January 29, 2014

To: Representative Lippert and Members of the House Judiciary Committee

From: Jeanie McIntyre, President, Upper Valley Land Trust

My comments today focus on the impact of the proposed legislation on one very common type of conservation easement – easements that are donated to land trusts. Most, but not all, of these gifts receive favorable treatment under federal tax law. The impact of the tax incentive is very important. According to the national Land Trust Alliance, hundreds of thousands of acres have been conserved by donation, due to the effectiveness of the federal tax provisions.

1. Legal Issues

Prior testimony has suggested that there is no current legal framework that governs the amendment of conservation easements and that legislation is required to provide a stable process and secure public confidence. In fact, there are applicable legal regimes, and the proposed legislation could weaken some protections for donors that exist presently. This could have a profound effect on land conservation in Vermont.

a. Common law

Since there are no statutes in Vermont that specifically address amendments of conservation easements, principles of common law apply. Common law judge-made doctrines develop gradually over time because of the principle of *stare decisis,* a legal principle by which judges are obliged to respect the precedent established by prior decisions. Common law pertaining to modification and termination of conservation "servitudes" is codified by the American Law Institute in Restatement (Third) of Property (Servitudes) Chapter 7, Section 7.11.

Land trusts make representations to donors about the way they will use and maintain conservation easement gifts. For instance, see the representations made by land trusts working in Vermont. (Attachment A, Part 1) A reasonable reader could conclude that the execution of a conservation easement deed involves a permanent commitment from the land trust to uphold the restrictions on a specific piece of property.

Many gift planning advisers and attorneys believe that a conservation easement is a "gift instrument" in which a donor conveys a real property interest and a land trust promises to uphold the restrictions set forth therein. Most conservation easement deeds contain "acceptance" language which ties together the Donor's intention and the Donee's reasons for accepting the gift. (Attachment A, Part 2 contains two examples.)

The Vermont Attorney General's office has confirmed that this legislation is intended to override common law. It will therefore replace protections for donors and their heirs (post mortem easements) that exist today. The law will constrain judicial avenues that donors have to pursue claims of fraud or abuse of trust. The specific differences are detailed in Attachment B.

The changes could have a serious and chilling impact on donor confidence because landowners who donate conservation easements with the express intent of conveying a restricted gift to protect a specific property would not be protected in the same manner as the donors of other types of restricted gifts.

b. Federal Tax Law

Although I have never worked with a landowner who did not expect my organization to uphold the terms of our contract and protect his or her property in perpetuity, I assume there may be some

donors who give their property interests to the Vermont Land Trust in the full faith that these may be swapped or released in the service of larger conservation objectives. If this legislation is enacted, such amendments could become more common. The problem is that under current law, donated easements that can be released in that way are not eligible to be claimed as charitable gifts for federal income taxes.

Generally, taxpayers are not permitted to claim deductions of "partial interest" gifts of property. An exception was created for conservation easements, and there are detailed rules and guidance about the specific requirements that must be met. To qualify, the easement must protect at least one of four conservation purposes and the conservation purpose(s) must be protected in perpetuity.

In order to determine whether a particular easement gift is eligible for a tax claim, the IRS reviews and relies on the wording of the easement itself. Therefore it is important that the wording the IRS relies on cannot be changed, and that the parties are bound to it. The particular language that is of interest relates to extinguishment and termination. The easement deed must be perpetual. The limited exceptions are:

i. If changed circumstances make the continued use of the property for conservation purposes impractical or impossible; then
ii. Termination or partial extinguishment of the conservation easement is permissible via a judicial proceeding; and
iii. The land trust must receive fair compensation for the value of its real property interest which has been terminated or extinguished.

A number of court cases further illuminate the easement terms necessary to meet the federal requirements. In the past several months there have been several court rulings that are relevant:

Mitchell v. Commissioner Revisited – 170(h) Requires Perpetuation of Conservation Easement Itself, Not Just Conservation Purposes
http://lawprofessors.typepad.com/nonprofit/2013/08/mitchell-v-commissioner-revisited-170h-requires-perpetuation-of-conservation-easement-itself-not-jus.html

Carpenter v. Commissioner Revisited: Federally-Deductible Conservation Easements Must be Extinguishable Only in a Judicial Proceeding
http://lawprofessors.typepad.com/nonprofit/2013/07/carpenter-v-commissioner-revisited-federally-deductible-conservation-easements-must-be-extinguishabl.html

Belk v. Commissioner - Tax Court Reaffirms its Holding that "Floating" Conservation Easements Are Not Deductible
http://lawprofessors.typepad.com/nonprofit/2013/06/belk-v-commissioner-tax-court-reaffirms-its-holding-that-floating-conservation-easements-are-not-ded.html

Belk v. Commissioner - "Floating" Conservation Easements Are Not Deductible
http://lawprofessors.typepad.com/nonprofit/2013/01/more-on-conservation-easements-and-perpetuity.html

The IRS has clarified in information letter GENIN 131378-2 that the presence of a state-adopted process for easement amendments does not relieve the taxpayer of the obligation to satisfy federal requirements. Specifically, the IRS letter states that the requirements outlined above must be met. (Attachment C.)

2. Remedies

a. Clarifying donor intent

We understand that the Vermont Attorney General's Office is hesitant to make determinations about whether a conservation easement is a restricted gift, and land trusts have not necessarily maintained the records that would enable this. However, going forward, the legislation could require that the easement identify itself as either "a restricted gift" or an unrestricted gift (some attorney's distinguish this as a "gift of restrictions.") Memorializing and recording the expectations of the parties within the deed will enable easy future reference. The legislation should clarify that the obligations of land trusts that accept "restricted gifts" of conservation easements are subject to the same existing legal framework as other restricted gifts.

b. Retroactivity

In the absence of a major problem or misdeed, it is quite unusual for a state law to interfere with previously established provisions of private contracts. In this instance, if the legislation reduces the protections for easement donors as outlined above, some donors would have made significant gifts, at great personal sacrifice, only to find out later that the "rules of the game" are no longer what they had thought. Unless the legislation includes allowance for these donors and their families to assert their intentions and a requirement that those be respected, the legislation should apply only to gifts made after the bill becomes law.

c. Ambiguity with federal tax law.

The Internal Revenue Code provides for four specific types of conservation values which, when protected in a conservation easement deed conveyed to a qualified holder, give rise to a qualifying charitable gift. There are any number of other public values which fall outside the scope of the Internal Revenue Code; however these do not justify gift claims for conservation easements. A state law that conflates "public conservation interest" with the IRS-defined "conservation purpose" and allows modification or release of easement terms without reference to and protection of the specific IRS-required elements that qualified and created the gift, could prove problematic for land trusts and donors.

Some IRS required provisions in an easement may be neither more or less stringent than State law, simply different[1]. The current wording in the proposed bill raises questions as to whether the definite language in a conservation easement will continue to be controlling in Vermont. Whether the specific easement language is considered to be a "criteria," a "condition" or a "requirement" or if it is "more stringent" or "more restrictive" than the state law should not matter, but the easement provisions must be followed.

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[1] For example:

- The IRS has very specific requirements for the calculation of proceeds resulting from the extinguishment of a conservation easement that is subject of a federal tax deduction. S.119 defines "adequate compensation" differently than the federal rule for such proceeds.
- The IRS states that extinguishment of a conservation easement that is the subject of a tax deduction may occur through a judicial proceeding in very narrow circumstances when "unexpected change in the conditions surrounding the property…can make it impossible or impractical the continued use of the property for conservation purposes." S.119 identifies a broader range of considerations and criteria that might warrant extinguishment of an easement.

We have previously asked that this legislation be revised to ensure that amendments for which judicial proceedings are required by the specific terms of the easement be added to the list of those exempt from this legislation to ensure those federally-required elements stay in place and are not frustrated. Our attorney has advised us that this would be the most straightforward way of resolving the potential confusion.

3. Administrative Oversight
S. 119 creates a role for the State in the administrative oversight of private conservation transactions. It's appropriate for the State to establish standards for the State agencies that hold conservation easements, but the precedent of replacing judicial with administrative oversight of private transactions should be considered carefully. Attorneys familiar with the evolution of Vermont's land use statutes have cautioned that this type of change is likely to be revisited and could open the door to expanded State involvement. Having established that the State has an interest in the administration of contracts and charitable conveyances to which it is otherwise not a party, subsequent legislative intervention could easily follow and could compromise the independence of private land conservation groups and their credibility with landowners.

4. Changes in Federal Law
I believe that most donors do not want or intend that the easements they grant should be swapped or released and most land trusts do not wish to do this either. I checked with Jeff Pidot, formerly of the Maine Attorney General's Office, to confirm Darby Bradley's testimony that not a single significant amendment had occurred in Maine since the passage of that state's legislation. His explanation: "the vast majority of land trusts in Maine, and certainly all those I've spoken to, do not have an interest in amending easements in (that) way…. It is only amendments that reduce conservation values of their protected lands that require court approval under our law. In my survey, land trusts reported that they like the law precisely because it deters landowners from trying to amend easements in destructive ways."

Should federal legislation be introduced to change tax law, there will almost certainly be a very vigorous debate involving land trusts, landowners, gift planners and policy makers. The future of the tax incentive for gifts of conservation easements will hang in the balance – and it is a frequent target of tax reformers, because conservation easements are the largest source of non cash deductions claimed on income tax returns.

Changes that could establish deductibility for "swap-able" easements might generate unintended perverse incentives. Land trusts might be encouraged to acquire conservation easements on "low value" conservation land, thus generating tax write-offs for donors, while banking the property for swaps later on. Even suggesting that some presently conserved land is of "low value" for conservation purposes is risky, for some might allege that easement holders have not been sufficiently rigorous in their review of potential conservation gifts and their consistency with conservation purposes under federal law. These and other areas of inquiry and argument will slow and complicate efforts to revise the tax rules.

It has been suggested that this legislation is urgently needed to allow for conservation easement amendments that are in the public interest and otherwise prohibited by federal tax regulations. My belief is that the urgency is overstated, the proposed draft is extremely complex, and the risk to donor confidence, and continuing eligibility for federal tax incentives is real.

The legislation is much improved from when it was originally introduced two years ago, but still fails to protect the interests of easement donors while clarifying the circumstances where flexibility is appropriate. We appreciate your careful consideration of these issues.

Attachment A.

Representations in outreach materials and in the easement deed itself imply that the Grantee is accepting specific obligations in exchange for the gift of an easement.

From the website of the Stowe Land Trust

"A conservation easement (or conservation restriction is a legal agreement between a landowner and a land trust or government agency that permanently limits the use of the land in order to protect its conservation values…

…When you donate a conservation easement to a land trust you give up some of the rights associated with the land. Future owners also will be bound by the easement's terms. The land trust is responsible for making sure the easement's terms are followed."

From the website of the Land Champlain Land Trust

"Do you want to ensure that your land remains free from unplanned or inappropriate development? Perhaps your family has owned the land a long time and it's something you treasure and want to conserve. Or maybe your land is special to you because of your memories living there.

…You can continue to own it, live on it, manage it, and conserve it with a conservation agreement known as a "conservation easement." The conservation of land ensures that a property will be protected from development forever."

From the website of The Nature Conservancy

"Most easements "run with the land," remaining with the property even if it is sold or passed on to heirs, thus binding in perpetuity the original owner and all subsequent owners to the easement's restrictions. The organization or agency that holds the conservation easement is responsible for making sure the easement's terms are followed into the future. They must be willing to monitor and defend the easement legally in the event it is ever violated.

Often landowners have no intention of subdividing their properties for development. But a conservation easement is still attractive to them because it reaches beyond their own lifetimes to ensure the conservation purposes are met forever. An easement binds heirs and other future landowners to comply with the easement's terms, such as prohibiting the building of roads or multiple housing units. It can give peace-of-mind to current landowners worried about the future of a beloved property, whether forest or ranch, stretch of river or family farm."

Language from Conservation Easement donated to UVLT 2013:

…Such conservation restrictions are interests in real estate and this document is a conveyance of such real estate, and are exclusively for conservation purposes (hereinafter "Purposes"), namely…

… Overall, to assure the Protected Property will be retained forever in its undeveloped, scenic and open space condition by preventing any use of the Protected Property that would significantly impair or interfere with the unique and significant qualities of public benefit and conservation values of the Protected Property

(And further…)

<u>Grantee Acceptance</u>
By accepting and recording this Easement for itself, its successors and assigns, Grantee agrees to be bound by the provisions hereof and to assume the rights and responsibilities herein provided for and incumbent upon the Grantee, all in furtherance of the conservation purposes for which this Easement is delivered.

Language from conservation easement donated to VLT in 2008:

(immediately follows an enumeration of the specific natural resources present on the property: acres of prime and statewide significant agricultural soil, frontage on River, fens and a deer wintering area)

… Grantors and Grantee recognize these agricultural, silvicultural, scenic and natural values of the Protected Property and share the common purpose of conserving these values by the conveyance of the conservation easement and restrictions and development rights, to prevent the use, fragmentation or development of the property for any purpose and in any manner which would conflict with the maintenance of these agricultural, silvicultural, scenic and natural resource values. Grantee accepts such conservation easement and restrictions and development rights in order to conserve these values for present and future generations.

Attachment B.

Some of the potential differences between existing common law treatment of restricted gifts and S.119 allowance for donee recipients/holders to amend easements that are restricted gifts:

Common Law	S.119
Modification of gift purposes or termination of gift possible only if changed circumstances make continued gift purposes impossible or impractical	"Impossibility" or "impracticality" not required for termination of gift or modification of gift purposes
Judge looks at the purposes of donor imposed restrictions to guide an alternative that "as nearly as possible" (cy pres) satisfies the intentions of the donor.	Panel hears receives testimony from public entities and the general public about current sentiment and priorities.
Judge approves the most minimal change needed to meaningfully accommodate the changed circumstances while upholding to the greatest extent possible the donor's intent.	Donor intent is one of a number of considerations balanced by the panel. (AG's office says the legislation will make "public conservation benefit" paramount over donor intent.)
Recipients of restricted gifts become obligated to uphold donor-imposed restrictions when they accept the gifts (this pertains to gifts made while the donor is alive and also post-mortem gifts). AG's office is backstop if there is misrepresentation during gift solicitation or abuse of trust after the gift.	Under some circumstances, donors will be notified if a recipient plans to alter the gift purposes or terminate the gift. Donors may not appeal the decision of the panel or judge. The AG may intervene on behalf of a donor but only within a specified period of time. Causes for appeal are limited.
Recipients of restricted gifts must uphold the terms of the gift until changed circumstances make them impossible or impractical (as described above). AG's office is backstop.	The legislation does not provide a role for the AG specific to upholding donor restrictions (and the AG has indicated the legislation will make other considerations paramount). Heirs do not receive notice or have appeal rights.
Donors/heirs/harmed parties could work with the AG's office to pursue claims of abuse, fraud, misrepresentation.	Panel may revoke amendment on basis of fraud, but only if the property hasn't since been sold "in good faith." Financial contributors may pursue damages, but are limited only to the amount of their contribution (which assumes that $ value is adequate compensation for the loss of intended gift purpose).
Donors may convey easement gifts in the form of charitable trusts (rarely done, could be of interest to donors concerned about the endurance of specific gift terms and obligations).	The legislation is intended "to supercede common law and existing statutes on charitable trusts that might otherwise apply to conservation easement amendments..."

Attachment C.

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF THE CHIEF COUNSEL

RECEIVED SEP 24 2012

September 18, 2012

CC:ITA:B01
GENIN-131378-12

UIL: 170.14-00

Upper Valley Land Trust
19 Buck Road
Hanover, NH 03755

Attention: Jeanie McIntyre, President

Dear Ms. McIntyre:

This letter responds to your request for information dated July 19, 2012.

In your request, you asked whether a contribution of an easement can be a qualified conservation contribution if the easement deed simply allows for extinguishment under applicable State law upon subsequent, unexpected changes in the conditions surrounding the property that make impractical or impossible the continued use of the property for conservation purposes.

Property rights have been described "as a 'bundle of sticks'--a collection of individual rights which, in certain combinations, constitute property." U.S. v. Craft, 535 U.S. 274, 278 (2002) (citations omitted). State law dictates what rights make up a person's bundle. Id. Once a person's property rights are established under State law, the tax consequences of a transaction involving that property are decided under Federal law. Patel v. Commissioner, 138 T.C. No. 23, slip op. 16, 2012 WL 2427326 at *7 (2012) (citing Commissioner v. Estate of Bosch, 387 U.S. 456 (1967); Aquilino v. United States, 363 U.S. 509, 512–513 (1960); Morgan v. Commissioner, 309 U.S. 78, 80-81 (1940)).

A "qualified conservation contribution" is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. I.R.C. § 170(h)(1). A contribution is not exclusively for conservation purposes unless it protects the conservation purpose in perpetuity. I.R.C. § 170(h)(5)(A).

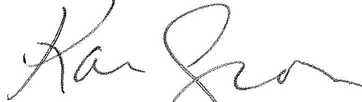
Under the Treasury regulations, a conservation purpose may be treated as protected in perpetuity if, upon a subsequent change in conditions that makes impossible or impractical the continued use of the subject property for conservations purposes, the easement is extinguished by judicial proceeding and all of the donee's

proceeds from a subsequent sale, exchange, or involuntary conversion of the property are used by the donee in a manner consistent with the conservation purposes of the original contribution. Treas. Reg. § 1.170A-14(g)(6)(i). The donee's proceeds must be at least equal to the proportionate value of the perpetual conservation restriction. Treas. Reg. § 1.170A-14(g)(6)(ii).

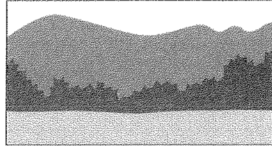
State law may provide a means for extinguishing an easement for State law purposes. However, the requirements of § 170(h) and the regulations thereunder must nevertheless be satisfied for a contribution to be deductible for Federal income tax purposes.

This letter has called your attention to certain general principles of the law. It is intended for informational purposes only and does not constitute a ruling. See section 2.04 of Rev. Proc. 2012-1, 2012-1 I.R.B. 7 (Jan. 3, 2012). If you have any additional questions, please contact me or Ron Goldstein at (202) 622-5020.

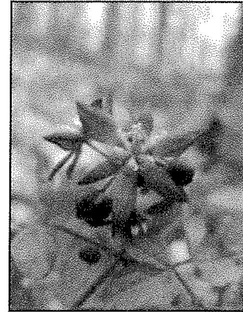
Sincerely,



Karin Goldsmith Gross
Acting Branch Chief, Branch 1
(Income Tax & Accounting)



UPPER VALLEY
LAND TRUST



July 19, 2012

Karin Gross
Supervisory Attorney
IRS Office of Chief Counsel
1111 Constitution Ave NW
Washington, DC 20224-0001

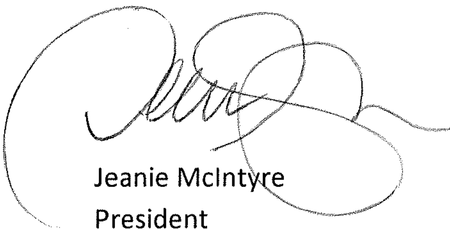
Dear Attorney Gross,

I am writing to request information concerning a conservation contribution described in sections 170(f)(3)(B)(iii) and 170(h) of the Internal Revenue Code.

Specifically, I seek information about whether a contribution of an easement is tax deductible if the easement allows the holder to extinguish it, wholly or in part, if subsequent, unexpected changes in the conditions surrounding the property make impractical or impossible the continued use of the property for conservation purposes, and provided that the holder must comply with all applicable state laws.

Thank you for providing information relevant to this question.

Sincerely,



Jeanie McIntyre
President

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