property right.¹³⁸ The spread, he argues, is manifest in many, if not most, easement contributions, indicating significant waste within the easement program.¹³⁹

Note, however, that although Professor Eagle’s overall point is a good one, the presence of a subjective value spread is not unique to easement contributions, but exists with respect to other types of property contributions.¹⁴⁰ Importantly, the subjective value spread takes on greater significance in the context of conservation easements because lost economic development value is not the right measure for the deduction for donated easements, and, therefore, problems associated with a subjective value spread may

137. *See supra* Part I.B.2.

138. Eagle, *supra* note 14, at 75–77.

139. *Id.*

140. For example, Professor Eagle illustrates his argument with a hypothetical charitable contribution of a pair of jeans, the subjective value of which, he posits, is less than the “fair market value.” *Id.* at 74–75. Of course, one could suggest here that the “fair market value” Professor Eagle asserts for the jeans is an overvaluation—the more accurate value is the value offered for purchase. This speaks to the problem of “fair market value” generally as the measure for the deduction when property values are highly uncertain. Taxpayers can exploit the uncertainty by plausibly maintaining that fair market value is much higher than the item would actually sell for between a willing buyer and a willing seller.

be addressed through choice of a different measure for the tax benefit.¹⁴¹ In other words, the tax system normally tolerates the windfalls (and inefficiencies) of a subjective value spread because the tax incentive is based on the value of the benefit to charity. Such value, in theory, is objectively equal to the value of the contributed property, and does not depend on subjective value. Furthermore, although the spread is of concern, administratively, it would be next to impossible to base a deduction on the subjective value of contributed property.¹⁴² However, in the easement context, where the value is not related to the conservation benefit, the subjective value spread is not a necessary outgrowth of the deduction. Accordingly, a better measure for the deduction may have the beneficial effect of reducing windfalls.¹⁴³

As discussed in Part I, the use of lost economic development value also carries significant administrative, policy, and reputational costs. On the administrative side, much of the enforcement apparatus of the IRS with respect to the conservation easement program is devoted to challenging a false measure for the deduction.¹⁴⁴ As an agency given the task of raising revenue and

141. For the normal charitable contribution, there is really no choice of value problem, because the fair market value works. That said, in cases in which the taxpayer's claimed value and the benefit received by charity are vastly different, Congress has intervened to change the measure of the deduction. For example, Congress addressed one version of this problem in the vehicle donation context. Concerned that taxpayers were basing deductions on fair market values printed in reference books, and that charities were receiving far less than such amounts from sales of the vehicles, the measure for the donation was changed from an appraised fair market value to sales proceeds. American Jobs Creation Act of 2004, Pub. L. No. 108-357, § 884, 118 Stat. 1418, 1632–34 (codified as amended at I.R.C. § 170(f)(12) (2010)). So, although the measure for the deduction remained fair market value, the actual price produced in a willing-buyer, willing-seller exchange (i.e., the benefit to charity) was preferred to a hypothetical price. Another example involved contributions of intellectual property, with respect to which Congress changed the measure of the deduction to be based largely on the income attributable to the property actually received by the donee. I.R.C. § 170(m) (2006). The author was involved in the drafting of both the vehicle and the intellectual property legislation. *See generally* Halperin, *supra* note 14, at 39–40 (discussing both examples).

142. Arguably, in some cases, the subjective value spread is just another way of describing an overvaluation problem—i.e., the “subjective value” really is, or should be, equated with the fair market value, but is not because of uncertainty. In some cases, of course, the subjective value and the lost economic development value could be the same. Often, however, they are not. *See generally* Eagle, *supra* note 14 (analyzing the subjective value spread in the context of conservation easements).

143. As argued below, although reducing windfalls is always a good idea, it should not be the main objective. Some windfalls (defined in terms of a subjective value spread) are unavoidable and are even acceptable if the conservation value of the property is high.

144. *See* McLaughlin, *supra* note 2, at 76 (“Nearly all of the cases actually litigated by the

closing the tax gap,¹⁴⁵ the IRS reasonably attacks the measure of the deduction as the principal means of minimizing abuse. Therefore, although it makes sense for valuation to be the focus of revenue agents, the emphasis on proving or disproving lost economic development value is unfortunate.

Further, with respect to policy, although IRS efforts to control valuation abuse may function to protect tax revenues, such efforts do not also serve the purpose of defining the conservation benefit. In addition, the revenue-based focus on valuation means that concomitant resources are not devoted to testing the conservation purposes of easements or developing standards for conservation benefits.¹⁴⁶ Moreover, and most importantly, the focus on debating a somewhat fictional and often uninformative number means that what should be the most important aspect of a program—promoting conservation—is shortchanged. Whether or not an easement is well designed to promote conservation is left principally to the conservation purpose requirement, which, as argued above, is largely unenforceable.¹⁴⁷

There may also be reputational fallout from basing the deduction on lost economic development value. As shown in Part I, the many abuses associated with the easement program may have damaged the cause of conservation, the credibility of land trusts, and the broader image of the charitable sector. The quest for the lost economic development value is the source of many of these abuses. It promises a lucrative tax benefit (magnified in many cases by additional state tax benefits), perhaps with little “parting cost” by taxpayers,¹⁴⁸ and a reasonable chance of success on valuation if the

IRS with respect to conservation easements [from] 1987 [to 2004] have turned on the issue of valuation.”); *see also supra* notes 51–54.

145. The tax “gap” is the difference between taxes owed and taxes paid and is the subject of ongoing concern. *See, e.g.*, U.S. DEP’T OF THE TREASURY, REDUCING THE FEDERAL TAX GAP: A REPORT ON IMPROVING VOLUNTARY COMPLIANCE (2007) (describing the tax gap problem and proposing policies to improve compliance); U.S. DEP’T OF THE TREASURY, UPDATE ON REDUCING THE FEDERAL TAX GAP AND IMPROVING VOLUNTARY COMPLIANCE (2009) (updating the aforementioned 2007 report).

146. The IRS has occasionally attempted to enforce the conservation purpose requirement by asserting that a given easement has no value because there is no conservation benefit. This “no value” argument has proven difficult to win because there is always likely to be *some* difference in the value of property after its use is restricted. *See McClure et al., supra* note 42, at 554 (2009) (noting the court’s “general rejection” of the zero value argument).

147. *See supra* Part I.B.3.

148. Eagle, *supra* note 14, at 47.

issue is litigated.¹⁴⁹ A more readily ascertainable measure for the deduction would avoid many of the worst aspects of these problems.

3. Conservation Value Should Be the Measure of the Tax Benefit

What should the measure of the tax benefit be? As suggested above, the measure should be based on the public benefit or benefit to charity secured by the contribution. That is, in theory, as with other charitable contributions, a value should be placed on the benefit conveyed to charity. In the case of conservation easements, this benefit is the conservation value.

Using conservation value as the measure for the tax benefit generally makes sense. It is, after all, the value of the good the tax system is trying to encourage.¹⁵⁰ The problem, however, is that there does not appear to be a quantifiable conservation value upon which a tax benefit could reliably be based. How does one reduce endangered species protection to a number for tax purposes? Or the scenic benefits of an open space easement? Or preservation of a historically important land area? As a general matter, conservation value, unlike market value, is qualitative, not quantitative.¹⁵¹

Indeed, it is precisely this problem of valuing conservation that led to use of lost economic development value as the measure for the deduction in the first place¹⁵²—as well as the resulting confusion. So, although a theoretically preferable measure for the tax benefit is the conservation value of the contribution, an exact rendering of conservation value probably is even more prone to uncertainty and manipulation than lost economic development value.

The difficulty of quantifying conservation value also makes reducing the conservation easement tax expenditure to a question of efficiency somewhat incongruous. Without a doubt, policymakers seek confidence that an expenditure is efficient, on a programmatic or a transactional basis. But when a program's

149. See *supra* notes 42–45.

150. Accord Halperin, *supra* note 14, at 41 (noting that “[t]he focus should be on actual benefit to the public” and not in the diminution in value to the donor).

151. Efforts are being made to quantify conservation benefits. See *supra* Part I.B.4. As discussed in Part III, such efforts should be encouraged through eligibility for a more valuable tax benefit.

152. See McLaughlin, *supra* note 2, at 68–69.

benefits cannot reasonably be quantified and compared to a program's costs, the answer should not be to abandon the program. Instead, steps should be taken to foster greater confidence in the program's benefits.

4. Possible Alternative Measures: A Percentage of the Value of the Entire Interest or Cost-Basis

If neither lost economic development value nor conservation value is to be used as the measure, what other measures are available? One candidate is a percentage of the value of the entire property to which the easement relates. An immediate benefit of basing the deduction on the value of the entire interest would be to eliminate reliance on an unverifiable, largely fictional, and not very informative number (i.e., lost economic development value) as the measure of the tax benefit. Valuation would still be required, but the valuation would be of the entire property interest, which is a much more objective figure than the valuation of a conservation easement. Once the value was determined, a set percentage of the value could be calculated to arrive at the amount of the tax benefit. Importantly, there would be no "after" valuation, no need to factor in assumptions about the likelihood of development, and no use of subdivision development analysis¹⁵³ or other questionable methods of valuation.

Another benefit of using the value of the entire interest would be that resources currently devoted to contesting easement values could be spent on the conservation benefit side of the equation. As noted in Part I, considerable administrative effort is currently spent pinning down the lost economic development value. If similar resources were directed toward ensuring conservation benefit, there should be greater assurances than currently exist that the public purposes of the program were being met.

In addition, taxpayers also would have greater certainty about the amount of the available tax benefit in deciding whether to contribute an easement. Further, eliminating reliance on lost economic development value would also dramatically reduce one main avenue of abuse of the easement program. With less gaming possible through valuation, and more enforcement focus on conservation benefits, there would be fewer opportunities for abuse, thus decreasing the considerable reputational costs of the

153. See *supra* note 40.

program.

An important objection to awarding the tax benefit based on a percentage of the value of the entire interest, however, is that without additional rules, there could be a new avenue for abuse.¹⁵⁴ Taxpayers could have an incentive to design easements with the weakest possible conservation purposes, with a guarantee that no matter how weak the easement, a deduction equal to a set percentage of the property's overall value would be awarded. In such cases, the IRS would be denied a weapon to debate the easement through a valuation challenge. Admittedly, this risk is real.¹⁵⁵ As discussed in greater detail in Part III, this risk must be countered by strengthening the requirements of contributed easements, and by providing for different percentages based on the conservation value of the contribution, which in some cases should be quite low.

The risk suggests that another alternative measure for the deduction should be considered. Namely, the deduction could equal a percentage of the donor's basis in the underlying property. In general, the basis of property is its cost and represents the amount that is not subject to tax when the property is sold for a gain, or the amount that is used to determine any loss.¹⁵⁶ Using a percentage of basis as the deduction would allow donors to recover a portion of their costs before ultimate disposition of the property, and so would represent a tax benefit in the form of accelerated cost recovery.

Using basis as the measure would not be unprecedented, as basis, and not fair market value, already is the amount of the charitable deduction for certain types of property.¹⁵⁷ Basis also would share

154. In the context of façade easements, donors for a time relied on informal IRS training materials to claim easement values based not strictly on the before-and-after method but rather on a range of values by which easements might be expected to reduce the value of the property. The IRS disavowed such an approach. See I.R.S. Gen. Couns. Mem. 200738013 (Aug. 9, 2007), available at <http://www.irs.gov/pub/irs-wd/0738013.pdf>; see also Colinvaux, *supra* note 55, at 24–25 (discussing façade easement scandals).

155. One way to check the risk would be to use the before-and-after value as a cap so that the deduction could not exceed the lesser of the set percentage of the entire interest value or the before-and-after value. However, this would reintroduce lost economic development value, and many of its pitfalls, back into the equation, and move away from what should be the goal: developing an approach to conservation value. Nevertheless, if the deduction is reformed, retaining lost economic development value as a cap to a deduction or credit as described in Part III should still be weighed.

156. I.R.C. § 1001 (2006).

157. For example, basis is the deduction for short-term capital gain property, I.R.C. §

the advantages discussed above with respect to using a percentage of the value of the entire interest—greater focus on conservation benefits and more taxpayer certainty as to the deduction amount. Further, with a basis approach, valuation of the property would not be necessary in many cases because basis is not a value concept.¹⁵⁸ Donors, of course, would have to know and document the basis in the property. But such recordkeeping is already required by present law, as taxpayers must track a property's basis in order to calculate gain or loss on disposition.¹⁵⁹

Importantly, under a basis approach, the tax benefit would be capped at basis, which in cases of property long held, might itself be relatively low, perhaps severely limiting the incentive. Further, a basis approach clearly would run counter to the general fair market value rule of present law for long-term capital gain, exempt-use property. This highlights both a strength and a weakness of a basis approach. The strength is that discarding the fair market value measure for appreciated easement property might symbolize a small step toward eliminating the fair market value deduction for appreciated property generally. The weakness of using basis is that if the goal of the tax benefit is to encourage contributions of high-value conservation property, basis and cost recovery might prove to be limited concepts. The purpose of the easement program is not, or should not be, merely to allow donors to recover their costs. Rather the goal is to encourage donors to make certain land use decisions with respect to their property—and to reward them for doing so.

Accordingly, the reward should be based, as much as possible, on the merits of the land use decision, i.e., the benefit to charity. And although neither the value of the entire interest nor the basis measure bears a direct relation to the conservation value of the property, on balance, the value of the entire interest appears to provide greater flexibility for a tax benefit that, overall, is designed

170(e)(1)(A), certain contributions to private foundations, I.R.C. § 170(e)(B)(ii), and for tangible personal property not intended for an exempt use, I.R.C. § 170(e)(B)(i).

158. Reliance on value would not be entirely eliminated, however, because if the property was a loss property, under the present law structure, the deduction once again would be based on fair market value. I.R.C. § 170(e) (providing for a reduction from fair market value only in the case of gain property).

159. I.R.C. § 1001; *see also* Treas. Reg. § 1.170A-14(h)(3)(iii) (as amended in 2009) (requiring that conservation easement donors reduce the basis of the underlying property by an amount allocable to the contributed easement; such amount, however, is based on the before-and-after value).

to generate easement contributions with a high conservation value.

C. The Amount of the Benefit and a Conservation Tax Credit

A critical issue in developing an alternative to lost economic development value is establishing the percentage of the new measure's value that would determine the amount of the tax benefit. A percentage set too high might encourage frivolous contributions, while one set too low might not be a sufficient incentive. Perhaps the easiest approach would be to set the percentage at a revenue-neutral rate, that is, the rate that would generate the same amount of revenue loss as under current law. At a minimum, this should allow for a reduction in administrative and reputational costs.¹⁶⁰ The percentage also could be set at a rate thought to optimize responsiveness and minimize waste.

Consistent with the discussion above, however, the rate should be set at a level that is tied to the conservation value of the contribution. This might best be achieved through the use of multiple percentages correlated to conservation value, i.e., the stronger the conservation benefits, the larger the tax incentives. In addition, the value of the tax benefit to the donor should depend directly on such conservation benefits, not on the donor's marginal tax rate. This means that the easement program should be converted from a deduction to a credit,¹⁶¹ with the value of the entire property serving as the measure for the credit.

The distinction between a deduction and a credit is an important one. One of the often-maligned quirks of deduction-based benefits is that they favor the more affluent (a so-called "upside-down" subsidy).¹⁶² As an initial matter, this is because many deductions (including the charitable deduction) are available only to taxpayers

160. This is not to suggest that coming up with a revenue neutral rate would be easy or that the conservation benefits would be the same. Facially, a revenue neutral rate merely says that the same dollar value of tax benefits are being claimed with the new measure as with the old. But it does not say anything about the comparative quality of easements. Success in reducing administrative and reputational costs ultimately would depend on the effectiveness of strengthening easement requirements.

161. See Halperin, *supra* note 14, at 47 (arguing that if the tax expenditure remains it could be replaced by tax credits, capped annually, and jointly administered by the IRS and a specialist agency such as the Bureau of Land Management).

162. See, e.g., CHARLES T. CLOTFELTER, FEDERAL TAX POLICY AND CHARITABLE GIVING 285 (1985) (noting the widespread criticism of the upside-down effect in the charitable contribution context); McLaughlin, *supra* note 2, at 29–35 (discussing the upside-down effect in the easement contribution context).

who itemize deductions,¹⁶³ who are generally wealthier than nonitemizers.¹⁶⁴ More fundamentally, a deduction's dollar value to the taxpayer depends on the taxpayer's marginal tax rate, with higher income itemizers receiving a more valuable tax benefit.¹⁶⁵ In effect, for deductions, the percentages that define the value of the tax benefit are derived independently from the activity that generates the benefit. By contrast, as a general matter, credits do not have an upside-down effect built-in. Credits can be targeted to certain income levels, may be refundable (and even tradable), and can be as generous or as stingy as necessary to produce the desired behavior.¹⁶⁶ Thus, in general, if the purpose of a tax benefit is to subsidize an activity, a credit provides more flexibility than a deduction.

Moreover, as a general matter, deductions, with their upside-down aspect, make sense when the reason for the deduction is to accurately measure income, i.e., when the goal is to remove certain expenses from the tax base (similar to an exclusion).¹⁶⁷ But, in the case of conservation easements, there is little reason to think that income measurement concerns are acute. Indeed, it is fairly clear that the easement deduction was intended as a subsidy. Although the conservation easement charitable contribution has had an awkward legislative history, the evidence indicates that Congress intended in 1976 and 1980 to encourage landowners to part with easements in order to subsidize conservation.¹⁶⁸ In other words, the purpose of the legislation was not just to remove the burden of taxation on landowners with respect to easement contributions.

Further, there is something in the nature of a partial interest easement contribution that suggests a nondeductible expense of a personal nature.¹⁶⁹ By definition, the taxpayer does not relinquish the entire property and often retains substantial rights and the

163. I.R.C. § 63(d).

164. *Tax Facts: Returns of Itemizers by AGI 1999-2000*, TAX POL'Y CENTER, <http://www.taxpolicycenter.org/taxfacts/displayafact.cfm?Docid=386> (last visited Nov. 11, 2011) (showing taxpayers who itemize deductions by income level); see also CLOTFELTER, *supra* note 162, at 285-86.

165. See CLOTFELTER, *supra* note 162, at 285-86.

166. For a discussion of tax credits and deductions and the relevant considerations informing use of one or the other, see generally Brian H. Genn, *The Case for Tax Credits*, 61 TAX LAWYER 549 (2008).

167. See Andrews, *supra* note 129, at 313.

168. See *supra* Part II.A.

169. See I.R.C. § 262 (2006) (disallowing deductions for personal expenses).

continued ability to use (and in some cases develop) it.¹⁷⁰ The taxpayer is also likely to be in personal agreement with and enjoy the post-contribution use of the property.¹⁷¹ To the extent the taxpayer has suffered a loss of income with respect to the contribution, the loss would occur upon sale and not at the time of the contribution.¹⁷² Accordingly, as an adjustment to measure income, a conservation easement deduction does not seem warranted.

As an additional distraction, the valuation of a partial interest within the charitable deduction framework has led to an overemphasis on private benefit issues,¹⁷³ again to the detriment of a focus on conservation benefits. This is because under the charitable contribution rules, the lost economic development value must be reduced by the value of any private benefit to the donor.¹⁷⁴ Although this rule is easy to state, it is difficult to apply in the partial-interest easement context. The principal issue is whether a donor's continued use and enjoyment of the property should offset the lost economic development value, i.e., to what extent is the very

170. This is the nature of a partial interest contribution. See *Turner v. Comm'r*, 126 T.C. 299 (2006); *Glass v. Comm'r*, 124 T.C. 258, *aff'd*, 471 F.3d 698 (6th Cir. 2006); JOINT COMM. ON TAXATION, *supra* note 14, at 284.

171. See *Eagle*, *supra* note 14, at 79.

172. This would be an argument for allowing charitable deductions for contributions of partial interests, but not until the "loss" of the partial interest becomes realized upon a sale of the underlying fee. See Sarah B. Lawskey, *The Sum of its Parts: Reforming Charitable Donations of Partial Interests*, 64 TAX L. REV. 37, 56-61 (2010) (arguing that as a general matter, a deduction for partial interests should be allowed but that the deduction should be limited to the donor's basis in the property).

173. See, e.g., JOINT COMM. ON TAXATION, *supra* note 14, at 285 (noting the valuation difficulties when the donor continues the personal use of the retained property).

174. This is just a straightforward application of the general rule that the charitable deduction be reduced by the amount of any return benefit received (*quid pro quo*), or denied outright if any private benefit resulting from the contribution exceeds the public benefit from the contribution (substantial return benefit). See *Ottawa Silica Co. v. United States*, 699 F.2d 1124, 1131-32 (Fed. Cir. 1983); Rev. Proc. 92-49, 1992-26 I.R.B. 18; Rev. Rul. 67-246, 1967-2 C.B. 104. Accordingly, the easement regulations require various reductions in the deduction to account for private benefit. Treas. Reg. § 1.170A-14(h)(3) (as amended in 2009) (providing that if "the donor or a related person receives, or can reasonably expect to receive, financial or economic benefits that are greater than those that will inure to the general public from the transfer, no deduction is allowable under this section. However, if the donor or a related person receives, or can reasonably expect to receive, a financial or economic benefit that is substantial, but it is clearly shown that the benefit is less than the amount of the transfer, then a deduction under this section is allowable for the excess of the amount transferred over the amount of the financial or economic benefit received or reasonably expected to be received. . .").

fact of retaining an interest a private benefit?¹⁷⁵ Although the retained interest has no direct bearing on the lost economic development value (which is supposed to be determined objectively based on the easement terms), the fact that the taxpayer continues to benefit from the property seems relevant to whether, or the extent to which, a donor should get a *charitable* deduction for the partial interest contribution. Arguably, however, in the context of a tax benefit designed to secure conservation goals, private benefit to the taxpayer is, or should be, of less importance than meeting the goal.¹⁷⁶

Further, as a policy matter, there is no obvious justification for providing wealthier taxpayers with a greater tax benefit than others—which is the natural result of using a deduction.¹⁷⁷ Indeed, some have argued that affluent taxpayers with an interest in conservation are likely to be less responsive to the tax benefit in deciding whether to make a contribution because the motivation for such taxpayers when making a contribution is not monetary.¹⁷⁸ This issue has also arisen in the context of “cash poor-land rich” taxpayers, or those with large-value deductions but not enough income to benefit from the deduction.¹⁷⁹ The charitable deduction rules have been changed (temporarily) to accommodate such taxpayers.¹⁸⁰

175. One illustration of private benefit concerns is when the donor has a residence on the property that becomes subject to the contributed easement. The donor continues to live on and enjoy the property, calling into question either the nature of the public benefit or the amount of private benefit to the donor. Situations such as this have led to calls for elimination or reduction of the tax benefit in cases where donors continue to maintain a residence on the property after the contribution. JOINT COMM. ON TAXATION, *supra* note 14, at 285.

176. Although positing that private benefit should be of only marginal concern in the easement context may seem anathema, any such reaction is partly because thinking about the conservation easements has been boxed in by the charitable deduction. Most tax benefits entail a significant private benefit to the taxpayer; indeed, often that is the whole point: the tax system provides a private benefit (the tax benefit) in exchange for activity thought to be socially desirable (e.g., installing energy efficient windows).

177. A deduction might be more appropriate when higher-bracket taxpayers require a larger incentive than others to undertake the desired activity.

178. See Eagle, *supra* note 14, at 89; McLaughlin, *supra* note 2, at 100.

179. See, e.g., McLaughlin, *supra* note 2, at 99.

180. Initially, easement contributions were subject to the generally applicable percentage limitation rules (which limit the charitable deduction as a percentage of the donor's adjusted gross income) and the carryover rules (which allow charitable contributions not deducted in one year by reason of the percentage limitations to be deducted over the five subsequent years). I.R.C. § 170(b) (2006). Land trust organizations and others argued that the percentage limitations and carryovers should be increased for easement contributions,

A credit, therefore, not only would provide tax benefits more equitably, but also would avoid some of the other pitfalls that have resulted from the decision to style the easement program as a charitable deduction. Nevertheless, some might object that a credit, like the present system, might not adequately address the problem of waste (i.e., paying more than necessary to secure the contribution). Although the level of waste depends on the credit percentage, the question ultimately should be whether waste, though unfortunate, is a reasonable cost of the program. The reasonableness of the waste will depend on whether the program is designed to maximize conservation benefits while providing a reasonable degree of confidence that such benefits significantly exceed any waste.

Another objection to the use of a credit might be based on transactional efficiency. Transactional efficiency concerns might arise if the value of the tax benefit as proposed exceeded, in any case, the lost economic development value. Then, some might argue, the government would be paying more for the easement than it was worth.¹⁸¹ For example, if the lost economic development value of the easement is \$100,000 and the tax benefit is \$150,000, then, arguably, the transaction is inefficient to the tune of at least \$50,000 because the government would have paid more for the property than it was worth.

Although the optics of this transaction are troubling, the issue presented highlights again the problem of value at the heart of the easement contribution. The key question is whether the benefit to charity is the same as the lost economic development value. In the usual case, the presence of a market establishes a value that can reliably be used as a proxy for the benefit given to charity, whether cash or in-kind. But without a market, the value given to easements does not really answer the question of the benefit to charity—i.e., the conservation value. Thus, if the conservation value of the

and succeeded in convincing Congress to pass temporary legislation to this effect. Pension Protection Act of 2006, Pub. L. No. 109-280, § 1219(c)(1), 120 Stat. 780, 1084–85 (codified as amended at I.R.C. § 170(f)(11)(E) (2009)). If the easement program were made a credit, the debate about percentage limitations and carryovers arguably would be more transparent and would shift to a debate about the credit percentage, refundability, and tradability of the credits.

181. See, e.g., McLaughlin, *supra* note 2, at 98–99 (arguing that “paying more for easements than a very modest premium over their market cost would be bad public policy” where market cost is calculated using the before-and-after method of easement valuation, and is an example of “transactional inefficiency”).

property were reliably calculated to be \$20,000,000, then clearly it would be worth it to spend \$150,000 to secure such value. Even if the donor ends up with an amount that is greater than the lost economic development value, the public, as a whole, still comes out ahead.

In short, although there clearly are concerns in this example about waste (i.e., the donor's price may be based on lost economic development value, not conservation value), an argument based on transactional efficiency, as such, should account for the fact that the merits of the transaction should be measured by reference to conservation value, not lost economic development value. If the conservation value is the measure for the tax benefit, and the benefit is a percentage (less than 100%) of such value, then transactional efficiency concerns are lessened even if the benefit exceeds the lost economic development value of the easement.

Of course, changing the measure of the tax benefit from lost economic development value to a percentage of the value of the entire property interest and shifting from a deduction to a credit would place significant pressure on the concept of conservation value¹⁸² and on the necessary rules to provide better assurances than currently exist that the conservation benefits of the program are significant and exceed the costs. Part III takes up the issue of reforming the conservation easement tax expenditure with an eye toward developing a stronger concept of conservation value.

182. In moving from a deduction to a credit, there are also concerns regarding fairness. For example, assume that the charitable contribution deduction is converted into a twenty percent credit and that there are two taxpayers both with \$500,000 of income and that the highest marginal rate is thirty-five percent. One taxpayer makes a charitable contribution of \$10,000 and the other makes no charitable contribution. One objection to the credit is that the taxpayer making the contribution will have to pay a tax with respect to a portion of the contributed funds (in this case, the credit is worth \$2,000, but does not fully offset the \$3,500 tax liability owed with respect to the \$10,000 of income). It could be argued that this result is unfair, and might be a serious disincentive to making charitable contributions. Another objection could be based on a comparison of the two taxpayers. Both must pay tax on the same base of income, \$500,000, even though one taxpayer has given a substantial amount to charity. If the charitable contribution is not viewed as consumption, then this arguably is unfair because the contributing taxpayer has less ability to pay than the noncontributing taxpayer. Interestingly, the deduction for charitable contributions already makes considerably less sense than a credit under a subsidy rationale for the tax benefit. This is because under a subsidy theory, the purpose of the tax benefit is to encourage certain behavior, and it follows that the value of the tax benefit should be set at a level that will optimally induce the desired behavior. See Mark P. Gergen, *The Case for a Charitable Contributions Deduction*, 74 VA. L. REV. 1393, 1396 (1988).

III. REFORMING THE CONSERVATION EASEMENT TAX EXPENDITURE

Parts I and II of this Article suggest that the conservation easement tax expenditure is problematic and misunderstood. As argued in Part I, it is difficult to conclude with conviction that the benefits of the program outweigh the considerable costs without having a measure of conservation benefits that can fairly be compared to program costs. Further, as argued in Part II, the conservation easement tax expenditure is not well designed to provide assurances that the program is delivering conservation benefits. This partly is due to the historical accident of making the conservation easement program a charitable deduction. This led to the adoption of an erroneous measure for the tax benefit—lost economic development value—a value that has managed to define thinking about the program both administratively and from a conservation benefits point of view. Part II also argues that a more appropriate measure for the tax benefit would be based on conservation value, and that a credit is preferable to a deduction.

Part III of the Article now explores some of the issues entailed in reforming the conservation easement tax expenditure with a central goal: that the program be changed in a manner that will produce a stronger conception of conservation value such that policymakers, land trusts, and the general public can be more confident about the benefits of the program and that the program is worth the costs.

A. Replace the Tax Expenditure with a Direct Spending Program?

One possible reform would be to replace the tax expenditure with a direct spending program.¹⁸³ In general, the principal reason for a spending program is the discipline such a program would provide. The appropriations process would serve as a constant check on supply and provide a cap on available funds. With scarce resources to acquire easements, better and more deliberate decisions would be made about which easements to acquire, and the conservation benefits from the acquisitions would be better articulated.¹⁸⁴ In addition, a purchase transaction would introduce

183. See, e.g., REPORT TO CONGRESS, *supra* note 23; Eagle, *supra* note 14, at 86.

184. See Halperin, *supra* note 14, at 45–47 (advocating for a direct spending program because “[t]he amount spent is known and relevant, projects can be prioritized based on merit, and the program can be targeted to accomplish specific conservation goals.”).

some market discipline to the price paid, better ensuring transactional efficiency and minimizing waste.

Although these points in favor of direct spending on conservation serve as useful critiques of the tax expenditure, to a certain extent, they are misdirected. Direct spending programs on conservation land (and easements) already exist.¹⁸⁵ So the choice is not necessarily either/or, but rather how best to allocate resources between the two policy tools, or whether there is value to the tax expenditure approach.

This Article argues that a conservation easement tax benefit should be retained. Although imperfect, privately-initiated, government-supported conservation has many benefits. As a general matter, the tax expenditure likely results in lower costs per acre covered and lower transaction costs per transaction than a direct spending program, fosters voluntary action, and promotes the value of conservation by encouraging the growth of land trusts and other private actors who develop expertise in, and act as guardians of, conservation property.¹⁸⁶ Thus, the focus should not be on an abolition of the tax expenditure, but rather on its improvement. However, advocates for the conservation easement tax benefit also should recognize the limitations of the program. It is, and should be, merely part of an overall conservation strategy,¹⁸⁷ and not an invitation to broaden conservation beyond the confines of public concern.¹⁸⁸

185. See, e.g., U.S. DEP'T OF AGRIC. FOREST SERV., FOREST LEGACY PROGRAM IMPLEMENTATION GUIDELINES (2003), available at http://www.fs.fed.us/spf/coop/library/flp_guidelines.pdf; see also *Forest Legacy Program*, U.S. DEP'T OF AGRIC. FOREST SERV., <http://www.fs.fed.us/spf/coop/programs/loa/aboutflp.shtml> (last updated Feb. 6, 2008) (describing the Forest Legacy Program with respect to which the U.S. acquires conservation easements through purchase); *Farm and Ranch Lands Protection Program*, NATURAL RES. CONSERVATION SERV., U.S. DEP'T OF AGRIC., <http://www.nrcs.usda.gov/wps/portal/nrcs/main/national/programs/easements/farmranch> (last updated Dec. 16, 2011) (describing the Farm and Ranch Land Protection Program, which "provides matching funds to keep productive farm and ranchland in agricultural uses.").

186. See, e.g., Nancy A. McLaughlin, *The Role of Land Trusts in Biodiversity Conservation on Private Lands*, 38 IDAHO L. REV. 453, 471 (2002) ("Although conservation easements are not useful in every situation and should not be viewed as a substitute for governmental regulation or acquisition of critical lands, they can be effective in protecting land where retained private ownership and limited use is consistent with biodiversity conservation goals."); Barton H. Thompson, Jr., *Conservation Options: Toward a Greater Private Role*, 21 VA. ENVTL. L.J. 245, 309-10 (2002) (describing the important role in conservation played by private organizations such as land trusts).

187. See Owley, *supra* note 2, at 150-51.

188. See McLaughlin, *supra* note 2, at 109 (noting that before any new incentives are

B. Elements of a Tax Credit

As argued in Part II, the current deduction could be replaced by a tax credit, with multiple percentages based on the value of the entire interest contributed. The overriding purpose of a credit would be to tie the tax benefit to the conservation value. The exact percentages would depend on a variety of factors, but the general framework should be low default percentage(s), with higher percentages available upon satisfaction of additional conservation benefit criteria.

1. Conservation Purposes

Present law treats conservation purposes as monolithic, considering preservation for recreation, scenic benefits and open space, historically important land areas, and ecosystem protection as fungible.¹⁸⁹ In fact, each type of easement is directed to a different conservation value—habitat protection, open space, public recreation, and historic preservation—and there is no reason that the tax credit percentages must be the same for each purpose. Conservation that addresses ecosystem protection, for example, arguably should take priority over other conservation values, a priority that could be reflected in higher credit percentages.¹⁹⁰

2. Exclusions

Congress should provide that in some cases, the conservation value of a conservation easement is zero (with the result that the credit is not available). One candidate for this treatment would be easements that protect property in a manner substantially similar to protections already established by local or state law. For instance, many façade easements on properties in historic districts should not be credit-eligible. For purposes of this exclusion, it would make no difference if a donor could show that the easement diminished the value of the retained property, or that the easement is perpetual (as compared to the vagaries of state or local law). In

adopted, efficiency must be considered).

189. I.R.C. § 170(h)(4) (2006).

190. See, e.g., Julia LeMense Huff, *Protecting Ecosystems Using Conservation Tax Incentives: How Much Bang Do We Get for Our Buck?*, 11 MO. ENVTL. L. & POL'Y REV. 138, 153–58 (2004) (considering how tax incentives can best be used to promote ecosystem protection, as distinct from promoting other conservation goals).

other words, it should be presumed that if public law restrictions are in place, private law restrictions, as a general matter, do not add significant new conservation value for credit purposes. Another candidate might be conservation easements on golf courses.¹⁹¹

3. Eligibility for, and Levels of, the Default Percentage(s)

As a general matter, present requirements for easement eligibility should be retained; however, a threshold conservation benefit eligibility standard should be introduced. In order for any easement to be credit-eligible, the easement must: (1) yield a significant public benefit, (2) be pursuant to a clearly delineated federal, state, or local governmental conservation policy, and (3) substantially restrict the development of the majority of the entire interest.¹⁹²

The significant public benefit test already exists as a requirement for open space easements,¹⁹³ so this would be merely an extension of that test to all types of conservation easements. The clearly delineated government policy requirement is currently imposed for non-scenic open space easements,¹⁹⁴ so this too would be an extension of a present law rule to cover all conservation easement contributions. The effect would be to require (at a minimum) that every private conservation easement be related to a public policy apart from the Code's current conservation purpose declaration.¹⁹⁵

The substantial restriction requirement would be new, and

191. For example, in South Carolina, the conservation easement credit is not available with respect to golf courses. S.C. CODE ANN. § 12-6-3515(B)(1)(c) (2010).

192. What constitutes a "majority" of the entire interest would depend on the type of easement and the property affected.

193. I.R.C. § 170(h)(4)(A)(iii).

194. I.R.C. § 170(h)(4)(A)(iii)(II).

195. There undoubtedly would be disagreement with respect to what constitutes a clearly delineated government policy, but experience with the standard should clarify the requirement over time. The requirement falls well short of mandating prior approval of an easement for tax benefit purposes, which likely would be too restrictive and cumbersome for government and private parties alike. *See* McLaughlin & Machlis, *supra* note 15, at 1594 n.3 ("Government certification of tax-deductible conservation easements would constitute a fundamental change in existing policy, and one that carries with it significant risks and costs. Accordingly, such a change should be seriously considered only if (i) the alleged problems with the current system are conclusively established and (ii) there is good evidence that government certification programs are feasible, would produce higher quality easements, and would produce benefits that outweigh their costs."). The requirement would be subject to legislative machinations, as developers or others might be able to sway a legislature to approve a specific easement. But arguably, if a donor is able to persuade an elected body to act, the outcome is no less public because of it.

important. Its purpose would be to ensure that no frivolous easements qualify for the credit and that only significant partial interests are eligible. Taxpayers seeking to get “something for nothing” would be dissuaded, because a gift of a property interest affecting a majority of the retained interest would represent a meaningful partial interest, and would not be given lightly.

Once the eligibility for default percentages is established, the level of the default percentages initially should be set quite low. One reason for this is to make the federal tax incentive less attractive. As noted earlier, it is likely that there already is considerable built-in waste in the easement program and many easement donors likely are motivated to give for non-tax reasons.¹⁹⁶ In addition, as a new credit, it makes sense to start with low percentages to test the responsiveness rate. Credit levels can be increased subsequently if the take-up rate is viewed as too low.¹⁹⁷

Perhaps most importantly, however, one reason that the percentages should be low is to realign the federal tax incentive relative to state law incentives. This would reflect a view that the role of the federal tax incentive is not, and has not been, to implement a federal conservation policy as such. Rather, the role of the federal tax incentive has been to foster private conservation efforts that occur on a more local level.¹⁹⁸ The larger the tax incentive becomes (e.g., through high credit percentages), the stronger the argument for more and sustained direct involvement by federal authorities in easement selection, modification, and termination.

Such sustained involvement, however, absent a more coherent federal conservation tax policy, generally is better exercised at the state or local level, as is seen in some states with tax credit programs.¹⁹⁹ Further, a less attractive federal incentive may also have the beneficial impact of encouraging more states to take the initiative and become involved in setting and enforcing local

196. See *supra* notes 137–144 and accompanying text.

197. In addition, as a practical political matter, it is easier to increase the benefit later than to decrease it.

198. See, e.g., Bray, *supra* note 1, at 152 (noting that conservation easements are acquired from the bottom up and so “may provide communities with an alternative opportunity to demonstrate their commitment to conservation values or to particular land use patterns, in contrast to the top-down imposition of zoning restrictions or development changes”); Korngold, *supra* note 14, at 1055.

199. See PIDOT, *supra* note 14, at 10–11 (discussing different state programs, including the program in Massachusetts, which requires prior state approval of conservation easements).

conservation standards. Indeed, one of the difficulties of an attractive, but open-ended, federal program is that more focused state and local standards may not develop as extensively as they otherwise would.

4. Enforcement, Perpetuity, and Eligible Donee Organizations

One constant concern in the easement program has been effective enforcement by the easement holder (the donee organization).²⁰⁰ At its core, the easement program is a private conservation program, with minimal government supervision.²⁰¹ Congress sets broad parameters through the conservation purpose requirement, which allows a fairly pluralistic and permissive notion of conservation. But, as noted above, once the contribution is made, there is little to no continuing government involvement. If easements are adversely modified (by amendment or disregard), lapse through failure to record, terminate by agreement, or simply are not enforced, the federal government has little recourse.²⁰² Because donation of an easement to charity likely creates a charitable trust, the state attorney general may have authority to intervene and enforce an easement.²⁰³ In addition, many states have rules about the creation, modification, and termination of conservation easements.²⁰⁴ But on the whole, as noted above, a

200. See Korngold, *supra* note 14, at 1059–60; McLaughlin, *supra* note 2, at 64–65.

201. See, e.g., McLaughlin, *supra* note 2, at 106 (stating that “[t]he current federal tax incentive program is a largely automatic, low-oversight program. . .”).

202. Such lack of recourse led to a proposal by the Bush administration to impose a penalty in the case of easement modifications. For a discussion of the proposal, see STAFF OF JOINT COMM. ON TAXATION, 109TH CONG., DESCRIPTION OF REVENUE PROVISIONS CONTAINED IN THE PRESIDENT’S FISCAL YEAR 2006 BUDGET PROPOSAL 239–41 (Comm. Print 2005).

203. The issue of whether an easement contribution creates a charitable trust has generated considerable debate in the scholarly literature. Four law review articles have debated the issue, with the central point turning on whether the provision in the Uniform Conservation Easement Act (UCEA) that states that conservation easements may be modified or terminated “in the same manner as other easements” has the effect of permitting modification or termination by agreement of the parties notwithstanding the perpetuity requirement of the easement (and the tax law). See Lindstrom, *supra* note 114, at 404–06; McLaughlin & Weeks, *supra* note 114, at 81–85; Nancy A. McLaughlin & W. William Weeks, *In Defense of Conservation Easements: A Response to The End of Perpetuity*, 9 WYO. L. REV. 1, 33–36 (2009); C. Timothy Lindstrom, Hicks v. Dowd: *The End of Perpetuity?*, 8 WYO. L. REV. 25, 35 (2008). Although it is beyond the scope of this Article to discuss the debate in any detail, Professor McLaughlin’s arguments that the UCEA should not be interpreted as allowing the dissolution of conservation easements by agreement in light of commentary on the UCEA, federal tax law, the Restatement of Trusts, the Restatement of Servitudes, the Restatement (Third) of Property, and the Uniform Trust Code are persuasive.

204. PIDOT, *supra* note 14, at 22–23.

reason for the conservation easement is to leverage the private property system for public land use purposes.²⁰⁵ Accordingly, enforcement is largely a private matter, with outcomes resting on the actions of the easement holder.

Private enforcement of a public trust is an issue that has divided commentators. Do conservation easements represent the elevation of one value above others, a value captured by private groups with little-to-no accountability to the public at large?²⁰⁶ Or are the land trusts surrogates for government, accountable to their donors and to the public through application of conventional common law charitable trust rules?²⁰⁷

This debate is manifested through arguments about the federal tax law requirement that easements must be perpetual to qualify for the deduction. An argument in favor of perpetuity as a condition of the tax benefit is that a perpetual restriction in many cases best provides meaningful long-term conservation.²⁰⁸ On the other hand, an argument against perpetuity is that a conservation land use decision made today generally is ad hoc, piecemeal, and occurs with imperfect information.²⁰⁹ Perpetual easements lock in the present land use, making the use hard to alter amid changing circumstances, including the evolving preferences of subsequent owners and surrounding communities. Under this view, an essentially private transaction between a property owner and a private organization becomes an immutable decision, unaccountable to democratic oversight,²¹⁰ and also fragments ownership. A counter-argument is that existing charitable trust doctrines and the exercise of the eminent domain power are effective and important checks on permanence and dead-hand

205. Korngold, *supra* note 14, at 1055.

206. *See, e.g.*, Korngold, *supra* note 14, at 1042–43; Mahoney, *supra* note 13, at 744 (concluding that conservation easements “may further the interests of members of the present generation at the expense of future generations”); Owley, *supra* note 2, at 143, 146–51.

207. *See, e.g.*, Nancy A. McLaughlin, *Rethinking the Perpetual Nature of Conservation Easements*, 29 HARV. ENVTL. L. REV. 421, 519–20 (2005).

208. *See, e.g.*, McLaughlin & Machlis, *supra* note 15, at 1594.

209. *See* Korngold, *supra* note 14, at 1063–64; Mahoney, *supra* note 13, at 744–45, 757–58 (arguing that the present generation is not omniscient about the future because of imperfect information); Owley, *supra* note 2, at 152, 170 (noting the “haphazard, piecemeal nature” of conservation easements).

210. *See, e.g.*, Bray, *supra* note 1, at 137–38 (providing an overview of the debate); Korngold, *supra* note 14, at 1043, 1059, 1064–65.

control.²¹¹

Both sides of the debate have valid concerns. In the context of a new conservation credit, however, perpetuity is the better rule. In part, this is because conservation is, to a certain extent, undervalued by the private property system.²¹² Although perpetuity offends some core property law principles,²¹³ perpetual easements are like affirmative action for conservation; normal rules are switched off to redress a perceived land use imbalance in favor of development. And though a term easement would not sound the death knell for conservation efforts,²¹⁴ there are valid concerns that an original donor might have a change of heart and not renew, new fee owners might not share the conservation goals of the easement and opt out, and perhaps most importantly, land trusts might not invest the same level of commitment to a temporary interest as they would to a permanent interest.

Regardless, the choice between perpetual and term easements is, to a certain extent, a false one. There is of course no guarantee of perpetuity, nor should there be. In fact, perpetuity is a fiction—an important fiction that guides behavior, but a fiction nonetheless.²¹⁵

211. See generally McLaughlin & Machlis, *supra* note 15, at 1579–82. But see Richard B. Collins, *Alienation of Conservation Easements*, 73 DENV. U. L. REV. 1103, 1103–04 (1996) (noting that courts have created various ways to avoid dead-hand property restrictions).

212. See generally PAUL GOLDSTEIN & BARTON H. THOMPSON, JR., *PROPERTY LAW: OWNERSHIP, USE & CONSERVATION* 228–31 (2006) (discussing the limitations of the private property system for protecting endangered species and habitat).

213. See, e.g., JOHN C. GRAY, *THE RULE AGAINST PERPETUITIES* § 201 (4th ed. 1942). Concerns about “dead hand” control of land use decisions led to the rule against perpetuities and the rule against restraints on alienation. See RESTATEMENT (THIRD) OF PROP.: SERVITUDES § 3.3 cmt. b (2000).

214. See Owley, *supra* note 2 (arguing for renewable term conservation easements); Bray, *supra* note 1, at 144 (noting that if the tax law allowed a deduction for term conservation easements “it is possible—though by no means certain—that land trusts would be able to acquire and protect land at rates similar to the present.”).

215. See PIDOT, *supra* note 14, at 23 (noting that even if state attorneys general are empowered to enforce the perpetuity requirement by virtue of charitable trust law, “many state conservation easement laws fail to address this issue or do so ambiguously For the attorney general to become involved there must be a system for publicly tracking conservation easements . . . [and] even if a conservation easement is abandoned, the attorney general may decide that enforcing an easement is not a priority if the public had no involvement in its creation.”); Bray, *supra* note 1, at 138 (referring to easements as “facially permanent”); James L. Olmsted, *Capturing the Value of Appreciated Development Rights on Conservation Easement Termination*, 30 ENVIRONS ENVTL. L. & POL’Y J. 39, 46–47 (2006) (noting that “[w]e cannot be sure that every, if any, ‘perpetual’ conservation easement will last for perpetuity. Quite to the contrary, we can be sure that every conservation easement ever drafted will eventually terminate or require amendment.”); see also Owley, *supra* note 2, at 155–61 (discussing whether conservation easements are too easily changed).

Although many factors are involved, at bottom, the perpetuity of an easement depends upon the easement holder's willingness to enforce its property right. To the extent the affected parties mutually agree (formally or informally) to a changed land use, absent a costly intervention by the state, the perpetual easement may be altered as a practical matter.²¹⁶

The above arguments point to the importance of the integrity and solvency of the easement holder. Currently, not much is required of an eligible (nongovernment) donee. Like others qualified under section 501(c)(3) of the Code, qualified donees must meet standard requirements,²¹⁷ including filing annual information returns.²¹⁸ They must also meet the commitment and resources test of the regulations—namely, the organization must “have a commitment to protect the conservation purposes of the donation, and have the resources to enforce the restrictions.”²¹⁹ However, the commitment test may be satisfied by including appropriate language in the organization's articles of incorporation,²²⁰ leading one commentator to conclude that it “can be a mirage.”²²¹ The resources test is generic; no set aside of funds is required.²²²

More could be done to monitor the effectiveness and viability of conservation organizations. Although private efforts to buttress land trusts have made significant strides in recent years,²²³ some

216. Further, although credit-eligible easements should be perpetual, modifications to easements should not be viewed with inherent suspicion. As commentators have noted, easements may be drafted to allow for amendments that facilitate conservation. Susan N. Gary, *The Problems of Donor Intent: Interpretation, Enforcement, and Doing the Right Thing*, 85 CHI-KENT L. REV. 977, 1037–38 (2010) (describing amendment provisions and the Land Trust Alliance's recommendation of their inclusion in conservation easement agreements); Nancy A. McLaughlin & Benjamin Machlis, *Amending and Terminating Perpetual Conservation Easements*, PROB. & PROP., July–Aug. 2009, at 52, 56 (noting that “land trusts should negotiate for the inclusion of a standard amendment provision.”).

217. I.R.C. § 501(c)(3) (2006) (setting forth rules requiring tax exempt organizations to meet specific purposes and prohibiting the inurement of private shareholders, substantial lobbying, and political activity).

218. I.R.C. § 6033.

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

220. *Id.*

221. *See* Halperin, *supra* note 14, at 36.

222. *Id.*

223. *See, e.g.*, LAND TRUST ALLIANCE, *supra* note 63, at 14-15 (noting that 135 land trusts had earned accreditation as of September 2011, but also that fifty percent of land is currently protected by non-accredited land trusts, and thirty-eight percent of land is protected by The Nature Conservancy, a current applicant); *see also supra* note 106.

legal change regarding donee eligibility is also warranted. A rule could, and should, be adopted that suspends a land trust's ability to accept new credit-eligible donations if an audit of the organization reveals repeated failures to enforce easements or an unsustainable ratio of easements held to available resources. Tax exemption of the organization and general eligibility to receive charitable contributions need not be affected.²²⁴ Rather, the goal would be to prevent organizations with a poor management track record or inadequate resources from acquiring new easements.²²⁵

5. Higher Credit Percentages Based on Satisfaction of Additional Conservation Criteria

The reason for providing a tax benefit for conservation easements is to encourage the contribution of property with a high conservation value. The principal problem with the tax benefit, however, is the difficulty in quantifying conservation value. Admittedly, basing the measure for the benefit on the value of the entire interest does not bear a direct relationship to conservation value. Rather, this measure makes sense not only as a matter of administrative convenience and taxpayer certainty, but also because it would remove the current confusing and erroneous measure and largely eliminate the ability to manipulate the amount of the tax benefit through a taxpayer-favorable valuation process.²²⁶ With a more appropriate measure in place, there would be room for greater focus on the conservation value of the contributed properties.

224. In other words, if an organization ceases to be a credit-eligible donee, this need affect only future easement contributions and not ongoing exempt status under section 501(c)(3) of the Code, or the ability to make deductible charitable contributions to the organization as a general matter. In 2005, the Senate Finance Committee staff proposed revocation of tax-exempt status as a penalty for regular and continuous enforcement failures. STAFF OF S. COMM. ON FIN., 109TH CONG., REP. OF STAFF INVESTIGATION OF THE NATURE CONSERVANCY, at Executive Summary 10 (2005). However, revocation of tax-exempt status is a difficult sanction to impose. See Colinvaux, *supra* note 55, at 66 (arguing that often revocation may be an unreasonable sanction). Another Finance Committee staff proposal would impose excise taxes on officers and directors of the conservancy organization for enforcement failures. *Id.* at 10; see also Halperin, *supra* note 14, at 37 (noting that the excise tax proposal "would put real teeth in the enforcement obligation").

225. Professor Halperin suggests limiting donee eligibility to "organizations that hold a substantial number of easement grants and have sufficient staff to monitor and enforce compliance." Halperin, *supra* note 14, at 37.

226. As noted *supra* Part II, a measure based on a percentage of the taxpayer's basis in the property would also have these benefits.

In addition, setting the default percentages at a low rate should help minimize waste and abuse,²²⁷ while still providing a conservation incentive. However, if all the available percentages are set too low, some valuable conservation property might not be contributed. The issue then becomes how to provide a greater incentive for the higher value conservation property. One way would be to increase the default percentages upon satisfaction of additional conservation criteria.

At one extreme, higher credit percentages would be available for properties that have been pre-approved by a designated high-ranking federal government official.²²⁸ This undoubtedly would create a process similar to an appropriations process, whereby donors and land trusts would lobby on behalf of particular properties and easement terms. The transaction costs for each donation would increase, and politics (not conservation) surely would mar the process.

The benefits, however, would be greater government investment in the substantive conservation policy of the program, and development over time of conservation standards for properties likely to obtain a higher credit percentage.²²⁹ Overt political favoritism might also be checked by the involvement of the land trust in the process, and, to a certain extent, through oversight by watchdog organizations. Additionally, the availability of a potentially generous credit would both foster competition in conservation (much akin to a grant program) and provide a way for high conservation value properties to define their worth and appropriately reward their donors for their contributions.

Another approach for encouraging conservation easements for higher value conservation properties would be to tie higher credit

227. Low percentages, especially combined with a substantial restriction requirement (*see supra* text accompanying note 195) would make frivolous easements much less attractive—with not much to gain, but a substantial property right relinquished.

228. Allowing a state official to, in effect, authorize a federal tax credit might prove problematic for a number of reasons, thus limiting this option to federal officials only. If the idea were implemented, the legislation would likely have to specify the offices and officials that could approve the credit.

229. An alternative or supplemental approach would be to impose an annual dollar cap on the credit, as with some other present tax credit laws. *See, e.g.*, I.R.C. § 45 (2006) (detailing the new markets tax credit, which provides a subsidy for investments in low-income communities). In addition to limiting cost, a cap would require a process for allocation, which could be done by an agency with greater expertise than the IRS in conservation policy. *See* Halperin, *supra* note 14, at 47–49 (explaining the benefits of a cap and the involvement of a government agency with relevant policy expertise).

percentages to the satisfaction of process-based rules designed to produce good conservation outcomes. This could be achieved by requiring something akin to a publicly available “conservation appraisal” of the easement. Instead of appraising the before-and-after value of the easement, the purpose would be to appraise the easement’s likely conservation value. Variables affecting conservation value would include expected conservation benefits,²³⁰ the strength of the donee organization,²³¹ the strength of state and local law on conservation easements,²³² and the level of conservation protection provided by the easement’s terms.²³³

Key issues here would be the credibility of the appraisal (and appraiser), appraisal cost, and the ability of the IRS to challenge an appraisal’s findings and deny eligibility for the higher thresholds. The variables appraised would have to be sufficiently standardized to make issuing such appraisals fairly objective, verifiable (and so subject to challenge), and relatively low-cost. Over time, the goal of the conservation appraisal would be to have a generally accepted method of assessing the conservation value of an easement. Initially, the best party (for lack of a better alternative) to perform such appraisals would likely be the donee organization.²³⁴

230. The appraisal should provide a detailed explanation of the conservation benefits and explain how the easement would also satisfy the threshold eligibility requirements.

231. This could include, for example, whether the donee is accredited by a rigorous accreditation program (e.g., the Land Trust Alliance’s program), has (and follows) a monitoring plan for easement enforcement (including a plan for resources), has a system for tracking the easements it owns, makes the terms of the easements held publicly available, and provides full, complete, and timely filing of the Form 990.

232. For instance, factors of importance might include whether the state attorney general has unambiguous power to enforce conservation easements and whether there is a history of enforcement in the state, the ease of abandonment of easements under state law, the effect of the recording statutes on easement status, whether easements escheat to the state, whether the state has a public registry tracking easements, and whether the state is involved in easement creation and defining valid conservation purposes.

233. The easement should be reviewed for compliance with, among other things, current Treasury regulation requirements such as use restrictions on the donor and requirements for transfer of easements (i.e., that transfer may be made only to another conservation organization or to the public). Ideally, easement terms would be assessed for consistency with established best conservation practices.

234. A donee organization could not realistically assess its own strength in an objective manner. This would have to be derived independently of the appraisal, perhaps through satisfaction of reportable metrics on the Form 990 and by accreditation. Such formal donee involvement could increase the cost to land trusts of accepting easement contributions, but donee organizations should arguably be performing a fairly extensive analysis of each possible contribution in any event. Higher cost per easement could also lead to better easement quality. Professor Halperin suggests that “the donee should be required to certify *publicly* that it views the public benefit to be at the level of the claimed deduction.” Halperin,

Although the donee is an interested party, and so might be inclined always to issue a positive appraisal (and thus render the default percentages obsolete), the donee would be accountable to the public and the IRS for the appraisal and, as a conservation organization, should take its role as a conservation broker seriously.²³⁵

6. Refundability and Carryovers

In theory, the credit should be refundable (i.e., to the extent the donor does not have sufficient tax liability to use the credit, the unused portion should be paid out, or “refunded” to the donor). A refundable credit would be the fairest means of ensuring that donors receive the same amounts with respect to a conservation contribution. However, refundable credits add a layer of administrative complexity, and also become a magnet for abuse (not to mention increasing the revenue cost of the credit), making the more traditional and politically accepted nonrefundable credit a better option. Carryovers, perhaps up to fifteen years, should be allowed.²³⁶

7. Summary

Of course, if Congress were to adopt a new conservation tax credit, the above and other details would have to be negotiated, and there is no one right way to design such a credit. Still, by way of summary, the goal of the credit should be to fashion rules that develop conservation value. This can be done by prioritizing some purposes over others, eliminating the tax benefit for some types of easements, providing different credit levels (with tougher initial eligibility requirements for all easements) depending on assurances

supra note 14, at 42.

235. In addition, higher credit percentages could be available for taxpayers that have performed a “conservation benefit impact statement,” in an attempt to encourage the standardization of the quantification of conservation benefits. *See supra* notes 96–100. The conservation benefit statement may be conceptualized as the inverse of an Environmental Impact Statement, a requirement established by the National Environmental Policy Act that has since come to be a valuable tool in assessing the environmental impact of development.

236. Many state credits permit carryovers. For a comparison of state features, see WILLIAM M. SILBERSTEIN, CONSERVATION TAX CREDIT STATE BY STATE COMPARISON, ALL-ABA COURSE OF STUDY (2005), available at <http://files.ali-aba.org/files/coursebooks/pdf/CL053-CH02.pdf>; *Summary of State Tax Credits for Conservation*, PRIVATE LANDOWNER NETWORK, <http://www.privatelandownernetwork.org/exchange/pun.aspx?id=862> (last visited Nov. 16, 2011).

of conservation value, and strengthening donee eligibility.

A new conservation tax credit is, of course, not the only option. The current deduction is by now fairly well entrenched. The deduction model could be retained, but as with the proposed credit, the measure for the deduction could be changed. Similarly, many of the ideas above could be incorporated into the deduction. The overriding goal, however, should be to push the conservation tax benefit toward a better articulation of the conservation value at stake.

IV. CONCLUSION

A fundamental problem with the conservation easement tax expenditure is that the measure for the tax benefit—lost economic development value—is erroneous. Use of such an erroneous measure obscures the conservation benefits of the program by focusing attention and resources on divining a largely extraneous and unhelpful number. Further, to a considerable extent, the easement program is reflexively justified and understood based on this false measure, as if it represented the conservation value of the program.

This Article has argued that, in theory, the measure for the tax benefit should be changed to one that better approximates conservation value. This would help ensure that the program is efficient, in the sense that conservation benefits would exceed program costs.

However, the theory must account for the fact that conservation value is not, at least not yet, readily susceptible to quantification for tax purposes. Accordingly, this Article has also argued that a second-best approach would be to change the measure of the tax benefit to a more objective number—the fair market value of the underlying fee interest—not only to provide greater certainty, but more importantly, to shift administrative and legal resources and attention to where it should be: on the conservation benefits of the program.

Finally, this Article has argued that serious consideration should be given to converting the deduction to a credit. This would make the tax benefit more equitable and would provide greater flexibility by more easily allowing for different levels of tax benefit to be provided based on satisfaction of conservation criteria, which could evolve over time to account for society's changing needs. In any

event, irrespective of the details, the conservation easement tax expenditure should be designed to promote a concept of conservation value—as an affirmative value—that represents the best use of the land. The value of the tax expenditure should no longer be defined by what is lost, but rather by what is gained.