

NOTIONAL GENEROSITY: EXPLAINING CHARITABLE  
DONORS' HIGH WILLINGNESS TO PART WITH  
CONSERVATION EASEMENTS

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## I. INTRODUCTION

A recent series of four Internal Revenue Service ("IRS") reports on "noncash contributions"<sup>1</sup> contains some dramatic information. The most exciting and mysterious data relate to the average value of donated conservation easements.<sup>2</sup> It turns out that Americans are remarkably generous when giving away conservation easements. As Figure 1 shows, Americans give away easements in enormously valuable chunks<sup>3</sup> in comparison to other kinds of real and personal property.<sup>4</sup>

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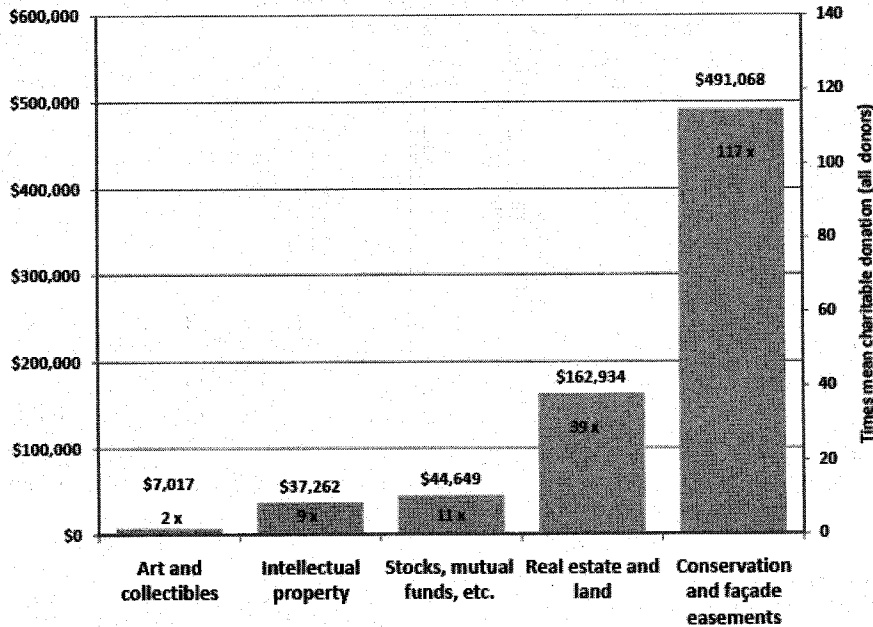
<sup>1</sup> See Janette Wilson & Michael Strudler, *Individual Noncash Charitable Contributions, 2003*, INTERNAL REVENUE SERVICE STATISTICS OF INCOME BULLETIN, Spring 2006, 58 [hereinafter IRS 2006]; Janette Wilson & Michael Strudler, *Individual Noncash Contributions, 2004*, INTERNAL REVENUE SERVICE STATISTICS OF INCOME BULLETIN, Spring 2007, 78 [hereinafter IRS 2007]; Janette Wilson, *Individual Noncash Contributions*, INTERNAL REVENUE SERVICE STATISTICS OF INCOME BULLETIN, Spring 2008, 68 [hereinafter IRS 2008]; Pearson Liddell & Janette Wilson, *Individual Noncash Contributions, 2006*, INTERNAL REVENUE SERVICE STATISTICS OF INCOME BULLETIN, Summer 2009, 67 [hereinafter IRS 2009].

<sup>2</sup> A conservation easement is "a nonpossessory interest . . . in real property imposing limitations or affirmative obligations" on the holder of the underlying land. Uniform Conservation Easement Act § 1(1) (1981) ("UCEA"). See *infra* Part II.

<sup>3</sup> The IRS does not track contribution data on a return-by-return basis. Letter from IRS to Author (July 2, 2009) (on file with Author). IRS statisticians compile estimates of the number and value of noncash contributions using a random sample chosen from the population of returns. See, e.g., IRS 2006, *supra* note 1, at 67. For tax year 2003, the sample consisted of 182,810 returns; the population totaled 131,291,334. *Id.* at 27, 706. About 28,000 of the sampled returns included a Form 8283 ("Noncash Charitable Contributions"), used by taxpayers who make noncash donations in excess of \$500. *Id.* at 58, 67. IRS statisticians gather data, e.g., information on the type of property donated and the claimed fair market value of that property, for each noncash donation listed on the forms. *Id.* at 67.

<sup>4</sup> Art, intellectual property, securities, and real estate are the next four most-highly-valued kinds of donated property.

**Figure 1: Average per-donation value of the five most valuable kinds of donated property, 2003–2006 (relationship between these values and the arithmetic mean of all filers' charitable donations measured on right-hand Y axis)<sup>5</sup>**



Looking at these numbers, one might conclude that donors of these five types of property are more generous than the average charitable donor. The

<sup>5</sup> This chart presents data in the four IRS bulletins cited in footnote 1. In the 2008 and 2009 bulletins (covering the 2005 and 2006 tax years, respectively), the IRS provides data separately for conservation easements and façade (historic preservation) easements. IRS 2008, *supra* note 1, at 69; IRS 2009, *supra* note 1, at 68. In the two earlier bulletins, those data are grouped together. IRS 2006, *supra* note 1, at 59; IRS 2007, *supra* note 1, at 78. In order to illustrate data from all four tax years in Figure 1, I grouped conservation and façade easement data together. This grouping likely results in an understatement of average donated-easement values: in tax years 2005 and 2006, the average values of façade easements were significantly lower than conservation easement values. IRS 2008, *supra* note 1, at 69; IRS 2009, *supra* note 1, at 68.

In creating Figure 1, I excluded a sixth type of property donation, “other vehicles,” for which average donations were in the \$8,000 to \$10,000 range, because the data was grouped with automobile donation data in 2003 and 2004. IRS 2006, *supra* note 1, at 59; IRS 2007, *supra* note 1, at 78.

I calculated the average values of donated property used in this figure, and throughout the Article, by dividing the total amount claimed by easement donors on Form 1040, Schedule A by the number of donations made. I used the Schedule A figure instead of the reported fair market value of the easements because the fair market value figure would overstate the extent to which easement donors are actually giving away property of deductible value. In other words, the Schedule A figure represents the maximum amount an easement owner can claim as a deduction. IRS 2009, *supra* note 1, at 69–70.

average art donor, for example, would by virtue of an average gift of art, rank among the top 1% of all charitable donors.<sup>6</sup>

Simply making a large gift, though, does not make one generous. The dictionary definition of “generous” is “showing readiness to give more of something, especially money, than is strictly necessary or expected.”<sup>7</sup> With regard to charitable donations, what is expected? One way to think about this is to say that a person making an average gift is doing what is expected. In order to say something about an individual’s generosity, then, we would compare the size of his gift to the size of a mean gift. It is also necessary to take wealth into account: an acceptable measure of generosity should recognize that a person who gives away his last dollar is more generous than a person who gives away two dollars of his two million. Thus, in assessing an individual’s generosity, we will want to know not only the absolute size of his gift, but also the mean value of donations made by individuals of similar wealth.

The IRS’s noncash contribution data make it possible to correlate taxpayers’ adjusted gross income (“AGI”) with the kinds of property donated and the value of those donations.<sup>8</sup> By doing this, it is possible to determine whether conservation easement donors are more generous than land donors or simply wealthier. Figure 2 illustrates:<sup>9</sup>

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<sup>6</sup> This estimate is based on data and coefficients of variation available on the IRS website. *See, e.g.*, INTERNAL REVENUE SERV., INDIVIDUAL INCOME TAX RETURNS 2003: PUBLICATION 1304 at Table 2.1CV (2005), <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=134951,00.html> (last visited Oct. 17, 2010).

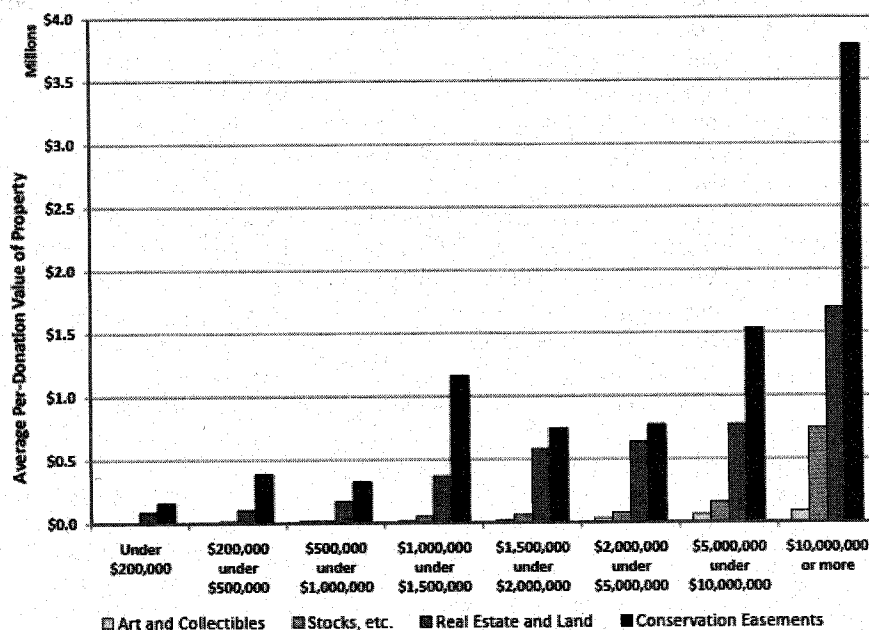
<sup>7</sup> OXFORD ENGLISH DICTIONARY 721 (2d ed. 2005).

<sup>8</sup> A taxpayer’s AGI is her total income, less several above-the-line deductions. 26 I.R.C. § 62 (2006). Charitable deductions are below-the-line deductions; that is, they are subtracted from AGI in calculating taxable income. Temp. Treas. Reg. § 1.67-1T(a)(1) (1988).

Income is by no means a perfect proxy for wealth; however, the two are often related. The ideal way to study willingness to part would be to group donors by a more direct wealth measure such as net worth. I use AGI because that data is available in the IRS charitable contribution data sets. *See, e.g.*, IRS 2006, *supra* note 1.

<sup>9</sup> Figure 2 does not include intellectual property because of the small number of donations made.

**Figure 2: Average per-donation value of property by income group, 2003-2006<sup>10</sup>**



This picture shows that donors with relatively equal incomes make larger individual donations of some kinds of property than others, and that the patterns are consistent. Donors in all income groups are more willing to part with easements, for example, than with securities. Easement donors are particularly generous: they are ready to give more property to charity than expected.

This Article offers an explanation for why easement donors appear more generous than donors of other types of property. Part II describes conservation easements as property interests and also explains the law and regulations governing easement donations. This background is necessary to understanding the various possible explanations for donated-easement generosity laid out in Parts III and IV. The hypotheses offered in Part III ultimately prove unconvincing. The hypothesis presented in Part IV, though, appears to have traction. It suggests that the easement values are high because many easement donors are giving away something that, while possibly valuable to someone else, is of little value to them. If correct — and there does not appear to be another viable explanation for the data — it means that donors should be willing to accept an amount less than the current tax bene-

<sup>10</sup> This chart is based on data contained in four IRS bulletins. See sources cited *supra* note 1. The IRS provided me with additional data that separated easements from other kinds of real property donations for several of the years in question. (Data on file with Author.)

fit in return for their donations. Thus, some amount of tax revenue foregone under the current approach represents waste. Part V explores various legislative changes aimed at eliminating this wasted revenue and thereby improving the efficiency of subsidies for easement acquisition. Part VI briefly concludes.

## II. CONSERVATION EASEMENTS AND EASEMENT DONATIONS

This Section describes the nature of the property interest that landowners are donating to charity and the specifics of federal law and regulations governing that donation (or, more precisely, the deductibility of that donation).<sup>11</sup>

### A. Conservation Easements as a Malleable Form of Property

#### 1. A Hybrid Servitude. . .

As Professor Federico Cheever has observed, conservation easements differ significantly from what the common law would have called an easement.<sup>12</sup> First, the common law only permitted a limited number of negative easements: to prevent landowners from blocking air, light, or artificial streams; or, to prevent landowners from acts that might destabilize structures on adjacent parcels.<sup>13</sup> The common law would not have enforced an attempted conservation easement. However, conservation easements do resemble the traditional negative easements insofar as they allow easement holders to prevent activity on servient tenements.<sup>14</sup>

Second, unlike common law negative easements, the typical conservation easement grants the holder affirmative rights, that is, the right to do something on that land.<sup>15</sup> Most conservation easements allow the holder to enter onto the property in order to monitor the landowner's compliance with

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<sup>11</sup> For an excellent description of the law of conservation easements, see Peter M. Morrisette, *Conservation Easements and the Public Good: Preserving the Environment on Private Lands*, 41 NAT. RESOURCES J. 373 (2001).

<sup>12</sup> Federico Cheever, *Public Good and Private Magic in the Law of Land Trusts and Conservation Easements: A Happy Present and a Troubled Future*, 73 DENV. U. L. REV. 1077, 1080-81 (1996).

<sup>13</sup> JOSEPH WILLIAM SINGER, *INTRODUCTION TO PROPERTY* 212 (2d ed. 2005). The common law's negative view of negative easements can be explained by remembering that, in an era without good land records, land buyers would have had a difficult time seeing evidence of a negative easement during their pre-purchase inspection of the property. *Id.*

<sup>14</sup> In easement terminology, the dominant tenement (or parcel) is the parcel that benefits from the easement, and the servient tenement is the parcel that is affected by the easement. In an in-gross easement, in which an individual holds the "dominant" rights, which do not attach to a particular piece of property, there would be an easement holder and a servient tenement. *Id.*

<sup>15</sup> UCEA § 4(5) (1981). Although state laws authorizing the creation of conservation easements vary, the UCEA is the basis for many. See Cheever, *supra* note 12, at 1082-83. For purposes of simplicity, this article will focus on the terms of the UCEA.

the terms of the easement or to conduct biological assessments.<sup>16</sup> Such activities are only possible with access to the property. Along the same lines, conservation easements may contain provisions that allow the holder to enter onto the property in order to apply land treatments, such as controlled burns or the eradication of invasive species.<sup>17</sup> Finally, conservation easements might also contain covenant-like provisions which require the landowner to perform certain affirmative acts, such as applying land treatments on a regular basis.<sup>18</sup>

## 2. *Containing a Flexible Set of Restrictions.* . . .

It is possible to craft an accurate, but general, definition of a conservation easement: it is “a legally binding agreement between the owner of the land subject to the easement and the holder of the easement that restricts the development and future use of the land to achieve certain conservation goals . . . .”<sup>19</sup> While all conservation easements meet this broad definition, land-use restrictions and other terms contained in individual conservation easements often vary from property to property.<sup>20</sup> As the Open Space Institute, a New York land trust, explains, “[e]ach conservation easement is tai-

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<sup>16</sup> See Nancy A. McLaughlin, *Conservation Easements — A Troubled Adolescence*, 26 J. LAND RESOURCES & ENVTL. L. 47, 48 (2005); Alexander R. Arpad, *Private Transactions, Public Benefits, and Perpetual Control of the Use of Real Property: Interpreting Conservation Easements as Charitable Trusts*, 37 REAL PROP. PROB. & TR. J. 91, 117 (2002). Biological assessments are intended to provide information to the easement holder regarding the status of fish, wildlife, or plants with which it is concerned. This information can be valuable to an easement holder that has ecological goals for a larger region of which the individual parcel is but one piece. Pursuant to federal tax regulations, if the easement contains provisions that would allow the landowner to exercise rights that might impair the “conservation interests associated with the property,” then

the donor must agree to notify the donee, in writing, before exercising any reserved right, *e.g.* the right to extract certain minerals which may have an adverse impact on the conservation interests associated with the qualified real property interest. The terms of the donation must provide a right of the donee to enter the property at reasonable times for the purpose of inspecting the property to determine if there is compliance with the terms of the donation. Additionally, the terms of the donation must provide a right of the donee to enforce the conservation restrictions by appropriate legal proceedings, including but not limited to, the right to require the restoration of the property to its condition at the time of the donation.

Treas. Reg. § 1.170A-14(g)(5)(i) & (ii) (1999).

<sup>17</sup> See A.M. Merenlender et al., *Land Trusts and Conservation Easements: Who is Conserving What for Whom*, 18 CONS. BIO. 65, 67–68 (2004).

<sup>18</sup> *Id.* at 67.

<sup>19</sup> Nancy A. McLaughlin, *The Role of Land Trusts in Biodiversity Conservation on Private Lands*, 38 IDAHO L. REV. 453, 453 (2002).

<sup>20</sup> Jeff Pidot provides this example: “A study by the Bay Area Open Space Council (1999) showed that roughly half of the conservation easement holders surveyed did not use a model easement . . . .” JEFF PIDOT, *REINVENTING CONSERVATION EASEMENTS: A CRITICAL EXAMINATION AND IDEAS FOR REFORM* 8 (2005).

lored to fit the needs and desires of each individual landowner and the parcel of land. No two are alike."<sup>21</sup> According to Jeff Pidot,

[i]t is often stated that each conservation easement *should* be unique and negotiated to the parties' particular specifications . . . . Indeed, the framers of the [UCEA] intended to provide a loose legal framework with latitude for the parties to arrange their relationships as they saw fit.<sup>22</sup>

Professor Gerald Korngold provides some examples of the various restrictions that might be contained in a conservation easement:

Easement documents typically include specific clauses, such as those that limit or prohibit additional building on the premises, timber cutting or tree removal, subdivision of the parcel, grants of rights-of-way easements, construction of roads and driveways, storage of trash, the use of all-terrain vehicles, or disturbance of the surface.<sup>23</sup>

Easement terms are also malleable in the extent to which they explicitly permit post-easement-creation land use.<sup>24</sup> As The Nature Conservancy, the nation's largest land trust,<sup>25</sup> explains:

There is no one-size-fits-all conservation easement. Each one is individually tailored to meet conservation objectives and the needs of the landowner . . . . Easements are . . . tailored to meet a landowner's needs, such as the need to build a house in the future for a daughter's family or the need to continue to derive income from the land through ranching.

[Easement terms] are designed to meet the needs of both parties by targeting only those rights (e.g., commercial development) necessary to accomplish specific conservation objectives.<sup>26</sup>

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<sup>21</sup> Open Space Institute, Land Conservation at OSI, [www.osiny.org/site/DocServer/ConservationEasements2.pdf?docID=122](http://www.osiny.org/site/DocServer/ConservationEasements2.pdf?docID=122) (last visited Jan. 22, 2010).

<sup>22</sup> PIDOT, *supra* note 20 (emphasis added).

<sup>23</sup> 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, 1045 (2007).

<sup>24</sup> The easement cannot actually exist prior to the closing of the donation transaction; a landowner cannot hold an easement on her own property. SINGER, *supra* note 13, at 211–12.

<sup>25</sup> "[The Nature Conservancy] holds more easements (1983) and more acres of easements (3.2 million) than any other land trust in the U.S. These holdings represent more than one third of the total conservation easement acreage held by U.S. land trusts." Joseph M. Kiesecker et al., *Conservation Easements in Context: A Quantitative Analysis of Their Use by The Nature Conservancy*, 5 FRONT. ECOL. ENVIRON. 125, 126 (2007).

<sup>26</sup> The Nature Conservancy, *All About Conservation Easements*, <http://www.nature.org/aboutus/howwework/conservationmethods/privatelands/conservationeasements/about/allabout.html> (last visited Jan. 22, 2010) (on file with the Harvard Law School Library).



Donors and donees can write easements so that they allow uses such as farming, ranching, and the construction of additional, personal residences.<sup>27</sup> According to the American Farmland Trust, “[a]gricultural conservation easements often permit commercial development related to the farm operation or the construction of farm buildings.”<sup>28</sup> In 2007, The Nature Conservancy did a study of easements “explicitly designed to preserve biodiversity” and found that about fifty percent of easements created between 1984 and 1994 and about twenty percent created between 1995 and 2004 permit the landowner to subdivide the land, presumably for the purposes of building and selling additional homes.<sup>29</sup>

Because of their hybrid nature and the flexibility of their terms, conservation easements therefore represent something of an exception to the principle of *numerus clausus*.<sup>30</sup>

### 3. *That Lasts Forever?*

In two important ways, conservation easements are not so flexible: first, most parties create them with the intent that they will last in perpetuity;<sup>31</sup> second, consistent with this intent, they are difficult to terminate.<sup>32</sup> Both of these features are products of the combination of the state

<sup>27</sup> In a recent study, fifty-three percent of easements examined “allowed for some type of commercial land use such as ranching, recreation, forestry, farming, or lodging and camping.” Adena R. Rissman et al., *Conservation Easements: Biodiversity Protection and Private Use*, 21 CONSERV. BIO. 709, 715 (2007).

<sup>28</sup> American Farmland Trust, Agricultural Conservation Easements Fact Sheet, [http://www.farmlandinfo.org/documents/27762/ACE\\_06-2008.pdf](http://www.farmlandinfo.org/documents/27762/ACE_06-2008.pdf) (last visited Jan. 22, 2010). The American Farmland Trust is “the nation’s leading conservation organization dedicated to saving America’s farm and ranch land, promoting environmentally sound farming practices and supporting a sustainable future for farms.” *About Us*, American Farmland Trust, <http://www.farmland.org/about/default.asp> (last visited Oct. 26, 2010).

<sup>29</sup> Kiesecker et al., *supra* note 25, at 126, 128; *see also* Rissman, *supra* note 27 (noting that most easements surveyed allow for the construction of additional structures, and many of these easements contain no limits on how large those structures can be).

<sup>30</sup> As explained by Merrill and Smith, the principle is that “the law will enforce as property only those interests that conform to a limited number of standard forms.” Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1, 3 (2000). The primary purpose behind the principle is the avoidance of what Merrill and Smith call “externalit[ies] involving measurement costs”: “[p]arties who create new property rights will not take into account the full magnitude of the measurement costs they impose on strangers to the title.” *Id.* at 26–27. The costs of communicating “idiosyncratic property rights” will hinder what would otherwise be socially beneficial transactions. *Id.* at 27. Merrill and Smith believe non-possessory interests are generally subject to the principle. *Id.* at 16. Because of the extremely malleable nature of conservation easements, I am not as sure. It may not matter: marketability rationales are not relevant because conservation easements are, after the initial creation, not meant for re-sale. It might matter, though, when it comes to valuing property encumbered by an easement. *See infra* Part II.B.3.

<sup>31</sup> *See* Julia D. Mahoney, *Perpetual Restrictions on Land and the Problem of the Future*, 88 VA. L. REV. 739 (2002).

<sup>32</sup> *Id.* at 769 (“[C]onservation easements are engineered to be hard to undo.”). *But see* Barton H. Thompson, Jr., *The Trouble with Time: Influencing the Conservation Choices of Future Generations*, 44 NAT. RESOURCES J. 601, 609 (2004) (“Freeing land from a perpetual

property law authorizing the creation of easements and federal laws, including tax law.

Although the UCEA provides that “a conservation easement may be . . . released, modified, terminated, or otherwise altered or affected in the same manner as other easements,” there are obstacles to these events occurring.<sup>33</sup> First, federal law encourages the creation of permanent conservation easements. Federal tax law, for example, allows a landowner to deduct the value of a donated easement only if that easement is permanent.<sup>34</sup> In addition, if a conservation easement is used to create a wetlands mitigation bank, federal regulations allow the bank to sell mitigation credits only if the wetlands are subject to permanent restriction.<sup>35</sup>

Second, by requiring that only government agencies and non-profit land trusts can hold conservation easements, state and federal laws make it difficult to terminate conservation easements.<sup>36</sup> A charitable holder would invite the scrutiny of state and federal officials if it terminated or modified a conservation easement in a way that seemed contrary to the organization’s charitable purpose. Charities may lose their tax exempt status if they engage in activities inconsistent with their stated purposes.<sup>37</sup> Where the easement is held by a government agency, an attempt to terminate or modify would likely attract unwanted public attention; moreover, a court might find that effort to be unlawful.<sup>38</sup>

### B. Federal Tax Law and Easement Donations

Congress first authorized income tax deductions for donated conservation easements in 1976.<sup>39</sup> Since that time, critics have occasionally called

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conservation easement, although difficult, may be far easier to accomplish than changing a constitutional conservancy or a public park . . . . Even if the land trust has no interest in giving up its easement, the owner of the fee simple may be able to escape the easement’s restrictions on various legal grounds.”).

<sup>33</sup> UCEA § 2(a) (1981).

<sup>34</sup> See discussion *infra* note 61.

<sup>35</sup> Federal Guidance for the Establishment, Use and Operation of Mitigation Banks, 60 Fed. Reg. 58,605, 58,612 (Nov. 28, 1995) (“The wetlands and/or other aquatic resources in a mitigation bank should be protected in perpetuity with appropriate real estate arrangements (e.g., conservation easements, transfer of title to Federal or State resource agency or non-profit conservation organization).”).

<sup>36</sup> The UCEA provides that only “a governmental body empowered to hold an interest in real property” or “a charitable corporation, charitable association, or charitable trust” formed for conservation purposes, may hold a conservation easement. UCEA § 1(2)(i)–(ii) (1981). See also, 26 U.S.C. § 170(h)(1)(B) (2006).

<sup>37</sup> David Biemesderfer and Andras Kosaras, *The Value of Relationships Between State Charity Regulators and Philanthropy* 11 (2006), available at [http://www.givingforum.org/s\\_forum/bin.asp?CID=2983&DID=9298&DOC=FILE.PDF](http://www.givingforum.org/s_forum/bin.asp?CID=2983&DID=9298&DOC=FILE.PDF).

<sup>38</sup> *Cf. Friends of Van Cortlandt Park v. City of New York*, 750 N.E.2d 1050, 1053 (N.Y. 2001). Although the case did not involve termination of a conservation easement, court stated that “parkland is impressed with a public trust, requiring legislative approval before it can be alienated or used for an extended period for non-park purposes.” *Id.*

<sup>39</sup> McLaughlin, *supra* note 19, at 455:

for reform or repeal.<sup>40</sup> Despite criticisms, Congress has to date neither reduced the amount of available tax benefit nor eliminated deductibility altogether. If anything, Congress has, over the years, increased tax incentives.<sup>41</sup> Today, those incentives include not only the income tax deduction found in Section 170(h) of the Internal Revenue Code (the “Code”), but also the estate tax deduction at Section 2031(c).<sup>42</sup>

Several key points need to be emphasized for purposes of the analysis here. First, conservation easement deductions are an exception to a general statutory prohibition on deducting donations of partial interests in property.<sup>43</sup> Second, the Code only allows deductions for easements that are both permanent and exclusively intended to achieve one of four stated conservation purposes.<sup>44</sup> Third, the fair market value of conservation easements is usually determined by the “before and after” method of appraisal.<sup>45</sup>

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The Internal Revenue Service first officially recognized the availability of a charitable income tax deduction for the donation of a conservation easement in 1964, but it was not until the Tax Reform Act of 1976 that the first express statutory authority for the deductibility of donated conservation easements was enacted.

Professor McLaughlin and others have done an excellent and thorough job laying out the history and mechanics of the federal tax law as it relates to donations of conservation easements. See Nancy A. McLaughlin and 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, 1569 n.33 (2008); Nancy A. McLaughlin, *Increasing the Tax Incentives for Conservation Easement Donations – A Responsible Approach*, 31 ECOLOGY L.Q. 1, 10–17 (2004); McLaughlin, *supra* note 19, at 455–58. For additional discussions of federal law on conservation easements, see C. Timothy Lindstrom, *Income Tax Aspects of Conservation Easements*, 5 WYO. L. REV. 1, 3 n.5 (2005); BARBARA L. KIRSCHTEN & CARLA NEELEY FREITAG, 521-3D T.M., CHARITABLE CONTRIBUTIONS: INCOME TAX ASPECTS A-76A-93 (2008).

<sup>40</sup> See, e.g., DEP’T OF THE TREASURY, A REPORT TO THE CONGRESS ON THE USE OF TAX DEDUCTIONS FOR DONATIONS OF CONSERVATION EASEMENTS (1987), reprinted in TAX NOTES TODAY, Dec. 18, 1987, Lexis, 7987 TNT 248-6; STAFF OF THE JOINT COMM. ON TAXATION, 109TH CONG., OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES 277–87 (2005). The following papers also have suggested that reforms are needed: Korngold, *supra* note 23; John D. Echeverria, *Regulating Versus Paying Land Owners to Protect the Environment*, 26 J. LAND RESOURCES & ENVTL L. 1 (2005); Carol Necole Brown, *A Time to Preserve: A Call for Formal Private-Party Rights in Perpetual Conservation Easements*, 40 GA. L. REV. 85 (2005); 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 (2004); Julia D. Mahoney, *Perpetual Restrictions on Land and the Problem of the Future*, 88 VA. L. REV. 739 (2002); PIDOT, *supra* note 20.

<sup>41</sup> For example, Congress added the estate tax benefit in the Taxpayer Relief Act of 1997. Taxpayer Relief Act of 1997, Pub. L. No. 105-34 § 508 (1997). In addition, in 2006, Congress added Section 170(b)(1)(E) to the Internal Revenue Code. Pub. L. No. 109-280, § 206 (2006). This provision loosened generally applicable temporal restrictions on the use of easement donation deductions to reduce income. KIRSCHTEN & FREITAG, *supra* note 39 at A-136.

<sup>42</sup> 26 U.S.C. § 2031(c) (2006).

<sup>43</sup> 26 U.S.C. § 170(f)(3) (2006).

<sup>44</sup> 26 U.S.C. § 170(h)(4) (2006).

<sup>45</sup> See KIRSCHTEN & FREITAG, *supra* note 39, at A-90.

### 1. Deductions for Donations of Partial Interests in Property

Allowing a deduction for the charitable donation of a conservation easement is an exception to the general rule barring deductions for donations of partial interests in property.<sup>46</sup> There are only three such statutory exceptions: remainders in personal residences or farms, co-tenancies, and conservation easements (or as the Code calls them, “qualified conservation contributions”).<sup>47</sup>

When Congress first barred deductions for donations of partial property interests in 1969, by adding Section 170(f)(3) to the Code, the rationale expressed in the legislative history was that such donations created the possibility of double deductions for donors “who donated to a charity the use of property for a limited period of time.”<sup>48</sup> For example, the owner of a commercial building who allowed a charitable organization to use an office rent-free could both exclude the non-received rent from her income and then further reduce her income by virtue of the charitable deduction.<sup>49</sup> In banning deductions for partial interests, Congress limited this donor to the same tax benefit received by the landlord who had rented out the office and then donated the proceeds to charity.<sup>50</sup>

Even though the double-benefit lease transaction was the only partial interest problem that Congress specifically identified in 1969, it is clear from both the language of Section 170(f)(3)(A),<sup>51</sup> and court interpretations of that language,<sup>52</sup> that the provision “broadly prohibit[s] charitable contribution deductions of less than a taxpayer’s entire interest in property.”<sup>53</sup>

<sup>46</sup> 26 U.S.C. § 170(f)(3)(A) (2006).

<sup>47</sup> 26 U.S.C. § 170(f)(3)(B) (2006). In addition to these statutory exceptions, there are also some regulatory exceptions. For example, the regulations provide that a taxpayer is entitled to a deduction for the donation of a partial interest when that interest is donated to one charitable organization at the same time as the donor donates all of her remaining interest in the property to another charity. Treas. Reg. § 1.170A-7(a)(2)(ii); *see also* KIRSCHTEN & FREITAG, *supra* note 39, at A-69-A-73 (describing two other such exceptions); Scott Andrew Bowman & Danaya C. Wright, *Charitable Deductions for Rail-Trail Conversions: Reconciling the Partial Interest Rule and the National Trails System Act*, 32 WM. & MARY ENVTL. L. & POL'Y REV. 581, 595–610 (2008).

<sup>48</sup> KIRSCHTEN & FREITAG, *supra* note 39, at A-68.

<sup>49</sup> *Id.*

<sup>50</sup> In other words, each would receive a deduction equal to the value of the rent.

<sup>51</sup> Section 170(f)(3)(A) provides that:

In the case of a contribution (not made by a transfer in trust) of an interest in property which consists of less than the taxpayer’s entire interest in such property, a deduction shall be allowed under this section only to the extent that the value of the interest contributed would be allowable as a deduction under this section if such interest had been transferred in trust. For purposes of this subparagraph, a contribution by a taxpayer of the right to use property shall be treated as a contribution of less than the taxpayer’s entire interest in such property.

26 U.S.C. § 170(f)(3)(A) (2006). This is sometimes known as the “partial interest rule.” *See* Bowman & Wright, *supra* note 47, at 595.

<sup>52</sup> *See, e.g.*, Logan v. Comm’r, 68 T.C.M. (CCH) 658 (1994); Stjernholm v. Comm’r, 58 T.C.M. (CCH) 389 (1989); Stark v. Comm’r, 86 T.C. 243 (1986).

<sup>53</sup> KIRSCHTEN & FREITAG, *supra* note 39 at A-68.

Although Congress later specifically exempted conservation easements from the “partial-interest rule,” it did not do so unaware of potential problems.<sup>54</sup> In fact, at a 1979 hearing before the House Ways and Means Committee, (now Professor, then Deputy Assistant Secretary at the Department of the Treasury) Daniel I. Halperin argued that:

[I]t may well be difficult to ascertain the diminution in market value of a parcel of property resulting from the transfer of less than the taxpayer’s entire interest in the property for conservation purposes . . . . While valuation problems arise under other parts of section 170, 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. Second, 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 date; in particular, it may have no material impact on the continuing enjoyment of the property by the donor of the easement.<sup>55</sup>

In these comments, Halperin identifies two problems: first, establishing an accurate value for an easement is difficult because it is not clear when the donor would have exercised the donated property rights; second, and related, there is a possibility that donors’ incentives will be distorted because the rights being donated, measured at the moment of donation, have little value to them. Both of these problems emanate from the fact that conservation easements are negative partial interests in property. As discussed in Part IV.B, negative partial interest donations create a fundamentally different kind of tax concern than transfer-of-temporal-interest problems such as the double-benefit lease.

## 2. *Statutory and Regulatory Requirements*

In order for a donated conservation easement to qualify for a tax deduction, it must constitute what the law calls a “qualified conservation contribution.”<sup>56</sup> The requirements of a qualified conservation contribution are laid out in Section 170(h) of the Code and further explained in the relevant regulations.<sup>57</sup> There are four essential qualifying features.<sup>58</sup>

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<sup>54</sup> *See id.*

<sup>55</sup> *Miscellaneous Tax Bills: Hearing on H.R. 4611 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 Sec’y, Treasury Dep’t).

<sup>56</sup> *See* 26 U.S.C. § 170(f)(3)(B)(iii) (2006).

<sup>57</sup> *Treas. Reg.* § 1.170A-14 (1999).

<sup>58</sup> The statute sets out what appears to be three elements of a deductible easement:

Qualified conservation contribution.

(1) In general. For purposes of subsection (f)(3)(B)(iii), the term “qualified conservation contribution” means a contribution —

First, the easement must be a “qualified real property interest.”<sup>59</sup> This means that it must be, if not an entire interest or a remainder interest, then “a restriction (granted in perpetuity) on the use which may be made” of the underlying real property.<sup>60</sup> This provision contains two elements that must be satisfied. First, the easement must be permanent. Although the Uniform Conservation Easement Act suggests that conservation easements of lesser duration would constitute recognized property interests as a matter of state property law, the donation of such easements will not give rise to a federal tax deduction.<sup>61</sup> Second, the easement must restrict use of the underlying property. In other words, the land-use restrictions contained in the easement must not duplicate applicable local, state, or federal land-use restrictions, such as those that might be found in a zoning ordinance, or private restrictions, such as those that might be found in subdivision covenants.<sup>62</sup> It is important to emphasize that a qualifying easement does not have to restrict *all* use of the underlying property nor even limit post-easement use to levels of pre-easement use; a conservation easement will meet the test if it ensures that, post-easement, the property will continue to provide some benefit to the public.<sup>63</sup>

The second element of a qualified conservation contribution is that the easement be donated to a “qualified organization.”<sup>64</sup> These donees are, generally speaking,<sup>65</sup> government agencies and what are often known as “land trusts.”<sup>66</sup> Land trusts play a central role in easement donations and the suc-

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- (A) of a qualified real property interest,
  - (B) to a qualified organization,
  - (C) exclusively for conservation purposes.

26 U.S.C. § 170(h)(1) (2006). Kirschten and Freitag, however, break the third requirement, that the easement be “exclusively for conservation purposes,” into two parts, “conservation purposes” and “exclusively for conservation purposes.” KIRSCHTEN & FREITAG, *supra* note 39, at A-77. For reasons discussed later in the Article, I believe this to be the correct approach.

<sup>59</sup> 26 U.S.C. § 170(h)(1)(A) (2006).

<sup>60</sup> 26 U.S.C. § 170(h)(2) (2006).

<sup>61</sup> 26 U.S.C. § 170(h)(2)(C) (2006). How does the law ensure that the easement actually lasts forever? The tax code does not, but the applicable regulations provide that where a conservation easement is later terminated due to an “unexpected change in the conditions surrounding the property” that “makes impossible or impractical the continued use of the property for conservation purposes,” the proceeds must be used by the land trust in “a manner consistent with the conservation purposes of the original contribution.” Treas. Reg. § 1.170A-14(c)(2) (2009).

The donation of a less-than-permanent easement may be deductible under state tax law. See Jesse J. Richardson, Jr., et al., *Conservation Easements: What Are They and Who Participates?*, Horizons (Virginia’s Rural Economic Analysis Program, Blacksburg, Va.), Jan./Feb. 2005, at n.1.

<sup>62</sup> See KIRSCHTEN & FREITAG, *supra* note 39, at A-78.

<sup>63</sup> See Treas. Reg. § 1.170A-14(b)(2) (1999) (“Any rights reserved by the donor in the donation of a perpetual conservation restriction must conform to the requirements of this section.”).

<sup>64</sup> 26 U.S.C. § 170(h)(1)(B) (2006).

<sup>65</sup> There are no available data on the percentage of easements donated to the various types of qualified organizations.

<sup>66</sup> For the technical definition of “qualified organization,” see 26 U.S.C. § 170(h)(3) (2006) and Treas. Reg. § 1.170A-14(c) (1999). See also KIRSCHTEN & FREITAG, *supra* note

cess or failure of the conservation easement tax subsidy program.<sup>67</sup> They are the gatekeepers of that program, deciding which easements to accept, negotiating the terms of those easements, and monitoring and enforcing those terms.<sup>68</sup>

Land trusts are not required to accept every potential easement donation. Beyond the legal requirement that a land trust can accept only those easements whose purposes are consistent with the trust's stated goals,<sup>69</sup> individual land trusts may reject an easement for a variety of reasons associated with the costs of accepting and maintaining a conservation easement. Land trusts need to expend time and money on negotiating and drafting easement terms and must verify that the appraiser's valuation is accurate.<sup>70</sup> Once an easement is in place, the land trust should be interested in monitoring and enforcing its terms. This can also involve significant expense.<sup>71</sup> Moreover, if a trust accepts a technically legal, but subjectively substandard, easement, it risks harm to both its external reputation and internal morale.

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39, at A-78-A-79. In the case of historic preservation easements, the common nomenclature is "trust for historic preservation" or "preservation trust." See, e.g., CONNECTICUT TRUST FOR HISTORIC PRESERVATION <http://www.cttrust.org/> (last visited Oct. 26, 2010); PRESERVATION TRUST OF SPARTANBURG <http://www.preservespartanburg.org/> (last visited Oct. 26, 2010). For the purposes of simplicity, all easement donees will hereinafter generally be referred to as "land trusts."

<sup>67</sup> See McLaughlin, *supra* note 19; Erin B. Gisler, *Land Trusts in the Twenty-First Century: How Tax Abuse and Corporate Governance Threaten the Integrity of Charitable Land Preservation*, 49 SANTA CLARA L. REV. 1123 (2009).

<sup>68</sup> See generally LAND TRUST ALLIANCE, STARTING A LAND TRUST: A GUIDE TO FORMING A LAND CONSERVATION ORGANIZATION (1990). For a description of how the country's largest land trust, the Nature Conservancy, makes selection decisions, see Kiesecker et al., *supra* note 25 at 126.

<sup>69</sup> See Treas. Reg. § 1.170A-14(c)(1) (1999).

<sup>70</sup> The donor, land trust, and appraiser may be subject to civil or criminal penalties for overstatements of fair market value. See KIRSCHTEN & FREITAG, *supra* note 39, at A-197-A-206; Notice 2004-41, 2004-28 I.R.B. 31.

<sup>71</sup> Gerald Korngold provides a more skeptical view:

While many organizations do a fine job of stewarding the conservation easements that they hold, others do not fare as well. Quality stewardship requires periodic inspection and monitoring of the burdened property, discussions with the fee landowner over general issues and incipient and actual violations, and enforcement actions if resolution of disputes becomes impossible. Without adequate stewardship, the conservation benefit to be enjoyed by the public dissipates. Where a tax benefit accompanied the creation of the easement, this means that the public has paid for a conservation advantage that has been squandered through inaction or misjudgments of a nongovernmental organization . . . .

There has been a concerted effort by leading conservation groups to provide education and best practices for stewardship, as well as a recommendation that nonprofits seek accompanying stewardship funds from donors of conservation easements. This advice may help the situation — longitudinal studies will ultimately tell the story. But more importantly, these steps are not mandatory on nonprofits and there is no evidence that they will be adopted and implemented effectively, especially by those low-performing nonprofits who most need to upgrade their operations.

Korngold, *supra* note 23, at 1062–63.

The third requirement is that the easement must be created “for conservation purposes.”<sup>72</sup> There are four permissible varieties of conservation purpose: enhancing opportunities for public recreation or education;<sup>73</sup> protecting land that provides “relatively natural habitat” for fish, wildlife, or plants, or contains a “similar ecosystem”;<sup>74</sup> preserving open space “for the scenic enjoyment of the general public” or pursuant to a government conservation policy;<sup>75</sup> or, finally, preserving “a historically important land area or a certified historic structure.”<sup>76</sup>

The conservation purpose requirement ensures that the public receive some minimum amount of benefit from the creation of the easement.<sup>77</sup> The first type, the recreation and education easement, is the only type which requires that members of the public have the right to actual physical access onto the underlying real property.<sup>78</sup> The next type, the relatively natural habitat or ecosystem easement, provides a public benefit insofar as it permanently protects land values that contribute to the health of fish, wildlife, or plant populations.<sup>79</sup> The third type, open space easements, benefit the public by improving landscape aesthetics, regulating harmful forms of growth

<sup>72</sup> 26 U.S.C. § 170(h)(1)(c) (2006).

<sup>73</sup> 26 U.S.C. § 170(h)(4)(A)(i) (2006).

<sup>74</sup> 26 U.S.C. § 170(h)(4)(A)(ii) (2006).

<sup>75</sup> 26 U.S.C. § 170(h)(4)(A)(iii) (2006). “Open space” easements must yield “a significant public benefit.” *Id.* The inclusion of this language in the statute is clearly not intended to imply that other kinds of easements do not have to provide a public benefit; rather, the implication is that the preserved scenery must be visually accessible to some minimum number of people. Treas. Reg. §§ 1.170A-14(d)(4)(ii)(B), (d)(4)(iv)(A)(6) (1999). If an open space easement is created pursuant to a government policy, that policy must be “clearly delineated.” 26 U.S.C. § 170(h)(4)(A)(iii) (2006).

<sup>76</sup> 26 U.S.C. § 170(h)(4)(A)(iv) (2006).

<sup>77</sup> In other words, the requirement eliminates the possibility that easements might be created to protect land or structures that do not possess significant, pre-easement conservation value.

<sup>78</sup> Treas. Reg. § 1.170A-14(d)(2)(ii) (2009). Historic preservation easements created pursuant to Section 170(h)(4)(A)(iv) may require public physical access if

the historic land area or certified historic structure which is the subject of the donation is not visible from a public way (e.g., the structure is hidden from view by a wall or shrubbery, the structure is too far from the public way, or interior characteristics and features of the structure are the subject of the easement).

Treas. Reg. § 1.170A-14(d)(5)(iv)(A) (1999). Public access may actually run counter to the conservation purposes of habitat or ecosystem protection easements created pursuant to Section 170(h)(4)(A)(ii) due to the fact that such access might disturb habitat or wildlife. *See, e.g.*, I.R.S. Priv. Ltr. Rul. 200208019 (Feb. 22, 2002).

<sup>79</sup> As many scholars have noted, the protection of habitat is crucial to the long-term conservation of species, and the protection of habitat on private land is particularly important. *See* Holly Doremus, *Biodiversity and the Challenge of Saving the Ordinary*, 38 IDAHO L. REV. 325, 336 (2002) (“More than ninety percent of [species listed as endangered or threatened under the Endangered Species Act] occur on private lands, and roughly two-thirds depend on private lands for at least sixty percent of their habitat.”) (citing U.S. GEN. ACCOUNTING OFFICE, ENDANGERED SPECIES ACT: INFORMATION ON SPECIES PROTECTION ON NONFEDERAL LANDS 4 (1995)); Craig Groves et al., *Owning Up to Our Responsibilities: Who Owns Lands Important for Biodiversity*, in *PRECIOUS HERITAGE: THE STATUS OF BIODIVERSITY IN THE UNITED STATES* 275 (B. Stein et al., eds., 2000). Put differently, “fewer than 10% of endangered species occur exclusively on public land.” Kiesecker et al., *supra* note 25, at 125 (citing



(such as sprawl), and preserving traditional land uses (such as farming or ranching).<sup>80</sup> Finally, by maintaining the historic appearance of land or buildings, historic preservation easements supply public goods such as cultural connections with the past, visible examples of important architectural achievements, and, in some cases, the economic viability of a neighborhood or a larger area.<sup>81</sup>

In order for the easement to provide a public benefit, the underlying land must have provided some pre-easement public benefit.<sup>82</sup> Thus, the “conservation purposes” requirement is a tool for ensuring that only appropriate properties are eligible for participation in the conservation easement program. The regulations support this view insofar as they focus on the pre-easement conservation qualities of the property.<sup>83</sup>

The fourth, and final, requirement is that the easement be created “exclusively for conservation purposes.”<sup>84</sup> In contrast to the “conservation purposes” requirement, which is meant to ensure that only beneficial properties qualify for participation in the program, the “exclusively for conservation purposes” requirement is a means of ensuring that qualifying properties pro-

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J. Michael Scott, et al., *Nature Reserves: Do They Capture the Full Range of America's Biological Diversity?*, 11 *ECOL. APPL.* 999 (2001).

The habitat or ecosystem easement is particularly useful in this effort for two reasons. First, it is a more politically feasible means of protecting habitat on private land than the alternative, that is, regulation. See Barton H. Thompson, Jr., *Providing Biodiversity Through Policy Diversity*, 38 *IDAHO L. REV.* 355, 368–69 (2002) (“[P]roperty owners are less likely to oppose governmental investment programs than to oppose regulation.”). Second, current federal and state wildlife laws focus on protecting the habitat of threatened and endangered species; easement subsidies, on the other hand, are available for “the protection of a relatively natural habitat of fish, wildlife, or plants,” without regard to the condition of populations dependent on those habitats. 26 U.S.C. § 170(h)(4)(A)(ii) (2006).

<sup>80</sup> See Charles J. Fausold & Robert J. Lillieholm, *The Economic Value of Open Space: A Review and Synthesis*, 23 *ENVTL. MGMT.* 307, 307–08 (1999); VIRGINIA MCCONNELL & MARGARET WALLS, *THE VALUE OF OPEN SPACE: EVIDENCE FROM STUDIES OF NONMARKET BENEFITS* (2005).

<sup>81</sup> See David Listokin et al., *The Contributions of Historic Preservation to Housing and Economic Development*, 9 *HOUSING POL'Y DEBATE* 431, 431–32 (1998); Ellen Edge Katz, *Conserving the Nation's Heritage Using the Uniform Conservation Easement Act*, 43 *WASH. & LEE L. REV.* 369, 369–70 (1986).

<sup>82</sup> Section 170(h) does not contemplate the donation of easements intended to promote the restoration of land or structures that do not already provide a public benefit. See 26 U.S.C. § 170(h).

<sup>83</sup> See, e.g., Treas. Reg. § 1.170A-14(d)(4)(ii)(A) (1999) (“the factors to be considered” in whether preservation of a particular piece of land would provide a scenic enjoyment benefit are: “(1) The compatibility of the land use with other land in the vicinity; (2) The degree of contrast and variety provided by the visual scene; (3) The openness of the land (which would be a more significant factor in an urban or densely populated setting or in a heavily wooded area); (4) Relief from urban closeness; (5) The harmonious variety of shapes and textures; (6) The degree to which the land use maintains the scale and character of the urban landscape to preserve open space, visual enjoyment, and sunlight for the surrounding area; (7) The consistency of the proposed scenic view with a methodical state scenic identification program, such as a state landscape inventory; and (8) The consistency of the proposed scenic view with a regional or local landscape inventory made pursuant to a sufficiently rigorous review process, especially if the donation is endorsed by an appropriate state or local governmental agency.”)

<sup>84</sup> 26 U.S.C. § 170(h)(1)(C) (2006).

vide post-easement public benefit. In other words, while meeting the “conservation purposes” requirement ensures that the land in question *can* provide a recreational, ecological, scenic, or historic benefit, the “exclusively for conservation purposes” requirement addresses the issue of how much of that land’s beneficial quality the conservation easement document must preserve.

Again, the structure and language of the regulations seem to indicate that this is the IRS’s approach. The “exclusively for conservation purposes” regulations are found in a separate section from the “conservation purposes” regulations, and primarily address what the regulations call “inconsistent use.”<sup>85</sup> The regulations focus primarily on the kinds of uses the easement can and cannot permit the landowner to undertake *after* creation of the conservation easement. So, the regulations provide that “[a] donor may *continue* a pre-existing use of the property that does not conflict with the conservation purposes of the gift.”<sup>86</sup> As to future, non-pre-existing uses contemplated by the easement terms, the test is whether those uses, even if inconsistent with the conservation purposes of the easement, would “impair significant conservation interests.”<sup>87</sup> If they would not, then the easement may permit them.<sup>88</sup>

Taken together, the two pieces establish what might be seen as an envelope of conservation purposes within which the land trust and the donor are free to negotiate use restrictions. This is easiest to see in the context of “relatively natural habitat” and scenic easements.<sup>89</sup> In order for the landowner to qualify for a tax deduction, her property must have certain characteristics: it must house some relatively natural habitat<sup>90</sup> or be sufficiently scenic.<sup>91</sup> However, once established, the easement terms are permitted to allow future uses that result in changes to those characteristics.<sup>92</sup>

There are two critical points for purposes of the discussion here. First, assuming the property provides sufficient pre-easement public benefits, the

<sup>85</sup> Treas. Reg. § 1.170A-14(e)(1)–(2) (1999).

<sup>86</sup> Treas. Reg. § 1.170A-14(e)(3) (1999) (emphasis added).

<sup>87</sup> Treas. Reg. § 1.170A-14(e)(2) (1999).

<sup>88</sup> *Id.*

<sup>89</sup> 26 U.S.C. § 170(h)(4)(A)(ii)–(iii) (2006).

<sup>90</sup> Treas. Reg. § 1.170A-14(d)(3)(i)–(ii) (1999).

<sup>91</sup> Treas. Reg. § 1.170A-14(d)(4)(ii) (1999).

<sup>92</sup> “Donors who donate conservation easements frequently reserve rights with respect to existing or future uses of the property that do not impair the conservation purposes of the gift and, therefore, do not jeopardize the allowance of a deduction.” KIRSCHTEN & FREITAG, *supra* note 39 at A-86 (citing I.R.S. Priv. Ltr. Rul. 200208019 (Feb. 22, 2002) (donor retained right to develop eight residential lots); I.R.S. Priv. Ltr. Rul. 9632003 (Aug. 9, 1996) (donor retained rights to conduct ranching and agricultural activities and to construct related structures); I.R.S. Priv. Ltr. Rul. 9603018 (Jan. 19, 1996) (donors retained rights to conduct agricultural, forestry, and equestrian activities, to subdivide portions of the property, and to construct an additional residence and associated improvements); I.R.S. Priv. Ltr. Rul. 9318017 (May 7, 1993) (taxpayer retained rights to create hiking trails, including footbridges, and to install and maintain water systems and utility lines); I.R.S. Priv. Ltr. Rul. 9218017 (May 1, 1992) (taxpayer retained rights to conduct agricultural and timber activities, to hunt, fish, and gather firewood, and to drill water wells)).

law allows all pre-existing uses of the property to continue.<sup>93</sup> Second, vague language such as “relatively natural” and “significant conservation interests” leaves open the possibility that the easement might permit the donor to engage in a range of new, post-easement land uses.<sup>94</sup> Logically, the only situation in which this would not be true is where the pre-easement property barely met the “conservation purposes” test. Ironically, those properties that easily clear the bar of the “conservation purposes” test, for example, the most “relatively natural” properties, will be best positioned to legally accommodate a high level of future inconsistent uses.<sup>95</sup>

### 3. Valuation Method and Issues

The tax law provides that, assuming all other requirements are met, the donor is entitled to a deduction equal to the fair market value (“FMV”) of the easement.<sup>96</sup> However, the law does not suggest how to measure the FMV.<sup>97</sup> Because there is no actual market for conservation easements, an appraisal is required.

The law requires that a qualified appraiser value all conservation easement donations.<sup>98</sup> Most appraisers use what is known as the “before and after” method to estimate fair market value.<sup>99</sup> Conceptually, this method is simple. First, the appraiser estimates the value of the property before the restrictions contained in the proposed conservation easement are in place.<sup>100</sup> Then, the appraiser estimates the value that the underlying property will retain after the easement has been donated, that is, with the easement restrictions in place. The estimate of the easement’s fair market value is the difference between these two figures.<sup>101</sup>

Valuing the unrestricted property is no different from valuing any other parcel of real estate.<sup>102</sup> In contrast, the appraiser will face a greater challenge

<sup>93</sup> Treas. Reg. § 1.170A-14(e)(3) (1999).

<sup>94</sup> The donor will be required to “pay” for these future uses in the form of a decreased tax deduction because they increase the “after” value of the property used in valuing the easement. See *infra* Part IV.B.2.

<sup>95</sup> Whether this in fact occurs will depend on the preferences of the donor and the land trust and the extent to which the two parties press these preferences in negotiations.

<sup>96</sup> According to the IRS, FMV is:

the price that property would sell for on the open market. It is the price that would be agreed on by a willing buyer and a willing seller, with neither being required to act, and both having reasonable knowledge of relevant facts . . . . Determining the [fair market] value of donated property would be a simple matter if you could rely on fixed formulas, rules, or methods . . . . Using such formulas, etc., seldom results in an acceptable determination of FMV. There is no single formula that always applies when determining the value of property.

INTERNAL REVENUE SERV., PUBLICATION 561 2 (2007).

<sup>97</sup> See KIRSCHTEN & FREITAG, *supra* note 39, at A-111-A-113.

<sup>98</sup> 26 U.S.C. § 170(f)(11) (2006).

<sup>99</sup> KIRSCHTEN & FREITAG, *supra* note 39, at A-90.

<sup>100</sup> *Id.* at A-90-A-91.

<sup>101</sup> *Id.*

<sup>102</sup> The regulations provide that the “before” value:

in estimating the “after” value of the restricted property. The appraiser will have a more difficult time finding recent sales data to include in his estimate, owing to the fact that there may not be nearby comparable, and comparably restricted, properties.<sup>103</sup> The fact that easements can vary greatly in the extent to which they permit post-easement inconsistent uses would make the search for comparable “after” properties that much more difficult.<sup>104</sup>

### III. LESS-THAN-SATISFYING EXPLANATIONS OF DONATED-EASEMENT GENEROSITY

Despite their flexibility, it is clear that conservation easements represent a meaningful property interest, one that can and does reduce the value of the underlying parcel. So, what explains charitable donors’ high willingness to part with conservation easements?

One can conceive of several possible explanations. Before proceeding to the most convincing hypothesis, laid out in Part IV, it is worth briefly addressing some other, ultimately unsatisfying, possibilities.

In approaching the question, there are two avenues to explore. First, one can focus on the donors. That is, conservation easement donors might share a personal characteristic that explains their high willingness to part with conservation easements. As explained below, two such characteristics are wealth and the desire to make large, single gifts. A second avenue of inquiry relates not to the donors, but to the easement-donation transaction. Specifically, it could be that the incentives to donate easements are different from the incentives to donate other kinds of property. In other words, the costs of donating are lower or the benefits are higher.

#### A. Donor Characteristics

##### 1. Wealth

The fact that the average donated easement has a fair market value of nearly \$500,000 might be explained by the fact, if proven, that most conser-

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must take into account 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) (1999).

This is consistent with general principles of real estate valuation. APPRAISAL INSTITUTE, THE APPRAISAL OF REAL ESTATE 305–27 (12th ed. 2001).

<sup>103</sup> At least one reported case includes reference to an appraiser’s “after” opinion relying on sales of comparably restricted properties. *Dennis v. United States*, No. 92-0020-A, 1992 U.S. Dist. LEXIS 15409, at \*4–5 (E.D. Va. filed Sept. 28, 1992).

<sup>104</sup> See *supra* Part II.A.2.

vation easement donors are very wealthy people. After all, who else could afford to make such large charitable gifts?<sup>105</sup>

The AGI of donors does not fully explain the high average FMV of donated easements. The percentages of easement donors in high-AGI groups are greater than the percentage of high-AGI filers generally. So, for example, while individuals with AGIs between \$2 million and \$5 million account for only .07 percent of filers,<sup>106</sup> they make up 6.6 percent of easement donors.<sup>107</sup> It is not, however, the case that lower-AGI individuals do not donate easements. Individuals earning less than \$500,000 account for about 70 percent of easement donations; about 57 percent of those donors report AGIs under \$200,000.<sup>108</sup>

Moreover, while easement donations made by high-AGI individuals raise the average FMV of donated easements, the data on lower-AGI donations is still striking: the average FMV of easements donated by those reporting AGI under \$500,000 is more than \$260,000.<sup>109</sup>

More important, while wealth can be correlated to the average FMV of donated easements, it does not explain donors' high willingness to part with them. As illustrated by Figure 2,<sup>110</sup> donors in all AGI groups are consistently more willing to give away easements than any other kind of property. The following table compares willingness to part with real estate and conservation easements across AGI groups:

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<sup>105</sup> It is worth reiterating that, due to limitations in IRS data, AGI must be used as (an admittedly imperfect) proxy for wealth.

<sup>106</sup> IRS, Publication 1304, 34, tbl. 1.2 (2008), available at <http://www.irs.gov/pub/irs-soi/06inalcr.pdf>.

<sup>107</sup> Data on file with Author.

<sup>108</sup> *Id.*

<sup>109</sup> *Id.*

<sup>110</sup> See *supra* Part I.

TABLE 1. RELATIVE WILLINGNESS TO PART WITH  
CONSERVATION EASEMENTS.

AGI	Average FMV of Donated Easement is X Percent Higher than Average FMV of Donated Real Estate
Under \$200,000	187
\$200,000 to \$500,000	369
\$500,000 to \$1,000,000	188
\$1,000,000 to \$1,500,000	314
\$1,500,000 to \$2,000,000	128
\$2,000,000 to \$5,000,000	122
\$5,000,000 to \$10,000,000	198
More than \$10,000,000	223

It is clear from the data in Table 1 that wealth does not explain donated-easement generosity.

## 2. *The Desire to Make Large, Single Gifts*

One might argue that the data in Table 1 does not prove that donors are more willing to part with easements than with real property. Because IRS data does not reveal the total charitable donations made by individuals who give away particular types of property, it could be that land donors typically give away four parcels at a time, while easement donors prefer to make large gifts of one piece of property. If this were true, it would mean — given the numbers in Table 1 — that donors were more willing to part with real property than with conservation easements.

Statistical analysis shows that this scenario is very unlikely. Using the \$200,000 to \$500,000 AGI group as an example, one can compare the average value of a donated easement, or about \$388,000,<sup>111</sup> to the average annual charitable contribution of donors within that group, or about \$7,900.<sup>112</sup> Based upon standard deviations, and assuming a normal distribution, we can say that 99.8 percent of all included returns show annual contributions of less than \$8,500.<sup>113</sup> Thus, it is reasonable to assume that when a donor in

<sup>111</sup> Tables of Individual Noncash Charitable Contributions (Data on file with Author).

<sup>112</sup> Average computed from data in Table 2.2 for tax years 2003–2006 of Internal Revenue Serv., *SOI Tax Stats-Individual Tax Returns Publication 1304 (Complete Report)*, available at <http://www.irs.gov/taxstats/indtaxstats/article/0,,id=134951,00.html> (last visited Oct. 19, 2010).

<sup>113</sup> Based on population data and coefficients of variation obtained from Tables 2.1CV. *Id.*

this AGI group contributes an average chunk of real estate (\$105,000), conservation easement (\$388,000), or even securities (\$12,600), that donation likely represents her entire charitable donation for the year. If that is true, and the pattern exists across time, then one may conclude that charitable donors are much more willing to part with conservation easements than with other types of property.

### B. Benefits and Costs of Donating Easements

If donor characteristics cannot explain high willingness to part with easements, perhaps benefits and costs associated with donating easements can explain the phenomenon. The decision to make a charitable donation can be expressed as:

$$\text{if } B_{\text{non-tax}} + V * MR > V + C_{\text{transaction}}, \text{ then donate,}$$

where  $B_{\text{non-tax}}$  represents the value to the donor of pure and impure altruism<sup>114</sup> as well as the value of other possible non-tax benefits,  $V$  represents the value of the property, and  $MR$  is the taxpayer's marginal tax rate.  $V * MR$  is the dollar value of the tax benefit granted to the donor by Congress.<sup>115</sup> On the right side of the inequality are the costs of donating. In addition to the value of the gift, the donor must also take into account transaction costs ( $C_{\text{transaction}}$ ), such as the cost of searching for a donor, the cost of negotiating the terms of the donation, and the cost of hiring lawyers and appraisers.<sup>116</sup>

Is it possible that — compared to other types of property — the tax or non-tax benefits associated with donating conservation easements are particularly high or that the costs of donating are especially low?

#### 1. Generating Artificially High Tax Benefits by Overstating Fair Market Value

As with other kinds of not-readily valued property, the price of a conservation easement for tax purposes is based on an appraisal.<sup>117</sup> Because the tax benefit of donating property to a charity is a product of the value of the

<sup>114</sup> See *infra* note 133.

<sup>115</sup> This is admittedly an oversimplification. First, a donor may not be able to deduct the full fair market value of property. For example, if sale of the donated property would have generated ordinary income, then the number used to calculate the deductible amount would be the donor's basis in the property. Second, the donor may be limited in the extent to which he can use the deduction to reduce current income, either because of statutory limitations or lack of sufficient income. Finally, tax benefits may include benefits other than income tax benefits, such as estate or property tax benefits. These issues should not affect the usefulness of the model.

<sup>116</sup> For a good description of the process of creating and donating a conservation easement see ELIZABETH BYERS AND KARIN MARCHETTI PONTE, *THE CONSERVATION EASEMENT HANDBOOK* 43–68, 80–99 (2d ed. 2005). See also Open Space Institute, *Land Conservation at OSI*, [www.osiny.org/site/DocServer/ConservationEasements2.pdf?docID=122](http://www.osiny.org/site/DocServer/ConservationEasements2.pdf?docID=122) (last visited Jan. 22, 2010).

<sup>117</sup> 26 U.S.C. § 170(f)(11) (2006).

property and the donor's marginal tax rate,<sup>118</sup> that value is a critical variable in the decision to donate.

The IRS and other observers have expressed concern that the realm of conservation easement donation is characterized by an extraordinary amount of negligent or intentional overvaluation. As a report issued by the Joint Committee on Taxation explains:

Charitable deductions of qualified conservation contributions, including conservation and façade easements, present serious policy and compliance issues. Valuation is especially problematic because the measure of the deduction (i.e., generally the difference in fair market value before and after placing the restriction on the property) is highly speculative, considering that, in general, there is no market and thus no comparable sales data for such easements.<sup>119</sup>

The "before and after" method of estimating FMV for tax purposes means that there are actually two different ways an appraiser might overstate the FMV of the easement. An easement might be overvalued by inflation of the underlying property's "before value" or by understatement of its "after value."<sup>120</sup> An aggressive appraiser would find comfort in the fact that, due to the uncertainty surrounding estimates of value, the IRS will have a difficult time challenging the appraisal in court.<sup>121</sup>

There is some empirical evidence that substantial overstatement of FMV does occur in the easement donation context.<sup>122</sup> Nonetheless, the "widespread overvaluation" hypothesis is not particularly appealing. Because the number with which we are concerned is the *average* value of nearly 14,000 easements, overstatement would have to be present in a very large number of cases in order for it to be a significant factor.<sup>123</sup> Moreover,

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<sup>118</sup> The dollar amount of the tax benefit is expressed as  $V \cdot MR$  in the decision-to-donate model above. See *supra* text accompanying notes 115–17.

<sup>119</sup> STAFF OF THE JOINT COMMITTEE ON TAXATION, *supra* note 40, at 281. See also Steven T. Miller, Commissioner, Tax Exempt and Government Entities, Remarks before the Spring Public Lands Conference in Washington, D.C. (Mar. 28, 2006); *supra* Part II.B.3.

<sup>120</sup> Assume, for example, that the range of estimates of "before value" is \$100 to \$110, and that the range of estimates for the "after value" is \$10 to \$20. Use of the before and after estimates of \$110 and \$10, respectively, results in an estimate of easement FMV (\$100) that is \$20 greater than an FMV estimate calculated using before and after estimates of \$100 and \$20, respectively.

<sup>121</sup> This is especially true with respect to "after" values. See *supra* Part II.B.3. A survey of recent cases in which the IRS has challenged easement valuation reveals that the IRS's challenge is usually focused on the estimate of "before" value.

<sup>122</sup> See Gisler, *supra* note 67, at 1137–44; *Tax Code Issues and Land Conservation: Hearing Before the Sen. Comm. on Finance*, 109th Cong. 1 (2005) (statement of Burnet R. Maybank, III, Director, S.C. Dep't of Revenue) (describing several discovered instances of conservation easement valuations which "shock the conscience"); Joe Stephens & David B. Ottaway, *Conservation Easements: Developers Find Payoff in Preservation*, WASH. POST, Dec. 21, 2003, at A1.

<sup>123</sup> Or, there would have to be an enormous amount of overvaluation in a smaller number of cases.



obvious and intentional overvaluation would require the complicity of the taxpayer, the qualified appraiser, and the donee.<sup>124</sup>

Although the opportunity for overvaluation is a possible explanation for high willingness to part, it seems fair to assume that the majority of fair market value estimates for donated easements are calculated in good faith.<sup>125</sup> And, as shown in Part IV below, the valuation issues are ultimately secondary: the design of the Section 170(h) program is inherently flawed and would produce inefficient results even in the absence of fair market value overstatements.

## 2. Unique Tax Benefits

Another possibility is that easement donations give rise to tax benefits that other property donations do not.<sup>126</sup> It is true that, while all qualifying charitable donations are deductible against income, annual limitations on deductions for easement donations have, in recent years, been less restrictive than for other kinds of property.<sup>127</sup> In addition, other types of tax benefits, e.g., estate tax deductions<sup>128</sup> and reductions in state income or property taxes,<sup>129</sup> are potentially available to easement donors.

Due to a lack of needed data, this is a difficult hypothesis to test.<sup>130</sup> We can say for certain, though, that the more generous annual limitations on easement deductions did not inflate values for tax years 2003 through 2005; these rules did not come into effect until 2006.<sup>131</sup> In order to estimate how valuable estate tax deductions might be to donors, one would need data on the extent to which they might ultimately be liable for estate taxes.<sup>132</sup>

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<sup>124</sup> See *supra* note 70.

<sup>125</sup> According to Burnet Maybank, III, who led an audit of conservation easements granted in South Carolina from 2001–2003, “the percentage of abuses [discovered] have [sic] been quite small.” Maybank Testimony, *supra* note 122, at 1.

<sup>126</sup> All donors of appreciated property, where the appreciation can be characterized as long-term capital gain, receive a tax benefit in addition to the deduction against income. See Daniel Halperin, *A Charitable Contribution of Appreciated Property and the Realization of Built-In Gains*, 56 TAX L. REV. 1, 2 (2002). Specifically, they never have to pay tax on the appreciation. See *id.*

<sup>127</sup> See, e.g., 26 U.S.C. § 170(b)(1)(E) (2006) (removing the annual limits on the use of deductions for easement donations for a limited time period).

<sup>128</sup> 26 U.S.C. § 2031(c) (2006).

<sup>129</sup> There are 12 states that provide state tax benefits in the form of credits, some of which are transferable. See Christen Linke Young, *Conservation Easement Tax Credits in Environmental Federalism*, 117 YALE L.J. POCKET PART 218, 219 (2008).

<sup>130</sup> Although one might be able to formulate hypothetical situations, the data for statistical analysis is not available. See Lindstrom, *supra* note 39 at 3 n.5 (describing a hypothetical scenario in which “the combined [income and estate tax savings] . . . amount to . . . 106% of the value of the easement donated”).

<sup>131</sup> Pension Protection Act of 2006, 26 U.S.C. § 170(b)(1)(E) (2006).

<sup>132</sup> Through the end of 2009, decedents would have no estate tax liability if the value of their gross estate was \$3,500,000 or less. 26 U.S.C. § 2010(a), (c) (2006). Because of this high limit, very few individuals are subject to the estate tax. For the tax year 2006, when the taxable estate limit was \$2 million, only .63 percent of decedents’ estates were liable for estate tax. Brian G. Raub, *A Look at Estate Tax Returns Filed for Wealthy Decedents Since 2001*,

### 3. Unique Non-Tax Benefits

Non-tax benefits associated with easement donation could provide another possible explanation for high willingness to part. Typical non-tax benefits would include the value to the donor of contributing to social welfare or of being a good citizen.<sup>133</sup> These benefits, though, inure to all charitable donors, and there is no reason to believe that they are higher for all easement donors.

Because of the unique nature of conservation easements, however, it is possible that some donors do receive unusual non-tax benefits. The donated conservation easement allows the donor post-gift use and enjoyment of the underlying land. In addition to the right to continue living on the property, owners also maintain a more symbolic connection to the land.<sup>134</sup>

In addition, easement donations provide a handy means of circumventing restrictions that would limit an owner's ability to control use of the

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INTERNAL REVENUE SERVICE STATISTICS OF INCOME BULLETIN, Fall 2009, 302; INTERNAL REVENUE SERV., INTRODUCTION TO ESTATE AND GIFT TAXES 950, 5 (2009).

<sup>133</sup> These are known as "pure" and "impure" altruism. Pure altruism benefits are the value to the donor of increasing the amount of public good provided by the particular charity. See Lise Vesterlund, *Why do People Give?*, in *THE NONPROFIT SECTOR: A RESEARCH HANDBOOK* 568, 571–72 (Walter W. Powell & Richard Steinberg eds., 2006). "Impure altruism" benefits include the value to the donor of recognition as a charitable individual, status in the community, the ability to develop social and business connections, and less tangible benefits such as the good feeling one obtains through donating to a worthy cause. See *id.* at 572–73. See also James Andreoni, *Impure Altruism and Donations to Public Goods: A Theory of Warm-Glow Giving*, 100 *ECON. J.* 464 (1990); William T. Harbaugh, *The Prestige Motive for Making Charitable Transfers*, 88 *A.E.A. Papers and Proc.* 277, 277 (1998) (distinguishing benefits that are "purely internal, derived from the donor's own knowledge of what he has given, and those the donor only gets when other people know how much he has given").

<sup>134</sup> It is interesting to consider the unique connection between property and the expression of values. In *City of Ladue v. Gilleo*, the Supreme Court described the difference between expression and real-property-based expression:

Displaying a sign from one's own residence often carries a message quite distinct from placing the same sign someplace else, or conveying the same text or picture by other means. Precisely because of their location, such signs provide information about the identity of the "speaker." As an early and eminent student of rhetoric observed, the identity of the speaker is an important component of many attempts to persuade. A sign advocating "Peace in the Gulf" in the front lawn of a retired general or decorated war veteran may provoke a different reaction than the same sign in a 10-year-old child's bedroom window or the same message on a bumper sticker of a passing automobile. An espousal of socialism may carry different implications when displayed on the grounds of a stately mansion than when pasted on a factory wall or an ambulatory sandwich board.

512 U.S. 43 (1994).

In addition, a conservation easement might symbolize far more important values. For example, in a rural farming community, the donation of an easement could send messages to the effect that "I'm proud to be a farmer," "I'm in this for the long haul," "I value our traditional way of life more than I value money," or, along the same lines, "I would never sell my land to rapacious developers." For case studies exploring the relationship between rural communities and conservation easements, see Morrisette, *supra* note 11 at 396–418.

property after her death.<sup>135</sup> Many easement donors express concern about how future generations will use their land.<sup>136</sup>

It is hard to imagine that either continued use or dead-hand control could account for donated-easement generosity. If the goal of easement donors is to obtain public recognition for their contributions to conservation, there are ways to do this that would be far more visible. A donor could, for example, donate the land to a county or city for use as “[Donor]’s Park” or “[Donor]’s Nature Preserve.” Moreover, a significant number of easements do not permit public access to the property; that is, many donors intentionally restrict the public’s ability to learn about and enjoy the benefits of the gift.<sup>137</sup> As to dead-hand control, there are other ways that a donor might achieve this control at much lower cost. A donor could, for example, place the land into a trust that restricted use of the property.<sup>138</sup> In addition, the future value of restrictions to a living donor would have to be discounted, perhaps substantially.<sup>139</sup>

#### 4. *Unusually Low Transaction Costs*

A donor will have more incentive to donate a piece of property where, all other things being equal, the transaction costs associated with donating it are lower. In addition, if it is difficult to find an organization willing and able to accept a donation, donors may make a property donation of lesser value. In effect, a donor may reduce the amount of her donation to account for the time she spent looking for an organization that would accept her donation.

The problem with this hypothesis is that the transaction costs associated with donating easements are probably higher than they are for any other kind of property. As described in Part II.B of this Article, federal tax law only allows easement donors to take deductions for donations made to “qualified organizations.”<sup>140</sup> That organization must be willing and able to accept the donation. Once the donor has located a willing donee, she will usually spend time, and possibly attorney’s fees, negotiating the terms of the ease-

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<sup>135</sup> See Julia D. Mahoney, *Perpetual Restrictions on Land and the Problem of the Future*, 88 VA. L. REV. 739 (2002); Barton H. Thompson, Jr., *The Trouble with Time: Influencing the Choices of Future Generations*, 44 NAT. RESOURCES J. 601 (2004).

<sup>136</sup> See McLaughlin, *supra* note 19, at 46 (“[T]he desire to exercise ‘dead hand’ control over family decision-making” is one of the “less flattering non-tax factors that may motivate easement donations.”).

<sup>137</sup> A recent study indicates that about 60 percent of easements held by land trusts do not permit public access; the data do not discern between donated easements and easements purchased by land trusts. Katherine Lieberknecht, *Public Access to U.S. Conservation Land Trust Properties*, 75 J. AM. PLAN. ASS’N. 479, 482 (2009). One would intuit that the latter type would more frequently allow for public access because of the fact that the landowner received greater financial compensation for the easement.

<sup>138</sup> Even if the duration of the restrictions were limited by the Rule Against Perpetuities, the landowner could retain control of the property for a significant amount of time after her death: a generation plus 21 years. See SINGER, *supra* note 13, at 333–36.

<sup>139</sup> See Lee Anne Fennell, *Death, Taxes, and Cognition*, 81 N.C. L. REV. 567, 583 (2003).

<sup>140</sup> 26 U.S.C. § 170(h)(1)(B) (2006).

ment with that donee. Finally, if she wants a federal tax deduction, she will have to pay an appraiser.<sup>141</sup>

#### IV. THE BEST HYPOTHESIS?

The best explanation for high willingness to part requires revisiting our model,

$$\text{if } B_{\text{non-tax}} + V * MR > V + C_{\text{transaction}}, \text{ then donate.}$$

This model assumes that  $V$  is the same on both sides of the inequality. In other words, it assumes that the donor's cost in parting with the property is identical to the property value upon which the tax benefit is based. Part IV, among other things, explains why this assumption is flawed.

A more accurate depiction of the model, when not-readily valued property is involved, would be:

$$\text{if } B_{\text{non-tax}} + FMV * MR > C_{\text{parting}} + C_{\text{transaction}}, \text{ then donate.}$$

Again,  $B_{\text{non-tax}}$  represents the value to the donor of non-tax benefits.  $FMV$  is the appraised fair market value of the not-readily valued property and  $MR$  is the taxpayer's marginal rate. On the right side of the inequality are the costs of donating.  $C_{\text{parting}}$  represents what I call "parting cost" and  $C_{\text{transaction}}$  represents transaction costs. Parting cost is the value of the donated cash or property to the donor. In the case of cash, the parting cost will be equal to the amount of cash donated. In other words, the ratio of  $C_{\text{parting}}/FMV$  will be 1.

In order to understand how parting cost — or more specifically, the difference between parting cost and fair market value — affects a donor's incentives, consider a charitable donor, June. Assume that June wants to give \$5 to charity. She has a five-dollar bill and an old pair of pants with a fair market value of \$5. June has not worn the pants for years and does not plan to wear them again. If June gives away the five-dollar bill and is subject to a 30 percent tax rate, she will be \$3.50 poorer after her donation, recapturing \$1.50 through the tax benefit.<sup>142</sup> On the other hand, because she places a very low subjective value on the pants, June will be better off making her \$5 donation in the form of those pants. Depending on the marginal tax rate, and on the relationship between June's subjective valuation and fair market value, June may actually be wealthier after she donates the pants to charity. If, for example, she would have accepted a buyer's offer of \$.50 for the pants, and her marginal rate is 30 percent, June's charitable donation nets

<sup>141</sup> Treas. Reg. § 1.170A-13(c)(3)(i)(B) (1996).

<sup>142</sup> This figure does not include the non-tax benefits June may have received from making a charitable donation. See Vesterlund, *supra* note 133 and accompanying text. It seems reasonable to assume that these would be the same whether she donated cash or pants.

her \$1 of new wealth.<sup>143</sup> June can take advantage of the spread between fair market value and her low parting cost.

If June had simply sold the pants for \$5, we would call her a savvy businessperson. Allowing June to exploit the subjective-value spread in the context of a charitable donation, however, represents a bad deal for taxpayers, to the tune of \$1 of lost tax revenue: June would have donated the pants — creating the same public benefit — in exchange for a tax benefit of only \$.50.

One might ask: why would June accept \$1 in profit when she could have received \$5 from selling her pants on the open market? For one thing, simply because the pants have a fair market value of \$5 does not mean that June could have obtained this amount in a transaction. The amount she received would be determined, in part, by her negotiating skills. In addition, selling entails some transaction costs, such as advertising and the time spent driving to a used clothes store. Finally, it could be that the combination of the \$1 profit and the non-tax benefits she receives from making a charitable donation exceed \$5.

Unlike June, potential easement owners do not have the option to sell. They could, of course, sell the entire property, but this would mean that they would no longer be able to use it. Thus, the subjective-value spread is the critical factor in understanding the incentives of easement donors.

The opportunity to capitalize on that spread, through what might be called “donative arbitrage,” inheres in donations of all types of not-readily valued property. For two reasons, large spreads are likely to be common in the realm of conservation easement donations. First, a negative partial interest donation allows a donor to give away specific property rights to which he attaches little subjective value but that have high market value, while at the same time retaining the rights she values most. Second, the flexible nature of conservation easements allows a donor to tailor easement terms so that she can keep those use or development rights she values most. Large spreads mean that the effective cost to the donor of each donated fair market dollar’s worth of easement is extremely low.

#### A. *The Subjective-Value Spread*

In the case of not-readily valued property, as noted above, FMV will not always equal  $C_{\text{parting}}$ . The reason is that, unlike cash, the value of property is subjective.<sup>144</sup> But for this fact, sales of property would not occur. For example, June would not pay \$10,000 for a car unless that car was worth at least \$10,000 to her. The seller would not accept \$10,000 unless the car was

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<sup>143</sup> The pants were worth \$.50 to her, but the tax benefit was worth \$1.50 (\$5 of FMV \* 30% marginal tax rate). This assumes June has income against which she can apply the charitable deduction, and that she itemizes her deductions.

<sup>144</sup> See Timothy J. Muris, *Cost of Completion or Diminution in Market Value: The Relevance of Subjective Value*, 12 J. LEGAL STUD. 379 (1983).

worth \$9,999 (or less) to him. However, to say value is subjective is not to say that it is irrational. In other words, when June offers \$10,000 for the car, she does not necessarily do that because she likes the car more than the seller does. Instead, June may be able to put the car to a more profitable use than the seller can.<sup>145</sup>

Unlike a sale, a charitable contribution of property does not generate any information about the subjective value of the property to the donor. It is possible, if not highly likely, that the donor's subjective valuation of the property will differ from the appraiser's estimate of fair market value.

In some cases, the donor's subjective valuation will be greater than the fair market value estimate. This would be the case whenever the property is uniquely valuable to the donor, as when, for example, it is her long-time residence. In this scenario, if the donor were considering giving his home to charity, the ratio of  $C_{\text{parting}}/\text{FMV}$  would be greater than 1. In other words, if her home has a fair market value of \$200,000, she would be better off giving away \$200,000 cash than giving away her home.<sup>146</sup>

In other cases, the donor's subjective valuation will be less than the fair market value estimate. For example, June, the donor described above, values her pants at \$.50, while the estimated fair market value is \$5. Unlike the donor described in the preceding paragraph, June would be better off donating her property than her cash: the ratio of  $C_{\text{parting}}/\text{FMV}$  in that case would be less than 1.

This example illustrates why, in certain cases, a donor would prefer to donate property with a fair market value of \$5 rather than \$5 cash and, in other cases, she would prefer the opposite. It is also easy to see why a particular donor who owned two pieces of property with the same fair market value might prefer to donate one rather than the other. June, for example, might own two pairs of pants, each with a fair market value of \$5, but with different parting costs. For example, she might be willing to sell the pair she never wears for \$.50, but she would not accept less than \$4 for the pair she wears once a week. If she wishes to give \$5 to charity, she will donate the former pair because the costs of donating that pair are lower.

### B. *Partial Interests and Subjective Value*

In order to explain the data illustrated in Figures 1 and 2 and Table 1, it is necessary to explain why donors might usually prefer to donate one *kind* of property rather than another, that is, prefer to part with \$1 worth of conservation easement FMV rather than \$1 worth of real estate FMV. The ex-

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<sup>145</sup> For an excellent discussion of subjective value and real property see Katrina Miriam Wyman, *The Measure of Just Compensation*, 41 U.C. DAVIS L. REV. 239, 262–72 (2007).

<sup>146</sup> This is the reason why property owners, and residential property owners in particular, would believe that the compensation offered them in eminent domain cases is inadequate. See Laura H. Burney, *Just Compensation and the Condemnation of Future Interests: Empirical Evidence of the Failure of Fair Market Value*, 1989 BYU L. REV. 789 (1989).

planation is partially rooted, as Daniel Halperin suggested,<sup>147</sup> in the unique partial-interest problem created by allowing deductions for the donation of negative interests in property.

In order to understand the power of a negative interest deduction *vis-à-vis* parting cost, imagine that the tax law allowed a deduction for the charitable donation of a negative easement on any kind of real or personal property. Further imagine that the deductible value of such easements would be the net present value of the use rights given away. Under these rules, a donor could donate a negative easement that prevented her, or any other person, from using any of her property “whenever I am not using it myself.” The donor would receive a deduction for all of her property, minus some small amount to account for the time during which she would actually use it in the future. She would receive this deduction with absolutely no parting cost.<sup>148</sup>

The tax law governing conservation easement deductions is not, of course, so generous. However, the example does serve to illustrate the key point: to the extent that a conservation easement donor succeeds in aligning the restrictions contained in the easement with her desired use of the property, she can generate a very large and profitable spread between the fair market value of the easement and her parting cost.

Two different aspects of Section 170(h) allow conservation easement donors to take advantage of, and then manipulate, the subjective-value spread.

1. *Splitting the Right to Use and Enjoy*

Property consists of a “bundle of rights,” including the right to exclude, the right to alienate, and the right to use and enjoy.<sup>149</sup> These are rights, not obligations. In other words, a landowner has the option to exclude or include whomever she wants, the option to sell or give away the property, and

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<sup>147</sup> See Halperin Testimony, *supra* note 55.

<sup>148</sup> Allowing deductions for donations of negative interests is both more and less problematic than allowing deductions for donations of affirmative interests, such as rights of way. On the one hand, the donor of an affirmative easement would face potential costs coterminous with the easement holder’s actual, eventual use of the easement. A substantial amount of use might interfere with the landowner’s own use of the land subject to the right of way. On the other hand, a landowner might donate the same right of way thousands of times, thus earning deductions that might exceed the fair market value of the entire property. If these were carefully donated, for example, to charitable organizations located on the other side of the country, the donor would incur very low parting costs. The law does not permit deductions for donations of affirmative interests, such as rights of way. See, e.g., Logan v. Comm’r, 68 T.C.M. (CCH) 658 (1994); Stjernholm v. Comm’r, 58 T.C.M. (CCH) 389 (1989).

<sup>149</sup> Merrill describes the “bundle of rights” view of property as nominalism, insofar as it emphasizes the possibility that bundles may be composed of nearly unlimited combinations of rights. He distinguishes this from what he calls “multiple-variable essentialism,” which views the right to exclude, the right to alienate, and the right to use and enjoy (along with other derivative rights) as necessary elements of “property.” Thomas W. Merrill, *Property and the Right to Exclude*, 77 NEB. L. REV. 730, 736–39 (1998).

the option to use and enjoy the property in any (legal, non-nuisance) manner that she chooses.<sup>150</sup>

Few, if any, property owners actively exercise all of these rights to their full extent and on a constant basis. Something close to full advantage is taken of some rights, such as the right to dispose of one's property and the right to exclude. However, property owners will rarely exercise the right to use and enjoy to its fullest potential because it encompasses so many possibilities.<sup>151</sup>

More importantly, the very purpose of legal recognition of the right to use and enjoy property is to ensure that landowners have the right not merely to exercise the right, but to exercise it in any lawful way that they choose.<sup>152</sup> Section 170(h) provides landowners with a financial reward for exercising the right to use and enjoy their property as long as this use and enjoyment does not include extensive commercial development. In other words, the strongest effect of conservation easements may not be to limit an individual landowner's right to use and enjoy the land, but rather to endorse specific uses of the land.<sup>153</sup>

Furthermore, the economics literature is replete with studies indicating that landowners place a high value on land used in the way encouraged by conservation easement subsidies.<sup>154</sup> So-called "hedonic value" studies show that landowners are willing to pay significantly more for properties that contain relatively natural habitat and scenic amenities.<sup>155</sup> Moreover, many studies show that people are also willing to pay significant amounts in order to

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<sup>150</sup> *Id.* at 739 ("[T]he general concept of private property [is based on] the understanding that, 'in the case of each object, the individual person whose name is attached to that object is to determine how the object shall be used and by whom.'") (quoting Jeremy Waldron, *What is Private Property?*, 5 OXFORD J. LEGAL STUD. 313, 327 (1985)).

<sup>151</sup> It is easy to think of examples. June owns at least two pairs of pants, and she cannot wear each of them every waking moment. A drive down almost any residential street will reveal homes that are smaller than permitted under the zoning ordinance. The common law developed the doctrine of adverse possession, in part, to encourage property owners to make some minimal use of their property. See John G. Sprankling, *The Antiwilderness Bias in American Property Law*, 63 U. CHI. L. REV. 519, 573-74 (1996). The development of the doctrine provides some evidence that landowners have often chosen not to make any use of their property.

<sup>152</sup> See Merrill, *supra* note 149, at 739.

<sup>153</sup> Among other things, conservation easements might allow owners to protect land that they choose not to develop from adverse possession claims. Alexandra B. Klass, *Adverse Possession and Conservation: Expanding Traditional Notions of Use and Possession*, 77 U. COLO. L. REV. 283, 308-09 (2006).

<sup>154</sup> See, e.g., CHRIS T. BASTIAN ET AL., *Environmental Amenities and Agricultural Land Values: A Hedonic Model Using Geographic Information Systems Data*, 40 ECOLOGICAL ECON. 337, 346 (2002) ("[R]emote agricultural lands, which include wildlife habitat, angling opportunities and scenic vistas, command higher prices per acre than those which primarily possess agricultural production capacity."); SANCHITA SENGUPTA & DANIEL EDWARD OSGOOD, *The Value of Remoteness: A Hedonic Estimation of Ranchette Prices*, 44 ECOLOGICAL ECON. 91, 102 (2003) ("[On-parcel] [s]cenic amenities were found to have a powerful influence on ranchette values . . .").

<sup>155</sup> See Stephanie A. Snyder et al., *Influence of Purchaser Perceptions and Intentions on Price for Forest Land Parcels: A Hedonic Pricing Approach*, 14 J. FOREST ECON. 47, 62 (2008):



have on-parcel access to recreational activities such as hiking, wildlife watching, all-terrain vehicle use, and hunting.<sup>156</sup>

As demonstrated above, section 170(h) is premised on two faulty assumptions: that the right to use and enjoy property in these ways is valueless, and that the right to use and enjoy property for extensive use or development is objectively the most important kind of right to use and enjoy.<sup>157</sup>

This is yet another way to view the “partial interest problem” created by deductions for conservation easement donations. These deductions allow landowners to donate restrictions on only part of their right to use and enjoy. The problem is that the program is most appealing to those taxpayers who value the right to use and enjoy their property in relatively undeveloped form, and least appealing to those who prefer to use and enjoy for more intensive, commercial development.<sup>158</sup> As an official from The Nature Conservancy (“TNC”) explained in a 1999 interview:

[L]andowners understand what they are trying to accomplish by placing their land under a conservation easement; most landowners have no intention of developing their property . . . the conservation easement program sells itself; landowners come to TNC to donate easements.<sup>159</sup>

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The variable describing the buyer’s intention to build either a primary or secondary home on the parcel proved to have a very large, positive influence over sale price per hectare. Buyers paid 41% more per hectare on average if they had plans to build a residence on the parcel over those who had other intended purposes or uses, a premium of \$988/ha. Those purchasers who responded that their primary reason for purchase was to own a place in which to enjoy wildlife paid a premium of \$631/ha. The positive influence of the wildlife variable might be indicative of the purchasers’ desire for hunting or bird watching on the parcel and reflective of the premium they are willing to pay to enjoy such recreational opportunities on private land.

In this study, purchasers’ intentions to subdivide, sell, or harvest timber from the property may not have been significant factors in their willingness to pay for land. *Id.* at 70; *see also*, Cynthia J. Nickerson & Lori Lynch, *The Effect of Farmland Preservation Programs on Farmland Prices*, 83 AM. J. AGRIC. ECON. 341, 341–42 (2001) (finding conservation easement restrictions did not significantly affect land prices, perhaps because “land buyers may buy preserved farm parcels as hobby farms . . . because they receive non-market values (unconnected to agriculture) from owning land in an agricultural area that is more likely to retain its rural character and open space.”); Echeverria, *supra* note 40, at 35 (referring to anecdotal evidence that conservation easements do not necessarily adversely affect land values).

<sup>156</sup> *See, e.g.*, John S. Baen, *The Growing Importance and Value Implications of Recreational Hunting Leases to Agricultural Land Investors*, 14 J. REAL ESTATE RESEARCH 399, 400 (1997) (“The widespread use of hunting leases in the South and southwestern U.S. is perhaps the best measure of the growth and ‘market value’ of recreational leases . . . . In Texas, ‘hunting lease’ income often far exceeds agricultural income and therefore ‘recreational’ use becomes by definition the highest and best use of the land . . . .”); Jason Henderson & Sean Moore, *The Capitalization of Wildlife Recreation Income into Farmland Values*, 38 J. AGRIC. & APPLIED ECON. 597 (2006).

<sup>157</sup> Ironically, the easement subsidy program may thus provide further evidence for what Sprankling called the “anti-wilderness bias in American property law.” Sprankling, *supra* note 151.

<sup>158</sup> *See* STAFF OF THE JOINT COMM. ON TAXATION, *supra* note 40, at 284.

<sup>159</sup> Morrisette, *supra* note 11, at 413.

To a landowner who prefers to use and enjoy her property in relatively undeveloped form, the parting cost of making a charitable donation of restrictions on development will be very low. Certainly, it will be much lower than the cost of parting with the property in its entirety, which would entail losing the rights she values most.

One might argue that landowners who donated conservation easements were in the process of changing their desires; perhaps they previously preferred to use and enjoy their property in undeveloped form but were on the verge of deciding to use it for intensive commercial development. This is not the case. First, landowners agree to at least some easements that do not allow any new post-easement uses.<sup>160</sup> Second, easement donors give away easements with values strikingly inconsistent with the values of other kinds of property with which donors of similar income are willing to part.<sup>161</sup> Thus, conservation easement donors act as if they are giving away something that is of low value to them.

It is true that even a landowner whose interests align completely with easement restrictions will pay a cost in the form of the lost option to change her mind in the future. However, the true cost of the loss of this option will vary, depending on the landowner and the discount rate she applies. This cost may also be offset by the value of the right to prevent others from developing the property in the future. Moreover, as discussed below, the donor is not required to fully relinquish her right to change her mind in the future. A landowner can temper her risk by preserving the right to change her mind through easement terms that allow new, future uses. If, for example, she falls on hard times and needs to squeeze some additional value out of the property, the easement might allow her to do this. Furthermore, it may well be that landowners substantially discount this risk through their, perhaps mistaken, belief that the easement restrictions can later be removed.<sup>162</sup>

Finally, assuming perfect information were available, one could make a good argument that a landowner should not deduct the value of the easement until she actually does change her mind, because it is only then that she has made a gift to charity.<sup>163</sup>

## 2. *Ratcheting Up the Spread*

In addition to allowing landowners to obtain donations for giving up rights they do not plan to use and enjoy, Section 170(h) provides a mecha-

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<sup>160</sup> The "exclusively for conservation purposes" regulations would permit new post-easement uses in nearly every case. See *supra* text accompanying notes 84-95.

<sup>161</sup> See *supra* Figure 2.

<sup>162</sup> See Nickerson & Lynch, *supra* note 155.

<sup>163</sup> Cf. *Bennett v. Comm'r of Internal Revenue*, 1991 Tax Ct. Memo LEXIS 651, \*18 (1991) ("Therefore, since petitioner failed in 1982 to execute a valid deed of gift or to effect real delivery of the piano to the college and continued to possess, use, and enjoy it until 1985, no gift of the piano to the college occurred in 1982.").

nism for landowners to minimize parting costs by retaining those future development rights with the highest marginal subjective value.

Recall that the “exclusively for conservation purposes” regulations allow the donor and the land trust to lift restrictions on some amount of new and inconsistent post-easement uses.<sup>164</sup> These regulations permit the landowner to take the most subjectively valuable components of her development rights out of the donated bundle. Thus, for example, a donor might retain the future right to build additional residences for family members, build additional commercial buildings, or engage in a limited amount of residential development.<sup>165</sup> The extent to which a landowner can retain such options is limited only by the conservation purposes envelope described above.<sup>166</sup> As long as the property provides the public benefits specific to the applicable conservation purpose, the “exclusively for conservation purposes” regulations allow incursions into that purpose.<sup>167</sup>

It is true that if the “after” estimate accurately accounts for the fair market value of the post-easement uses permitted by the terms of the easement, then the landowner will have to pay for them. Each fair market value dollar of permitted post-easement use should reduce the fair market value of the easement by one dollar, thus reducing the amount of the available deduction.

Even though the landowner will have to pay for the retained rights, this may still prove to be a very good deal for the landowner. First, the landowner will only pay an amount equal to the product of the retained rights and her marginal rate for the fair market value of those rights.<sup>168</sup> More important, if a taxpayer can cherry-pick rights to retain, she will choose those with the highest subjective marginal value.<sup>169</sup> In other words, she will sort the rights most valuable to her into the “keep” basket and put the rest into the “donate” bin.

To be clear, this does not mean that the donated use rights do not have value to another person, or that the easement does not provide conservation value. What it means is that the donor can donate many fair market value dollars of property at a very low parting cost.

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<sup>164</sup> See *supra* text accompanying notes 82-92.

<sup>165</sup> See *supra* text accompanying notes 27-28.

<sup>166</sup> See *supra* text accompanying notes 89-92.

<sup>167</sup> *Id.*

<sup>168</sup> For example, increasing the “after” value of the property from \$1 to \$2 will reduce the fair market value of the easement by \$1, and will thus reduce the amount of tax benefit by the product of \$1 and the taxpayer’s marginal rate.

<sup>169</sup> The landowner’s subjective valuation of possible future uses will vary. She might, for example, care more about retaining the ability to build an extra home for her daughter than the right to build a second barn, even where each added the same amount of fair market value to the property.

### C. Why It Matters

As seen in the example of June and her jeans,<sup>170</sup> large subjective-value spreads create not only opportunities for donors, but also inefficiencies for the government in its efforts to acquire property that provides public benefits. In the case of \$5 jeans with a \$.50 parting cost, the amount of inefficiency (\$1) is relatively insignificant. In the case of \$500,000 easements, on the other hand, the inefficiencies are potentially very significant.

Of course, we cannot know easement donors' parting costs in the absence of a transaction. However, if we assume that real generosity (the willingness to accept parting costs in exchange for the benefits associated with charitable giving) is relatively constant across income groups, we can see from looking at Figure 2 that easement values far exceed the norm. Using the \$500,000 to \$1,000,000 AGI group as an example, and taking donated real estate values as the most conservative estimate of real generosity, the inefficiencies associated with *each* donation would be in the range of several hundred thousand dollars.

Overpaying for the public benefits created by conservation easements reduces the amount that could be used to meet other conservation needs. The total annual federal tax expenditure for conservation easements is in the neighborhood of \$590 million.<sup>171</sup> In comparison, direct federal spending for

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<sup>170</sup> See the introduction to Part IV *supra* for an introduction to this example.

<sup>171</sup> The IRS's data show that the total value of donated easements in 2003, 2004, 2005, and 2006 was \$1.49 billion, \$1.45 billion, \$2.1 billion, and \$1.75 billion, respectively. IRS 2006, *supra* note 1, at 59; IRS 2007, *supra* note 1, at 78; IRS 2008, *supra* note 1, at 69; IRS 2009, *supra* note 1, at 69. Multiplying the value of easement donations by a tax rate of 35 percent, tax expenditures for easement subsidies over the four-year period averaged about \$590 million annually since the marginal tax rates for the years in question range between 28 percent and 39.6 percent. 26 U.S.C. § 1(a). The 35 percent figure I use in estimating expenditures reflects an average of the 31 percent rate for income between \$89,150 and \$140,000 and the 39.6 percent rate for income over \$250,000. *Id.* This approach to estimating tax expenditures has been used before. See Korngold, *supra* note 23, at 1057.

It should be noted that, while a taxpayer reports the full value of the donated property in the year the property is donated, the tax benefit may accrue over a multi-year period due to annual limitations on the extent to which the deduction may be used against income. See 26 U.S.C. § 170(b)(1)(E) (2006). Because taxpayers may only carry deductions related to the contribution of conservation easements forward for 15 years, § 170(b)(1)(E)(ii), some of the benefit may never be realized. The extent to which deductions were actually carried forward beyond a given year would reduce the expenditure cost for that year due to the fact that the cost of related deductions in future years would be subject to discounting.

On the other hand, because of the rapid increase in easement donation levels, my estimate may well understate the present level of tax expenditures. The number of acres in the United States that are encumbered by non-historic preservation conservation easements doubled between 2000 and 2003. McLaughlin, *supra* note 16, at 49 (noting that number of acres encumbered, according to data collected by the Land Trust Alliance, rose from 2.5 million to 5 million between 2000 and 2003). The most recent data from the Land Trust Alliance show that 6.2 million acres were encumbered in 2005. LAND TRUST ALLIANCE, 2005 NATIONAL LAND TRUST CENSUS REPORT 5 (2006), available at <http://www.landtrustalliance.org/land-trusts/land-trust-census/2005-report.pdf>. The Land Trust Alliance data do not include easements donated to "national land trusts, such as The Nature Conservancy . . ." McLaughlin, *supra* note 16, at 51.

the acquisition of wildlife habitat through easement or fee purchase is only about \$680 million.<sup>172</sup> At the same time, conservation biologists estimate that an effective federal habitat acquisition program would require many additional billions of dollars annually.<sup>173</sup> Every tax dollar counts, especially when spending is currently far short of what is needed.

Perhaps even more important than the overall inefficiency of easement donations, the fact that parting costs undoubtedly vary among potential easement donors leads to a troubling conclusion.<sup>174</sup> Assume that June owns two pair of pants with a fair market value of \$5, and that one pair is worth \$.25 to her and the other pair is worth \$.50 to her. If the value of the tax benefit generated by donating \$5 of fair market value is \$1.50, June will have more incentive to donate the pants that are less valuable to her because she will net \$1.25 instead of \$1. The same would be true if June owned one pair and her sister May owned the other: whoever valued her jeans less would have the greater incentive to donate.

Thus, in the conservation easement context, landowners who most prefer to keep their land in its current condition (and who would thus give up very little in agreeing to land-use restrictions) will be the most likely to donate conservation easements. Because similar restrictions would be expensive to them, landowners who are most interested in developing their property will be the least likely to donate. This is the opposite of an optimal easement subsidy program, which would provide the greatest incentive to the owner who was most likely to reduce the conservation value of her property in the future.

#### V. IMPROVING THE EFFICIENCY OF GOVERNMENT SUBSIDIES FOR CONSERVATION EASEMENTS

Due to the overall shortage of funds available for conservation, it is worth thinking about some ways in which the subsidy program might be restructured to obtain more conservation for less money. There are two possible approaches, each of which carries some risk.

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<sup>172</sup> Jeff Lerner et al., *What's in Noah's Wallet? Land Conservation Spending in the United States*, 57 *BIOSCIENCE* 419 (2007). In this study, Lerner et al. estimate total federal spending on land conservation programs over a ten-year period, 1992 to 2001. The study covered 24 separate federal programs, split into four types: purchase of fee title interests, purchase of conservation easements, "rental" programs (year-to-year subsidy programs, such as the Conservation Reserve Program), and cost share programs, through which the federal government splits the cost of land conservation with a state. In the ten years covered by the study, the federal government spent a total of \$22.6 billion, or about \$2.2 billion per year, through these 24 programs. Ignoring year-to-year habitat "leases," federal spending for permanent acquisitions totaled about \$6.8 billion over ten years, or about \$680 million each year.

<sup>173</sup> See Mark L. Shaffer et al., *Noah's Options: Initial Cost Estimates of a National System of Habitat Conservation Areas in the United States*, 52 *BIOSCIENCE* 439, 441-2 (2002).

<sup>174</sup> I will assume, probably erroneously, that the value of the unique non-tax benefits attached to donating easements is constant across all easement donors. This assumption does not affect the analysis of the effects of variable parting costs on donor incentives. If the non-tax benefits varied in value, then this variation would have similar effects on those incentives.

The first approach is to require that the acquisition of conservation easements be conducted in the form of an actual transaction. The source of the current problem, from the perspective of the public treasury, is that Section 170(h) allows a landowner to unilaterally condemn her development rights, thereby fixing their value at the appraiser's "willing buyer, willing seller" estimate.<sup>175</sup> If there were an actual buyer involved, she would be able to negotiate a price somewhere between the conservation value of the easement and the landowner's parting cost. If she were a good negotiator, she would be able to pay just slightly more than the landowner's parting cost.

A second approach would be to convert conservation easements into a marketable form of property, that is, a commodity that could be bought *and* sold. Under this approach, land restrictions could still be donated, but once donated, the donee would be free to re-sell them to a party interested in either protecting or developing the property.<sup>176</sup>

#### A. *The Joint Committee on Taxation's Proposals*

Before discussing these two proposals, it is worth assessing two relevant proposals made by the Joint Committee on Taxation in 2005.<sup>177</sup> The committee recommended that Congress eliminate the "charitable contribu-

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<sup>175</sup> As mentioned above at note 146, the overpayment problem created by subjective-value spread can be seen as an upside-down eminent domain problem, or perhaps, "*Kelo's Revenge*." Government's use of the eminent domain power can be controversial because it captures the surplus between the fair market value of the condemned property and the landowner's subjective valuation. See Nicole Stelle Garnett, *The Neglected Political Economy of Eminent Domain*, 105 MICH. L. REV. 101, 104 (2006) ("The possibility that property owners may be undercompensated in the eminent domain process is frequently cited in the literature discussing the public use problem."). One rationale for the use of fair market value as the measure of compensation in eminent domain cases is that it prevents the landowner from exploiting bilateral monopoly scenarios, e.g., where the landowner owns the last parcel needed to complete a railroad. *Id.* at 107. In the case of conservation easement donations, on the other hand, it is the landowner who has the power to decide when condemning some amount of her development rights, for FMV\*MR, is in *her* best interests.

<sup>176</sup> Another theoretically possible, but practically difficult, means of reducing overpayment would be for the IRS to deny deductions in cases where the subjective-value spread was too great. In *McLennan v. United States*, 994 F.2d 839 (Fed. Cir. 1993), the IRS had denied the McLennans' deduction for a donated conservation easement; the McLennans paid the resulting tax and sued for a refund. At trial, the IRS argued that the McLennans lacked the requisite donative intent because, in crafting the terms of the easement, they were "motivated to maintain their property values and also obtain a tax deduction . . ." *Id.* at 840-41. (Donative intent is a required element of any deductible charitable donation. *Miller v. IRS*, 829 F.2d 500, 502 (4th Cir. 1987), *cert. denied*, 490 U.S. 1113 (1989).) In other words, the IRS argued that the McLennans did not part with subjective value, pointing to provisions in the donated easement that gave the landowners:

1. the right to subdivide the easement property into eight parcels;
2. an unrestricted right to build four new family residences and roads to these residences;
3. the right to cut timber to accommodate the residential structures; and
4. the right to farm portions of the property.

*McLennan v. United States*, 24 Cl. Ct. 102, 104 (1991).

Neither this argument nor the government prevailed.

<sup>177</sup> See STAFF OF THE JOINT COMMITTEE ON TAXATION, *supra* note 40, at 277-87.

tion deduction[ ] for a contribution of a façade easement . . . that recently has been or is being used, or is reasonably expected to be used, by the donor or a family member as a personal residence (principal or otherwise),” and for other conservation easements, “if the donor (or a family member of the donor) has a right to use all or a portion of the real property as a personal residence (principal or otherwise) at any time after the contribution.”<sup>178</sup> The committee also recommended that, in order “[t]o address the valuation concern,” the deduction for all contributions should be limited to 33 percent of the fair market value of the donated easement.<sup>179</sup>

The “no personal residence property” proposal represents an attempt to get at the problems created by the subjective-value spread. The underlying idea is that a donor is less likely to be inclined to exercise her development rights with regard to property on which she resides.<sup>180</sup> In other words, her parting costs are likely to be quite low.

The “33 percent limit” proposal is a rougher cut at the same issue. The underlying idea here seems to be that donors appear to be overly willing to part with fair market value, and thus there must be a problem somewhere in the system. If Congress were to reduce the amount of the available deduction, then the financial impact of large spreads (and overvaluation) would be reduced.<sup>181</sup>

Each of these proposals fails to adequately address the problem of subjective-value spread, and the latter might exacerbate some of the incentive problems that plague the current regime. The “no personal residence property” proposal is both over- and under-inclusive. It is over-inclusive because some owners of residence property may actually be inclined to develop that property in the near future. It is under-inclusive because owners of non-residence property may desire and intend to keep the property in its undeveloped condition for uses such as recreation, hunting, or mitigation banking. The “33 percent of FMV” proposal would reduce the amount of

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<sup>178</sup> *Id.* at 282–83.

<sup>179</sup> *Id.* at 285–86.

<sup>180</sup> The staff’s report argues that:

Whenever possible, tax incentives should be targeted to those persons who are most likely to modify their behavior in substantial part because of the provision of the tax benefit. Otherwise, providing such benefits constitutes a windfall rather than an incentive. The present charitable deduction regime for qualified conservation contributions provides a windfall to those taxpayers who grant an easement or other restriction to a qualified organization if the activity or use restricted by the easement or restriction likely would never occur. For example, a person who purchases a residence in a historic district that has homes that were designed and constructed in a particular period and with a particular architectural style generally does not acquire the home with the intention of altering the exterior of the building in a manner that would be inconsistent with the neighboring structures. Similarly, a person who acquires real property located by a nature preserve often is attracted to the area because of the preserve, and in such cases would not alter or use the acquired property for a purpose that would impede or contravene such preservation efforts.

*Id.* at 284.

<sup>181</sup> *Id.* at 285–87.

overpayment in cases where parting costs were low. On the other hand, it would reduce the incentives for landowners who desire to develop to donate. Moreover, it would mean that only those donors with extraordinarily low parting costs, that is, landowners least likely to develop, would be inclined to make donations.

*B. Creating Actual Buyer-Seller Transactions Using Cash Donations, Government Grants, or Government Purchases*

A more effective proposal, first made by the Department of Treasury over 20 years ago,<sup>182</sup> would be to eliminate the deduction for the donation of conservation easements and to replace it with subsidies or grants for the direct purchase of those easements.<sup>183</sup>

Under one approach, land trusts would rely on tax-deductible cash donations from donors to fund the purchase of easements from landowners.<sup>184</sup> A second approach, which could be used in conjunction with the first, would be for Congress to establish a grant-making institution that would make grants to land trusts to be used for the purchase of easements. Congress could fund this institution with an amount equivalent to the tax expenditures saved by eliminating the deduction for easement donations. A third approach would be to use those same appropriations to add to funds used by federal agencies to purchase easements from landowners.<sup>185</sup>

By inserting a buyer into the easement acquisition transaction, each of these approaches would help reduce the extent to which the public overpays for easements. The use of a buyer would result in a price more reflective of the landowner's true parting cost. If, for example, the landowner truly had no desire to develop, a buyer should be able to purchase the easement for relatively low cost. Overall, inserting a buyer should enable the public to acquire more easements for the \$590 million that is now being spent through foregone tax revenues.<sup>186</sup>

There are some potential risks involved in moving to this approach. If the first model were adopted, it is possible that land trusts would have difficulty raising necessary funds from private donors. The primary risk in using

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<sup>182</sup> DEP'T OF THE TREASURY, *supra* note 40.

<sup>183</sup> Even if the law were altered to prohibit donations of conservation easements, landowners would still be free to donate their entire fee interest in the property, subject to a restriction preventing alteration. As a donation of an entire interest in property, this would not raise the same problems as donations of partial interests, such as conservation easements. Fee donations would result in at least the same amount of conservation value to the public and a greater tax benefit to the donor, but fewer private benefits to the landowner.

<sup>184</sup> Cash donations to qualified non-profits are deductible. 26 U.S.C. § 170 (2006).

<sup>185</sup> For a description of the many existing federal land and easement purchase programs, see Lerner et al., *supra* note 172. It would be possible to provide landowners who sold easements under any of these models with what would perhaps be more efficient tax benefits: Congress could exempt the sale of easements from federal tax, or it could allow the landowner's entire basis in the property to be applied in determining the amount of the gain from the sale. A full analysis of the impacts of such measures is beyond the scope of this paper.

<sup>186</sup> See *supra* note 169 and accompanying text.



the second two models, which depend upon Congressional appropriations, is that Congress would not actually appropriate the funds. Forcing land trusts to rely either on private donations or government grants would insert significant financial unpredictability into the easement acquisition process.<sup>187</sup>

In addition to these risks, it is possible that both the grant-driven and direct government purchase model would add new transaction costs to the process, thereby reducing the amount of money available for easement acquisition. Land trusts would be required to devote resources to grant applications, and the grant-making institution would have to create a system for processing them.

On the other hand, as Professor Korngold has noted, these approaches might add benefits insofar as they move subsidized easement acquisition toward a more coordinated model.<sup>188</sup> Rather than accepting easements on an ad hoc basis, land trusts or the government could focus on acquiring easements in a particular area or meant to protect specific kinds of habitat.<sup>189</sup>

Moreover, the insertion of a buyer would also address what might be called the “public-benefit problem.” The “before and after” valuation method estimates the value of lost development rights; this estimate sets the amount of the tax expenditure. 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.<sup>190</sup> A piece of land could have high conservation value and low development value or, in the alternative, it could possess low conservation value and high development value. Unfortunately for the taxpayers, they will forego a substantial amount of tax revenue in protecting the latter parcel. The insertion of a buyer should address this problem.<sup>191</sup> Assuming that land trust buyers are both knowledgeable about and interested in conservation, the amount they would be willing to pay for a particular easement should be based on the extent to which it provides conservation benefits.<sup>192</sup>

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<sup>187</sup> See, e.g., Robert L. Glicksman & George Cameron Coggins, *Federal Recreational Land Policy: The Rise and Decline of the Land and Water Conservation Fund*, 9 COLUM. J. ENVTL. L. 125, 162–172 (1983–1984) (noting that, while Congress has appropriated funds for land acquisition on a fairly consistent basis, the Department of Interior has not consistently used them for that purpose).

<sup>188</sup> See Korngold, *supra* note 23, at 1059–60, 1068–70.

<sup>189</sup> *Id.*

<sup>190</sup> One could argue that the conservation value and development value are correlated because high development value would indicate an impending threat to the conservation value of the land. But this would only be true where the property actually had some conservation value.

<sup>191</sup> The insertion of a buyer would also address overpayments related to, for example, unique non-tax benefits that the donor would obtain through donation. To the extent that the donor believes he will receive some community recognition from creating the easement, it would reduce the amount he was willing to accept for parting with it.

<sup>192</sup> Of course, the landowner’s starting point in negotiations would be the value of the development rights. However, given that this value may be speculative in many cases, a savvy buyer should be able to capture some of the difference between the conservation value and the development value of the property.

### C. Converting Conservation Easements to Development Rights

A third, perhaps more radical, proposal would entail the conversion of what are now called conservation easements into another form of property known as “development rights.” Under this approach, as under the current system, a landowner could donate his development rights to a land trust and take a deduction equal to their fair market value. In addition to donating the development rights, the landowner would be required to donate an option to purchase the underlying land for the “after” value used in the appraisal of the development rights.<sup>193</sup> After the donation, the land trust would be free — as other charitable recipients of donated property currently are — to exercise the option, combine the underlying land with the development rights it holds,<sup>194</sup> and then sell the fee interest to a willing buyer. Land trusts would be required to use the proceeds from those sales to fund the purchase of other easements. In the alternative, a land trust could opt to hold the development rights forever.

From the taxpayers’ perspective, one benefit of this system would be that donated development rights would be cash equivalent in the hands of conservation organizations. In other words, a land trust could maximize the value of the easements it held. It could sell development rights on parcels of low conservation value to fund the purchase of those on land with high conservation value. A second, more important, benefit is that this approach would eliminate the donation of notional gifts. Any donor who donated her development rights would have to do so with the knowledge that her property might ultimately be developed. In other words, she would have to be certain that she wanted to make such a generous gift to a conservation organization.<sup>195</sup>

One potential argument against using this approach is that it might require significant changes in both state and federal law. However, the needed changes would not be overwhelming. It is true that states do not currently recognize development rights as an interest in real property.<sup>196</sup> But the development rights described above are nearly identical to state law conservation easements. They would not be sold on the open market, and in fact would not be sold at all. A land trust interested in converting them to cash would simply exercise the option on the underlying land; after closing that transaction, the doctrine of merger would unite the development rights and the underlying land in a fee simple.<sup>197</sup>

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<sup>193</sup> The inclusion of the donated option would create an additional incentive for accurate valuation of the development rights: landowners would want to be certain that, if they were ultimately required to sell the underlying land, they would receive a fair price for it.

<sup>194</sup> See *infra* text accompanying note 196.

<sup>195</sup> For more on options and their use in encouraging the accurate assessment of property values see generally Lee Anne Fennell, *Revealing Options*, 118 HARV. L. REV. 1399 (2005).

<sup>196</sup> Some jurisdictions have integrated tradeable development rights into zoning systems. See, e.g., *Penn Central Transp. Co. v. City of New York*, 438 U.S. 104, 137 (1978).

<sup>197</sup> SINGER, *supra* note 13, at 226–27.

It is true that Congress would have to make one change to the tax law in order for these easement transactions to occur. The law would have to require that donations of development rights be accompanied by the donation of a permanent option to purchase the underlying land.<sup>198</sup>

Another likely objection to this proposal is that it would discourage participation in the Section 170(h) program. Like other property donors, landowners would be faced with the prospect that they would actually have to part with rights they wish to enjoy as well as those they do not. In addition, landowners would feel as though this result would be inconsistent with their desire to preserve their land.

Neither of these concerns is compelling. First, the point of the development rights system is to ensure that the donor's parting costs are linked to the fair market value of the donated property. The system would do this by making that property available for sale, albeit indirectly, to a real market actor. Second, while it is true that the donor's land might ultimately be developed, the donation would contribute to the charitable cause chosen by the donor — conservation. In fact, if land trusts were to act rationally in buying and selling development rights, the original donation would be used in its most efficient form, that is, either as a tool for land conservation or as cash.

## VI. CONCLUSION

Data on the average value of donated conservation easements reveal that donors are, on the surface, exceptionally generous in making gifts of easements. The only plausible explanation for these data is that donors' incentive to donate is strongly linked to their subjective valuation of the costs of donating. Donating a dollar's worth of easement is a much better deal than donating a dollar.

While it may be true that the public receives a benefit from easement donations, it also appears true that donors could be persuaded to donate for a much lower amount of tax benefit. In the absence of a market transaction, there will never be accurate information on the price that the public ought to be paying. Overpaying for easements wastes public dollars that could otherwise be used for additional conservation.

While the exact amount of overpayment is unknown, there is no debating the fact that allowing deductions for easement donations provides inverse incentives to landowners. As between a landowner who is interested in developing his property and one who is not, the latter has a greater incentive to donate because his parting costs will be lower. Many years down the road, it may turn out that, when he made the donation, the donor underestimated the likelihood that he would later be interested in developing. In such

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<sup>198</sup> Options are subject to the Rule against Perpetuities. *See, e.g.*, *Symphony Space, Inc. v. Pergola Props., Inc.*, 669 N.E.2d 799 (N.Y. 1996). It is unclear whether an option held by a charity would constitute a violation. If so, then a change in state law might be required.

cases, it is possible that the public will have made a good deal despite initially overpaying for the easement. However, the possibility that landowners will make such mistakes neither represents good policy nor is enough to justify the entire Section 170(h) program.