Bloomberg BNA

Tax Management
Real Estate Journal™

Anyone for Tennis? Technical Foot Faults and the Conservation Easement Tax Deduction

By Anson H. Asbury, Esq.[*]

To the casual spectator, like this author, tennis is a fairly easy game to understand. Two players serve and return the ball across the net until one player misses. The player who does not miss wins points and ultimately the match. That easy understanding belies a litany of technical rules that provide the groundwork for both fair play and competitive balance.

A conservation easement donation and the associated tax deduction is likewise an easy concept to explain. A taxpayer donates an interest in property to a charitable organization and receives a tax deduction based on the value of that gift. However, the requirements to secure that tax deduction are also numerous and complex.

The foot fault is an example of a technical rule in the game of tennis.[1] A player commits a foot fault when the player steps on the baseline while serving.[2] When a foot fault happens, a player should correct the error by serving again.[3] The rule is easy enough to observe because the player knows where the line is and can avoid it.[4] While great cause can be attributed to the foot fault in a particular instance,[5] the interpretation of the rule is fairly straightforward.

The perpetuity requirement, explained more fully below, is an example of a technical rule for a conservation easement tax deduction. The rule is intended to limit the eligibility for tax deductions to those conservation donations that require the donee hold the easement in perpetuity.[6] Unlike the game of tennis, the interpretation of this technical rule is not precisely straightforward. In fact, the nuances of the rule continue to evolve through litigation and new case law, even as the game is being played.

To place the foot fault rule in context, a player cannot lose a match based on a single foot fault.[7] Even in a tie game, a player would have to foot fault four consecutive times to lose the game.[8] That is not the case with the perpetuity requirement for conservation easement donations. A single technical error, a foot fault if

---

[*] Cream, *Anyone for Tennis* (ATCO Records 1968).

Anson Asbury of Asbury Law Firm in Atlanta, GA received his J.D. from Pennsylvania State University, Dickinson School of Law and received his LL.M. (Taxation) from Georgetown University Law Center.

[1] ITF (International Tennis Federation) Rule 18 (as published by the USTA):

18. FOOT FAULT During the service motion, the server shall not:

> a. Change position by walking or running, although slight movements of the feet are permitted; or
>
> b. Touch the baseline or the court with either foot; or
>
> c. Touch the area outside the imaginary extension of the sideline with either foot; or
>
> d. Touch the imaginary extension of the center mark with either foot.

If the server breaks this rule, it is a "Foot Fault."

[2] A player may commit a foot fault in four ways. See note 1, above.

[3] ITF Rule 20.

[4] In amateur play, the foot fault is generally regarded as an aspect of fair play. The USTA website opining about whether a player may call a foot fault against an opponent in an unofficiated game suggests, "The Code states that 'compliance with the foot fault rule is very much a function of the player's personal honor system.' If a player is committing flagrant foot faults, then an opponent CAN call him/her on it. But it is a pretty bold move to do so." United States Tennis Association, *Improve Your Game: Foot Faulting*, https://www.usta.com/Improve-Your-Game/Rules/Rules-and-Line-Calls/Foot_Faulting/.

[5] In the 2009 U.S. Open, Serena Williams lost her semifinal match to Kim Clijsters following a tirade over a foot fault call in the deciding match with the score 15-30. The foot fault made the score 15-40. Williams proceeded to abuse the line judge with profanity. Williams continued her dispute with the chair umpire, who penalized her an additional point for unsportsmanlike conduct. Williams lost the match on the unsportsmanlike conduct point. *See* Greg Garber, *Clijsters Wins After Controversial Ending*, ESPN (Sept. 13, 2009), http://espn.go.com/sports/tennis/usopen09/news/story?id=4468762.

[6] *See* S. Rep. No. 95-263, at 30 (1977) (Conf. Rep.).

[7] Disqualification notwithstanding. See note 5, above.

[8] If a player commits two consecutive foot faults, then that player has committed a service fault. ITF Rule 24. A service fault results in the loss of a point. A player generally must win four points to win a game, six games to win a set, and two sets to win a match. ITF Rule 5-7.

you will, can result in a disqualification of the transaction for tax purposes and disallowance of the entire deduction.

Enforcement of any tax rule is subject to interpretation, but in recent years the Internal Revenue Service has pressed particularly technical interpretations of the regulations that govern the tax deductibility of conservation easement donations under examination and in litigation. Some courts have accepted these arguments disallowing taxpayers' deductions and altering the outcome of entire cases.

This trend highlights the tension between Congressional intent and IRS enforcement with regard to qualified conservation contributions. Congress has done nothing to alter the tax benefits of conservation easement donations for a decade.[9] In fact, the most recent Congressional action made permanent the provision that allows a taxpayer to apply a greater percentage of a qualified conservation contribution against his or her adjusted gross income in carryforward years than other charitable contributions.[10] Yet the IRS remains focused on finding ways to undermine the tax deductions associated with these donations.

This article focuses on four provisions defining the phrase "in perpetuity" in the statute and regulations governing tax deductions for qualified conservation contributions. It does not address the various other regulatory provisions, or the charitable contribution regulations generally, which also have been the subject of judicial interpretation in the context of conservation easement donations. The four rules in focus here all have been the subject of recent judicial determinations — three of which announced new standards for compliance. Like the four ways of committing a foot fault, the violations in these cases range from obvious error to a sophisticated misunderstanding of the rules.

THE QUALIFIED CONSERVATION CONTRIBUTION

A brief introduction to the conservation easement tax deduction seems appropriate before diving into the technical aspects the rules. Section 170(h) of the Internal Revenue Code[11] allows a tax deduction for a "qualified conservation contribution"[12] or what has come to be known as the conservation easement tax deduction. The qualified conservation contribution is a policy-driven provision of the Internal Revenue Code designed to encourage environmental and historic preservation.[13]

A qualified conservation contribution may preserve undeveloped property or protect a historic location. A qualified conservation contribution is defined in §170(h)(1) as a contribution of (1) a qualified real property interest,[14] (2) to a qualified organization,[15] (3) exclusively for conservation purposes.[16]

The most common contribution is a restriction, granted in perpetuity, on the use of real property — a type of qualified real property interest.[17] A qualified organization may be a government agency or a qualified §501(c)(3) not-for-profit organization.[18] Many organizations that hold conservation easements, such as The Nature Conservancy and The Historic Savannah Foundation, are established for the primary purpose of protecting natural habitats and historic landmarks.

Conservation purposes include the preservation of land areas used for outdoor recreation by the general public, the protection of relatively natural habitats for wildlife, and the preservation of open spaces pursuant to a government conservation policy.[19] Protecting historically important land areas or certified historic structures is also a conservation purpose.[20]

Value has always been a key consideration in a conservation easement donation. It is a benchmark for both the donor and the recipient organization, and the logic follows. The burden of monitoring a conservation easement over 10 acres in rural Montana valued at less than $5,000 per acre is not terribly cost effective, even for the most ardent preservationist group.[21] Caretaker organizations operate within the same bud-

[9] The Pension Protection Act of 2006, Pub. L. No. 109-280, introduced a handful of changes to the qualified conservation contribution and related provisions affecting all charitable contributions. Special rules were added for eligible contributions of façade easements. The thresholds for the imposition of accuracy-related penalties were decreased and the reasonable cause defense for gross valuation misstatements was eliminated. General statutory definitions for qualified appraisers and appraisals were added. The 2006 amendments also increased the deduction limit for qualified for conservation contributions to 50% of the donor's adjusted gross income (from 30%) and added 10 years to the carryover period, for a total of 15 years.

See Pub. L. No. 109-280, Div. Q, §170, 120 Stat. 780, 1068 (2006).

[10] Protecting Americans from Tax Hikes Act of 2015, Pub. L. No. 114-113, Div. Q, §111, 129 Stat. 2242 (2015).

[11] Unless otherwise stated, all references to "Section" or "§" are to the Internal Revenue Code of 1986, as amended (the "Code"), and all references to "Reg. §" are to the Treasury regulations thereunder.

[12] The charitable deduction for the donation of a conservation easement became a permanent part of the Internal Revenue Code in 1980. Tax Treatment Extension Act of 1980, Pub. L. No. 96-541, 94 Stat. 3205 (1980) (adding §170(h) to the Code).

[13] For more on the history and development of the qualified conservation contribution, see Zachary Bray, *Reconciling Development and Natural Beauty: The Promise and Dilemma of Conservation Easements*, 34 Harv. Envtl. L. Rev. 120, 127 (2010).

[14] §170(h)(1)(A).

[15] §170(h)(1)(B).

[16] §170(h)(1)(C).

[17] §170(h)(2)(C). A qualifying real property interest may also consist of the donor's entire interest in real property other than a qualified mineral interest or a remainder interest in real property. §170(h)(2)(A) and §170(h)(2)(B). This article does not address those two types of qualified real property interests.

[18] §170(h)(3), §170(b)(1)(A).

[19] §170(h)(4)(A)(i), §170(h)(4)(A)(ii), §170(h)(4)(A)(iii).

[20] §170(h)(4)(A)(iv).

[21] The logic behind façade easements differs because the his-

ISSN 8755-0628

getary constraints as any other nonprofit and are often limited by access to the financial resources needed to take on a project with limited conservation value. Particularly in the context of open space easements, value is still the consideration that drives the partnership between the donor and the donee.

Like points in a tennis match, value is the easiest way to understand this game. Value is also historically the foremost concern in preserving any associated tax deduction. Until recently, conservation easement cases were tried only when the government challenged the value assigned to the donated property. Value is being set aside in the consideration of these cases as technical determinations prevail.

Now the IRS is attacking conservation easement donations on any and all available technical requirements associated with the deduction.[22] As some commentators have suggested, the IRS's aggressive approach to these transactions has only heightened the importance of seeking well-qualified tax advice.[23]

THE PERPETUITY REQUIREMENT

The perpetuity requirement has become central to the preservation of tax deductions based on conservation easement donations, but it wasn't always that way. The first Code section that allowed a federal tax deduction for a conservation donation required an easement of only 30 years.[24]

The Congressional largess of the short-term easement was not long-lived. One year later, the 30-year term requirement was replaced with the requirement that the contribution be ''granted in perpetuity.''[25] The change was made to ensure that easements qualify ''only in situations where the conservation purposes . . . will in practice be carried out''[26] and to ''limit deductible contributions to those transfers which require that the donee hold the easement.''[27]

The perpetuity requirement remained in the statute when the qualifying conservation donation became a permanent fixture in the Internal Revenue Code in 1980. The Senate report accompanying that legislation gave additional detail to the Congressional intent behind the perpetuity requirement.

> By requiring that the conservation purpose be protected in perpetuity, the committee intends that the perpetual restrictions must be enforceable by the donee organization (and successors in interest) against all other parties in interest (including successors in interest).[28]

Regulations governing qualified conservation contributions were finally issued in January 1986.[29] The regulations contain many technical provisions governing the deductibility of a qualified conservation contribution. The provisions under Reg. §1.170A-14(g) specifically set the parameters for the enforcement of conservation purpose in perpetuity. In this article we will focus on three of those provisions — recordation, subordination and proceeds. This article will also discuss a fourth provision — the emergence of a separate perpetuity requirement applicable to real property under §170(h)(2)(C) and Reg. §1.170A-14(b)(2). Recognition of this independent perpetuity requirement is a recent development.

These certainly are not the only technical requirements that apply to qualified conservation contributions, nor are they the only rules that have become more precise under the scrutiny of judicial review in recent years. Rules of broader application to deductions for all charitable donations also apply to these contributions, including the requirements of timely and qualified appraisals, substantiation, and substantial compliance.

Some have suggested that the perpetuity rule is simply a proxy for donative intent.[30] Yet it is now a technical touchstone for the deductibility of a conservation easement donation. If the donative intent of the parties is clear, or may be made clear through testimony and inquisition, then should that supersede the regulations in order to advance the preservation policy underlying the statute? We have yet to see that opportunity emerge in the jurisprudence. It remains for the reader to determine whether the rigid interpretation of these rules furthers the purpose of gauging the donor's intent and furthering the policy behind the legislation.

RECORD THAT DEED

We mentioned the common foot fault of stepping on the baseline above. However, a player may foot fault in three other ways.[31] Like the qualified conservation contribution, these other faults are more nuanced and demand a greater knowledge of the game.

---

toric value is endemic to the locale, regardless of the property's value in whole dollars. For example, preservationists in Sioux City, Iowa may seek to obtain and maintain façade easement donations of limited dollar value because the value is reflective of the local real estate market, yet it still serves the goal maintaining an historic element of that city.

[22] See the discussion of *Gorra v. Commissioner*, below.

[23] Ronald Levitt, Esq., a shareholder at Sirote & Permutt, stated, ''[The *Carroll* case] puts a big premium on using a good tax adviser.'' Erin McManus, *Conservation Easement Deduction Denied for Faulty Formula*, 82 Daily Tax Rep. K-2 (Apr. 28, 2016).

[24] §170(f)(3)(C) (1976). In 1976, a taxpayer who donated a qualifying lease, option or easement for a 30-year period was entitled to a deduction.

[25] §170(f)(3)(B)(iii) (1977).

[26] S. Rep. No. 95-263, at 30 (1977) (Conf. Rep.).

[27] *Id.* at 31.

[28] S. Rep. No. 96-1007, at 13-14 (1980), 1980-2 C.B. 599, 605.

[29] T.D. 8069, 51 C.F.R. 1496 (Jan. 14, 1986). The December 18, 1980, effective date of the regulations, however, coincided with the permanent enactment of the qualified conservation contribution. *See* Reg. §1.170A-14(j).

[30] Anson H. Asbury, *Understanding the Conservation Easement Donation Tax Deduction (or Strawberry Fields Forever)*, Fed. Law., Mar. 2016, at 28.

[31] See note 1, above.

ISSN 8755-0628

We begin here with the most common technical mistake seen in conservation easement deduction litigation — failure to timely record the deed of conservation.

The timely recordation of easement deeds has generated a series of cases that consider the perpetuity of conservation purpose. Failure to record the easement at the time of the donation is a consistent theme in these cases. The challenge facing taxpayers in these cases is that the task of recordation was entrusted to another partner in the transaction, often the recipient organization. The timing of recordation does not necessarily affect the validity of the easement. Nor does it affect the value associated with the donation in the hands of the caretaker organization. It can, however, affect the timing of enforcement. Enforcement of easements has become increasingly important as a measurement of the perpetuity requirement. As we will see, the courts seem to agree that an easement that is unenforceable at any time (whether or not that enforcement is triggered) is not protected in perpetuity.

The issue of timely recordation has arisen in several New York City façade easement cases. In most recordation cases, local law determines when and if the deed was properly recorded and enforceable. That determination in turn influences whether the conservation purpose is protected in perpetuity. So here a technical requirement has emerged from the regulations through case law and has done so largely by virtue of its interplay with local law. The laws of the State of New York governed the easement donations in all of these cases. Still, two Tax Court memorandum opinions dealing with the timely recordation of the easement deeds in New York reached different results based on different facts and a third case from the Southern District of New York found that recordation of a deed of conservation easement is crucial under New York law. Results could differ in other jurisdictions.

The taxpayers in *Zarlengo v. Commissioner* executed a façade easement over their historic New York City residence.[32] In September 2004, the taxpayers executed a conservation deed with the recipient organization, which was then left to record the document. The taxpayers took a deduction on their 2004 tax returns.[33] The deed was not recorded with the city registrar until January 26, 2005.[34]

The IRS challenged the deduction generally on the grounds that it was not a qualified real property interest and it was not made exclusively for conservation purposes. The court focused on the latter argument, specifically the requirement under Reg. §1.170A-14(g)(1) that protection in perpetuity must be based on legally enforceable restrictions such as recording the deed.

The court questioned the viability of the conservation deed during the period between execution in September 2004 and recordation in January 2005. The taxpayers argued that the easement was created and conveyed at the time of execution in September. The government relied on dicta in a prior Tax Court case[35] that an easement contribution is not effective until the recordation date under New York law.

The *Zarlengo* court agreed with the IRS. It relied on a provision of New York law specifically governing conservation easements that requires recordation for the conveyance to be effective.[36] Because recordation was mandatory for recognition of the instrument under local law, the court concluded that the 2005 recordation date controlled and denied the taxpayers' deduction for 2004.

Contrast that with the taxpayers in *Gorra v. Commissioner*,[37] who executed a conservation deed over the façade of their historic New York City home in 2006. They entrusted the deed to the recipient trust for recording and took a 2006 tax deduction for the easement donation.

The fully executed deed was delivered to the city registrar for recordation on December 28, 2006. However, the cover sheet for that submission listed an incorrect street number for the property, so the registrar returned it for correction. The trust made the correction and returned the deed; it was recorded on January 18, 2007.

The IRS argued that, because the conservation deed was not enforceable at the time of the donation, the conservation purpose was not protected in perpetuity. Relying upon a 19th century precedent of the New York Court of Appeals, which treats a deed as recorded on the date it is delivered to the registrar, the court found that the deed was recorded on December 28, 2006.[38]

To determine whether the qualified conservation contribution tax deduction was met, the court turned

---

[32] *Zarlengo v. Commissioner*, T.C. Memo 2014-161.

[33] The co-owners of the home, Dr. Zarlengo and his ex-wife, Ms. Sardin-Zarlengo, divorced in 1999 and filed separate tax returns in 2004, each claiming a deduction for their respective 50% interest in the townhome subject to the façade easement. Dr. Zarlengo was subject to a notice of deficiency for 2004. Ms. Sardin-Zarlengo received a notice of deficiency disallowing conservation easement carryover deductions for 2005–2007. Her liabilities for those years were determined on separate grounds.

[34] Petitioners argued on brief that the deed was mailed in December 2004, but the court found that they provided no credible evidence to demonstrate that allegation. *Zarlengo*, T.C. Memo 2014-161, slip. op. at 24 n. 10.

[35] *Rothman v. Commissioner*, T.C. Memo 2012-163. In *Rothman*, the court stated: "New York law does not regard an easement contribution as effective until the recordation date, we conclude that the contribution date for an easement on real property in New York is the recording date." *Id.*, slip. op. at 30. The court's determination in *Rothman* did not address whether recordation affected the perpetual restriction on the easement, but rather whether an appraisal was made more than 60 days before the contribution date. *Id.*, slip. op. at 29.

[36] N.Y. Envtl. Conserv. Law (NYEC law) §49-0305(4) (McKinney 2008 and Supp. 2014).

[37] *Gorra v. Commissioner*, T.C. Memo 2013-254.

[38] *Id.*, slip. op. at 41 (citing *Manhattan Co. v. Laimbeer*, 15 N.E. 712 (N.Y. 1888) ("In the matter of deeds and mortgages it is constantly spoken of that such papers are recorded when left at the clerk's office for such purpose")).

ISSN 8755-0628

to the regulations defining the perpetuity element of conservation purpose. Specifically, a deduction will not be disallowed because on the date of the gift there is a possibility that the conservation purpose will be defeated, as long as on that date the possibility is so remote as to be negligible.[39] If you accept the premise that the perpetuity requirement is a proxy for donative intent, then the remote future event regulation may be considered the pressure regulator on that principle — a saving clause of sorts. The regulation may stand for the proposition that the donation is not rendered invalid ''merely because the [donated] interest . . . may be defeated'' by a future act or event, if that act or event appears to be so remote as to be negligible at the time of the gift.[40] Leaning on the regulation, the court found that the possibility that the deed would not be recorded because of a clerical error in the cover sheet was remote. Accordingly, the recordation of the deed met the conservation purpose perpetuity requirement.[41]

While *Gorra* is included here to demonstrate the factual scrutiny that may be imposed on the recordation requirement, it is also notable because it is an exemplar of the IRS's broad attack on all technical aspects of a qualified conservation contribution. We focused on the timing of recordation argument. However, the IRS also challenged whether the donation was a qualified real property interest, whether there was a valid conservation purpose, whether the easement might be extinguished, whether the appraisal was qualified and conducted according to generally accepted accounting principles, and finally, whether the value assigned to the easement was correct. The IRS went on to assert accuracy, negligence, substantial understatement, and gross valuation penalties.

While the taxpayers met all of the government's technical attacks, they ultimately succumbed to a reduction in value of the easement. The result reinforced the importance of proper valuation in conservation easement donations, even in the face of technical attacks.

Finally, on the question of timely recordation, the United States District Court for the Southern District of New York faced similar facts in *Mecox Partners v. United States*.[42] The partnership chose district court to challenge the final partnership administrative adjustment that disallowed a $2.21 million façade easement deduction in 2004. Once there, the Department of Justice, Tax Division, moved for partial summary judgment on the grounds that the donation did not occur in 2004 because the deed of conservation easement was not recorded until November 17, 2005.[43]

The taxpayer delivered the deed to the recipient organization in December 21, 2004, but the deed was not recorded until nearly 11 months later. Unlike *Zarlengo*, where the taxpayers asserted that the deed had been delivered in the claimed year (even though not recorded until the next year), *Mecox Partners* made no such claim. Likely for the same reasons, the taxpayer did not analogize their facts to *Gorra* either. Instead, the taxpayer was forced to argue that *Zarlengo* and *Rothman* were incorrectly decided and that New York common law should recognize the deed as of the date of execution. The district court was not persuaded and held as a matter of law that recordation is necessary in New York for the effective conveyance of a conservation easement.

Timing was crucial in each of these cases. It was far easier for the Tax Court to accept the gap between submission and recordation of 21 days in *Gorra* than it was to waive the five months that passed in *Zarlengo*. The scrivener's error that prevented the timely recordation in *Gorra* also likely contributed to the court's leniency. Certainly difficult facts lead to challenging results, but taxpayers and qualified organizations should note that in the wake of these opinions, no aspect of execution may be taken for granted.

SUBORDINATE THAT MORTGAGE

Conservation deeds are not the only documents that must be recorded to protect a conservation purpose in perpetuity. Reg. §1.170A-14(g)(2) requires that any mortgage on the eased property must be subordinated to the easement in order to protect the conservation purpose in perpetuity.[44] The regulation requires that the party holding the mortgage execute an agreement subordinating its rights, including the right of foreclosure, to the qualified organization holding the easement to ensure that the conservation purpose of the donation may be carried out.

This second technical requirement is not a surprise to practitioners experienced in drafting conservation

[39] Reg. §1.170A-14(g)(3) provides that a deduction will not be disallowed under §170(f)(3)(B)(iii) and Reg. §1.170A-14 merely because the interest which passes to, or is vested in, the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible. *See* Reg. §1.170A-1(e). For example, a state's statutory requirement that use restrictions must be rerecorded every 30 years to remain enforceable does not, by itself, render an easement nonperpetual.

[40] *Id.*

[41] *Gorra*, T.C. Memo 2013-254, slip. op. at 42.

[42] *Mecox Partners LP v. United States*, No. 1:11-cv-08157-ER, 2016 BL 26549 (S.D.N.Y. Feb. 1, 2016).

[43] The government also argued that the June 13, 2005 appraisal did not meet the requirement of Reg. §1.170A-13(c)(3)(i) because it was not done within 60 days of the contribution date.

[44] ''[N]o deduction will be permitted under this section for an interest in property which is subject to a mortgage unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity.'' Reg. §1.170A-14(g)(2). The regulation continues, providing that for periods prior to its promulgation, that conservation purpose is satisfied ''only if the donor can demonstrate that the conservation purpose is protected in perpetuity without subordination of the mortgagee's rights,'' suggesting that protection *in fact* may be adequate substitute for a subordination agreement. While that may have been the case prior to publication of the regulation in 1986, see n. 28 and accompanying text, above, the courts have taught us, it is no longer the case.

ISSN 8755-0628

easements. It has, however, been in the litigation crosshairs for several years, and the resulting case law has generated new rules that were not clear from the regulations themselves.

It might be a matter of some debate, or maybe just careful reading, as to whether or not the Tax Court considered the subordination requirement for the first time in *Mitchell v. Commissioner*.[45] In either event, two new(ish) technical rules for recording subordination agreements were set forth in *Mitchell*.

In December 2003, the taxpayers in *Mitchell* granted a conservation easement over 180 acres of unimproved land adjacent to the Mesa Verde National Park in Colorado. The taxpayers took a deduction for the conservation contribution on their 2003 tax return. The eased property was subject to a private mortgage secured by a deed of trust at the time of the donation. The mortgage holder did not execute a subordination agreement with the donor until December 22, 2005.

The IRS challenged the donation on numerous grounds, including that the conservation purpose was not protected in perpetuity because the easement failed to meet the subordination and proceeds provisions of the regulations.[46] The taxpayer argued in turn that the 2005 subordination agreement met the requirements of the regulations, that the parties had an oral subordination agreement in place, and that any review of the subordination provisions must be read in conjunction with the so-remote-as-to-be-negligible regulation.

The government argued that the mortgagee's right in the property must be subordinate to the conservation easement on the date the easement is granted. The taxpayer pointed out that the regulation contains no such timing requirement.

Acknowledging that the regulation is silent as to when a taxpayer must subordinate a preexisting mortgage, the Tax Court nonetheless established a new rule applicable to qualified conservation contributions, specifically that "the regulation requires that a subordination agreement must be in place at the time of the gift."[47] The court reasoned that *if* the taxpayer had defaulted on the promissory note during the period between the grant of the easement and the subordination of the deed of trust, the mortgage holder could have foreclosed and eliminated the conservation easement. Based on that potential, the court held that the easement was not protected in perpetuity at the time of the gift.

The taxpayer argued that the subordination provision should be read in conjunction with its regulatory neighbor, the so-remote-as-to-be-negligible standard. The Tax Court found that during the period from 2003 to 2005, the taxpayer had the money to pay off the promissory note, casualty insurance was in place, and there were no lawsuits or late payments on any liabilities related to the property. All of these facts might satisfy the proposition that the risk of foreclosure at the time of the gift was negligible. Nonetheless, the court did not choose to follow that path.

Instead, the court set the stage for the other new technical rule announced in *Mitchell* by examining its then-recent considerations of the so-remote-as-to-be-negligible standard in *Carpenter v. Commissioner*[48] and *Kaufmann II*.[49] In those cases, the court held that the so-remote-as-to-be-negligible rule did not modify the extinguishment provisions of Reg. §1.170A-14(g)(6)(i) and the proceeds provisions of Reg. §1.170A-14(g)(6)(ii), respectively.

The *Mitchell* opinion then quoted language from *Kaufmann II* suggesting that the drafters of the regulation understood the difficulty (even the impossibility) of perpetual restriction under state law and defused the risk presented by unlikely events that could potentially defeat the donation with the so-remote-as-to-be-negligible regulation.[50] Yet the court continued with more language from *Kaufmann II* espousing the intent of the regulation drafters: "[t]hey did not however, consider the risk of mortgage foreclosure per se to be remote and negligible and required subordination to protect from defeasance."[51] Following those opinions, *Mitchell* established that the so-remote-as-to-be-negligible regulation on conservation purpose does not modify the mortgage subordination provision of those same regulations. Accordingly, the taxpayers' failure to subordinate the mortgage to the conservation easement until two years after the grant of the easement meant that the conservation easement was not protected in perpetuity for purposes of qualifying for the tax deduction, regardless of any real risk of extinguishment.

The Tenth Circuit affirmed the Tax Court's decision in *Mitchell* on both the timing requirement of the regulation (i.e., subordination required at the time of the gift) and nonapplication of the so-remote-as-to-be-negligible standard to the subordination requirement.[52]

Mitchell was followed by the court's memorandum opinion[53] in *Minnick v. Commissioner*.[54] The tax-

[45] *Mitchell v. Commissioner*, 138 T.C. 324 (2012). On a motion for reconsideration, the taxpayers in *Mitchell* argued that the Tax Court ruled on the subordination requirement in *Kaufman v. Commissioner*, 136 T.C. 294 (2011) (*Kaufmann II*) which was vacated by the First Circuit Court of Appeals in *Kaufman v. Shulman*, 687 F.3d 21 (1st Cir. 2012). The Tax Court disagreed, as did the Tenth Circuit Court of Appeals. *See Mitchell v. Commissioner*, T.C. Memo 2013-204, *aff'd*, 775 F.3d 1243 (10th Cir. 2015).

[46] The case was decided on the subordination issue so the court did not consider the merits of the government's proceeds argument, nor did it consider whether the taxpayer substantiated the donation or accurately valued the gift.

[47] *Mitchell*, 138 T.C. at 332 (2012).

[48] *Carpenter v. Commissioner*, T.C. Memo 2012-1.

[49] At the time *Mitchell* was decided the First Circuit Court of Appeals had not yet vacated the opinion in *Kaufman v. Commissioner*, 136 T.C. 294 (2011) (*Kaufmann II*). See note 78, below.

[50] *Mitchell*, 138 T.C. at 336-337 (2012) (quoting *Kaufmann II*, 136 T.C. at 306–307).

[51] *Id.*

[52] *Mitchell v. Commissioner*, 775 F.3d 1243 (10th Cir. 2015).

[53] *See* Judge Mary Ann Cohen, *How to Read Tax Court Opinions*, 2 Houston Bus. Law J. 1, 7 (2001).

ISSN 8755-0628

payer, a lawyer and former Congressman,[55] did not execute a mortgage subordination agreement until five years after granting a conservation easement over the encumbered property and 18 months after filing a petition in Tax Court. The tardy mortgage subordination, and whether it satisfied the perpetual conservation purpose requirement under the regulations, became the central issue in the case. The taxpayer argued, among other things, that Idaho's *cy pres* doctrine saved the conservation purpose. The Tax Court rejected that argument and found that the failure to subordinate the mortgage at the time of the donation did not protect the conservation purpose in perpetuity.

The Ninth Circuit Court of Appeals affirmed the *Minnick* decision following the Tenth Circuit's opinion in *Mitchell* holding that, ''[b]ecause a conservation easement subject to a prior mortgage obligation is at risk of extinguishment upon foreclosure, requiring subordination at the time of the donation is consistent with the Code's requirement that the conservation purpose be protected in perpetuity.''[56]

Given that history, the recent decision in *RP Golf v. Commissioner*[57] on the timely subordination of a mortgage interest should not be a surprise. However, the case is instructive on the depth of detail these technical provisions require. RP Golf, LLC was a partnership formed for the purpose of developing two golf courses in the metropolitan Kansas City, Missouri area. RP Golf and related entities secured developmental financing to build the golf courses. On December 29, 2003, National Golf, an entity wholly owned by the RP Golf partnership, executed a ''Permanent Conversation Easement'' over the golf courses granting their interest to a qualified Missouri nonprofit. The purpose of the easement was ''to protect and preserve . . . the conversation of the open space, scenic natural resources, natural habitat and aesthetic qualities of the Property'' through use as a golf course.[58] This purpose was consistent with the statutory policies of the State of Missouri of maintaining open spaces in light of encroaching urban and metropolitan development.[59] The easement was recorded on December 30, 2003.

When the easement donation was executed in 2003, there were still two mortgage encumbrances on the property subject to the easement. At that time, one of those mortgages was scheduled to mature on February 7, 2004, although that note was ultimately modified and extended to February 7, 2005. Officers of the respective banks signed consents subordinating the mortgage interests to the qualified donee on April 14, 2004. Both subordination agreements were recorded the following day and recited an effective date of December 31, 2003.

RP Golf claimed a charitable deduction of $16,400,000 for the easement donation on its 2003 tax return. Following examination, the IRS issued a notice of final partnership administrative adjustments disallowing the entire deduction, and the parties proceeded to Tax Court.

The government filed a motion for summary judgment, claiming that the easement did not protect a natural habitat[60] and was not pursuant to a clearly delineated federal, state, or local government policy[61] — yet two more technical arguments not discussed in this article. The court issued a preliminary opinion on the motion.[62] The taxpayers lost on the latter question, because neither the county where the easement was located nor an adjacent county exceeded 200,000 residents as required by the Missouri statute.[63] However, the court found that genuine issues of material fact remained on the first question and set the case for trial.[64]

The central issue at trial was whether or not the donation met the perpetuity requirement under §170(h)(5)(A). More specifically, the question turned on whether the subordination agreements with the banks satisfied the requirement of Reg. §1.170A-14(g)(2). The government argued that, because the subordination agreements were not signed (April 2004) until after execution of the easement agreement (December 2003), the underlying easement was not protected in perpetuity.

Under the government's theory, the conservation easement was unprotected from termination by an act of foreclosure by either bank from the date of the donation until the time that the banks executed the subordination agreements (approximately 100 days). The exposure created by this gap between execution of the agreement and subordination documents, the government argued, violated the perpetuity requirement.

The court noted that the subordination requirement had not been subject to judicial interpretation when

[54] *Minnick v. Commissioner*, T.C. Memo 2012-345, *aff'd*, 796 F.3d 1156 (9th Cir. 2015).

[55] Walter Minnick served in the 111th Congress (2009–2011) as the representative from Idaho. At least once, Congressman Minnick voted to extend the 50% deduction preference for qualified conservation contributions. H.R. Res. 1766, 111th Cong. (2010) (enacted) (Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, also known as the 2010 Tax Relief Act passed by Congress on December 16, 2010, extending §170(b)(1)(E) from December 31, 2009 to December 31, 2011).

[56] *Minnick v. Commissioner*, 796 F.3d 1156 (9th Cir. 2015) (*Minnick II*). The Ninth Circuit released two opinions in the *Minnick* case. A published *per curium* opinion addressed the validity of the donation. A second unpublished disposition addressed the procedural issue in the Tax Court, alternative arguments, and the accuracy-related penalty.

[57] *RP Golf v. Commissioner*, T.C. Memo 2016-80.

[58] *Id.*, slip. op. at 8.

[59] *Id.*, slip. op. at 9.

[60] §170(h)(4)(A)(ii).

[61] §170(h)(A)(iii)(II).

[62] *RP Golf v. Commissioner*, T.C. Memo 2012-282.

[63] *Id.*

[64] *Id.*

ISSN 8755-0628

the taxpayer's donation was made in 2003.[65] The taxpayer argued that an oral agreement was in place at the time the easement was signed and that the subsequent execution of the subordination agreements by the banks validated that claim. The taxpayer maintained that the oral agreement was enforceable under Missouri law, and the government countered by asserting Missouri's statute of frauds. The court examined the local law but ultimately rejected the oral contract claim based on a lack of evidence that any agreement was in place before the date of the easement.

The court acknowledged that both banks eventually consented to, and did, subordinate their respective interests in the easement property. But for purposes of the subordination requirement as interpreted by the court in *Mitchell* and *Minnick*, the court found that RP Golf and the banks did not enter into ''any agreements, oral or written, binding under Missouri law, regarding subordination to the easement on or before December 29, 2003, the date of the [easement donation] agreement.''[66]

The court continued, in a silent nod to the application of the so-remote-as-to be-negligible standard, that the possibility of foreclosure between December 29, 2003 and April 15, 2004 was not illusory. The court observed the senior note could have foreclosed on the property and effectively extinguished the easement donation had the mortgage set to mature on February 7, 2004 not been renegotiated. The court disallowed the partnership's entire $16.4 million charitable contribution for the 2003 tax year.[67]

MIND YOUR VALUES EVERYWHERE

If the technical provision that tripped up the Baltimore physician in *Carroll v. Commissioner*[68] were in a tennis match, it might require instant replay. Reg. §1.170A-14(g)(6) contains two restrictions that have been the subject of much litigation without yielding a great deal of clarity.[69] The first restriction is often described as the extinguishment provision. If the conservation purpose is extinguished in a judicial proceeding (or otherwise), then the resulting proceeds must be distributed to the donee in order to preserve the donation in perpetuity.[70] The second restriction, often described as the proceeds requirement, mandates that the proceeds distributed upon extinguishment have a fair market value that is at least equal to the proportionate value that the conservation easement bears to the whole property at the time of the gift.[71]

In *Carroll*, the Tax Court held that the distribution formula in the taxpayer's deed of conservation easement did not satisfy the proceeds requirement. In December 2005, Dr. Douglas Carroll granted a deed of conservation easement over 20.93 acres of farmland, including his personal residence, to the Maryland Environmental Trust and the Land Preservation Trust, Inc. (LPT). The taxpayer's family had owned the parcel subject to the easement since 1920. The property was located in the Spring Valley National Register Historic District in Baltimore County, Maryland. Four adjacent lots were all subject to conservation easements.

Dr. Carroll engaged a general practice attorney to prepare the deed of conservation easement. The attorney did not specialize in tax law but did prepare a detailed deed of conservation easement — several sections of which were recited at length in the Tax Court's opinion. A qualified appraiser determined the value of the easement and the Maryland Environmental Trust acknowledged receipt of the easement.

At trial, the government conceded that the easement was donated to qualified organizations but challenged the conservation purpose of the donation as well as whether it was a qualified real property interest. The court began by considering whether the donation was a qualified real property interest. For purposes of a conservation easement donation, §170(h)(2)(C) requires ''a restriction (granted in perpetuity) on the use which may be made of the real property.'' That restriction is amplified by Reg. §1.170A-14(b)(2) which provides, in part:

> A ''perpetual conservation restriction'' is a qualified real property interest. A ''perpetual conservation restriction'' is a restriction granted in perpetuity on the use which may be made of real property—including, an easement or other interest in real property that under state law has attributes similar to an easement (e.g., a restrictive covenant or equitable servitude).

Article I of the *Carroll* easement included the directive that ''[t]his Conservation Easement shall be perpetual,'' continuing that it ''runs with the land as an incorporeal interest in the property, enforceable with respect to the Property by Grantees against Grantors and their personal representatives, heirs, successors and assigns.''[72] Drawing the distinction first introduced in *Belk v. Commissioner*, discussed below,

[65] The opinions in *Mitchell* and *Minnick* preceded the decision in *RP Golf* but were not released until 2012 — nine years after the transaction.

[66] *RP Golf*, T.C. Memo 2016-80, slip. op. at 35. Given the facts of the case, it was unnecessary for the court to consider whether the subsequently recorded subordination agreements reciting an earlier effective date could have met the requirements of the regulation. The consent agreements recited an effective date of December 31, 2003, which missed recordation of the easement by one day (December 30, 2003) and execution by two (December 29, 2003).

[67] There is no indication in either of the *RP Golf* opinions that the government asserted penalties or that the court considered *them.*

[68] *Carroll v. Commissioner*, 146 T.C. No. 13 (2016).

[69] *See* n. 78, below.

[70] Reg. §1.170A-14(g)(6)(i).

[71] Reg. §1.170A-14(g)(6)(ii).

[72] *Carroll*, 146 T.C. No. 13, slip. op. at 9.

ISSN 8755-0628

the court found that the clear language of Article I of the easement — "[t]his Conservation Easement shall be perpetual" — described the qualified real property subject to the easement but did not address the conservation purpose of the donation.

Still, the court looked past this clear declaration of intent and considered the numerous other restrictions on the property set forth in the deed of easement to determine whether there was a qualified real property interest. It examined limitations on development rights, inspections by the donee organizations, and limitations on the size of structures already on the property. It also considered the testimony of representatives from both qualified organizations that they would litigate violations of the easement. Only after taking stock of all of these factors did the court determine that the easement satisfied the regulation "by providing legally enforceable restrictions that will prevent uses of the retained interest in the subject property that are inconsistent with the conservation purposes of the contribution."[73]

The court considered conservation purpose. The taxpayers maintained that the donation met the third requirement of §170(h)(4)(A),[74] to wit:

> the preservation of open space (including farmland and forest land) where such preservation is —
>
> > (I) for the scenic enjoyment of the general public, or
> >
> > (II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy,
> >
> > and will yield a significant public benefit.[75] The court reviewed the taxpayer's evidence in support of this proposition with the same scrutiny it applied to the qualified real property interest. The court quoted extensively from Reg. §1.170A-14(d)(4)(iii)(A) and §1.170A-14(d)(4)(iii)(B). There was no dispute that the donation was accepted by a state agency, the Maryland Environmental Trust, yet the court noted that the thoroughness of the agency's review and the approval of high-ranking government officials (including the Governor) established the taxpayer's satisfaction of this element. The court applied a similarly rigorous analysis to the qualification of the easement as a donation of significant public benefit, finding in favor of the taxpayer.

The court then turned to conservation purpose and the perpetuity requirement of that standard. It immediately focused on Reg. §1.170A-14(g)(6), which "addresses subsequent unexpected changes in the conditions surrounding the donated property that make it impossible or impractical to continue using the property for the intended conservation purpose."[76]

The court referenced the extinguishment and proceeds provisions of Reg. §1.170A-14(g)(6) in their entirety — Reg. §1.170A-14(g)(6)(i) and §1.170A-14(g)(6)(ii), respectively. With regard to the proceeds requirement, the court emphasized that the donee organization must immediately vest in a property right:

> with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift bears to the value of the property as a whole at that time.[77]

The court cited a long and nuanced string of cases in which the government, taxpayers, the Tax Court, and the First Circuit Court of Appeals wrestled with the extinguishment and proceeds provisions[78] for the proposition that these regulations are strictly construed. Notwithstanding the clarity of that reference, the court narrowed the issue to "whether the donee has an absolute right against the donor upon extinguishment"[79] and focused on the numerator of the calculation in the regulations that determined proceeds.

The taxpayer's easement agreement entitled the grantees to a property right equal to the ratio of the value the conservation easement to the value of the entire property on the effective date. The agreement continued to define that value as "the deduction for

---

[73] *Id.*, slip. op. at 17–18.

[74] Each of the four elements of §170(h)(4)(A) is a conservation purpose in and of itself. Satisfaction of any one of these elements is sufficient to establish the existence of a conservation purpose. *Id.*, slip. op. at 19 (citing S. Rep. No. 96-1007, at 10 (1980), 1980-2 C.B. 599, 604.)

[75] §170(h)(4)(A)(iii).

[76] *Carroll*, 146 T.C. No. 13, slip. op. at 26.

[77] *Id.*, slip. op. at 27 (quoting Reg. §1.170A-14(g)(6)(ii)).

[78] *See Kaufman v. Commissioner*, 134 T.C. 182 (2010) (*Kaufmann I*). That decision on partial summary judgment was the first of four court opinions over the next five years to carry that caption (including one by the First Circuit Court of Appeals). After the second Tax Court opinion, *Kaufman v. Commissioner*, 136 T.C. 294 (2011) (*Kaufmann II*), the First Circuit issued an opinion, *sub nom. Kaufman v. Shulman*, 687 F.3d 21 (1st Cir. 2012) (*Kaufmann III*), which vacated *Kaufman II*'s reading of the regulations. On remand, the case was decided on valuation, *Kaufmann v. Commissioner*, T.C. Memo 2014-52 (*Kaufmann IV*), and affirmed by the First Circuit on those grounds, *Kaufmann v. Commissioner*, 784 F.3d 56 (1st Cir. 2015) (*Kaufmann V*). We might quibble with whether the First Circuit indeed vacated that part of *Kaufmann II* urging strict construction, but it does not matter in the *Carroll* case because it was appealable to the Fourth Circuit Court of Appeals and thus is not bound by the precedent of the First Circuit. *See Golsen v. Commissioner*, 54 T.C. 742, 757 (1970), *aff'd*, 445 F.2d 985 (10th Cir.), *cert. denied*, 404 U.S. 940 (1971).

[79] *Carroll*, 146 T.C. No. 13, slip. op. at 31.

ISSN 8755-0628

federal income tax purposes allowable by reason of this grant.''[80] In the event of extinguishment, the proceeds would be split according the parties' percentage interests determined according to those property rights.

Reg. §1.170A-14(g)(6)(ii) defines the ratio for proceeds as the fair market value of the conservation easement over the fair market value of the entire property. The court concluded that, because the ratio in the taxpayer's agreement used a numerator based on the *deduction* allowed under §170, and not the value of the easement donation itself, the donation did not meet the precise language of the proceeds requirement under Reg. §1.170A-14(g)(6)(ii). As such, the court held the easement was not granted in perpetuity. The court reasoned that if the IRS denied the taxpayer's charitable contribution deduction for a reason other than valuation, and the easement donation were ultimately extinguished, the numerator in the easement agreement's proceeds ratio would be zero.

The court was not persuaded when the taxpayer pointed out the circular logic of its position — that the disallowance under Reg. §1.170A-14(g)(6) hinges on the possibility that the deduction might be disallowed under other grounds. The taxpayer's arguments about the application of state law under Reg. §1.170A-14(g)(6)(ii) and the so-remote-as-to-be-negligible standard were also unheeded.

The court then turned to the application of penalties. The taxpayers claimed that they had reasonable cause to avoid penalties because the donation was based on a qualified appraisal by a qualified appraiser and the taxpayer made a good faith investigation of the value. The court found that was not enough.

Dr. Carroll testified that he had prior experience with conservation easements (maybe because his four neighbors had them) but also that he handled this conservation easement without the consulting with a tax attorney or other tax advisor. Based in part on that claim of experience, the court found that the taxpayers did not act with reasonable cause when they declined to seek competent tax advice regarding the conservation easement and, therefore, were liable for accuracy-related penalties.[81]

DON'T MOVE THAT LINE

The final technical rule we will discuss is the perpetuity requirement as applied to a qualified real property interest under §170(h)(2)(C). This technical interpretation may be most similar to rule of tennis that imposes a foot fault when a player ''touch[es] the area outside the imaginary extension of the sideline with either foot.''[82] In *Belk v. Commissioner*,[83] it may be fair to say that neither the government nor the taxpayers saw were the court was going until it got there.

The perpetuity rule has been part of the qualified conservation contribution regulations for 30 years, and competent tax advisors have drawn up conservation easement donations for sophisticated donors and recipient organizations within those limits. Great care was assigned to observing the regulations and maintaining value in donations, while also planning within the construct of real word considerations.

One way of doing that in the context of large open space donations is to reserve an unencumbered parcel for the donor while placing an easement over the remainder of the property. The objective is to facilitate the donation while still allowing the donor to set aside a fixed number of acres for personal development and continued access to a parcel within the environmentally protected property. For example, a donor might make a one hundred acre donation and reserve four acres with an allowance to build a structure of no more than two stories and 4,000 square feet. The deed would not record the exact location (metes and bounds) of the reservation for two common reasons. First, the location had not been determined at the time the donation. But also, the location did not materially affect the value of the donation because acreage in an open space appraisal is effectively fungible.[84]

The Tax Court considered a reservation clause of a different sort in *Belk v. Commissioner*.[85] In *Belk*, the taxpayers donated an open space conservation easement over a 184-acre golf course. The easement agreement included a clause that allowed the taxpayers to substitute the property subject to the easement with contiguous property of an equal or greater area. The substitution provisions required a showing to the recipient organization that any proposed substitution was of the same or better ecological stability, equal or greater fair market value, and could be accomplished without an adverse effect on the conservation purpose or the existing conservation area.[86] The caretaker organization could reject any substitution proposal with a written explanation. If accepted, the easement deed had to be amended for the substitution and re-recorded with the local register of deeds to be effective.

The IRS contested the donation in a broadly worded notice of deficiency claiming, ''[i]t has not been established that all the requirements of §170 and the corresponding Treasury Regulations have been satisfied to enable you to deduct the noncash charitable contribution of a qualified conservation contri-

[80] *Id.*

[81] Dr. Carroll's claim of expertise was likely undermined by his concession before trial to more than $130,000 of unreported income during the three years before court, including rental income, capital gains, and qualified dividends. Nonetheless, the importance of a competent tax advisor cannot be overstated. See note 23, above.

[82] ITF Rule 18(d).

[83] 140 T.C. 1 (2013), *aff'd*, 774 F.3d 221 (4th Cir. 2014).

[84] These conservation easement reservation clauses are sometimes called ''floating home'' sites.

[85] 140 T.C. 1 (2013).

[86] These deed restrictions appear to be recanted in full in the Tax Court's opinion. *See id.* at 3–5.

ISSN 8755-0628

bution.''[87] The IRS maintained that the contribution was not a qualified real property interest and that it was not exclusively for conservation purposes.[88]

The IRS characterized the donation as a ''floating easement'' because of the substitution clause and argued that it could not be a qualified conservation contribution because it did not relate to a specific piece of property. The IRS further noted that the government combined its argument that the donation was not a qualified real property interest with the claim that the donation did not meet the perpetuity requirement of conservation purpose. The taxpayers likewise did not seem to distinguish between the two concepts in response to the government's perpetuity argument.[89]

The approach of the litigants on both sides was consistent with the Tax Court jurisprudence that preceded them. In *Turner v. Commissioner*,[90] the Tax Court discussed the §170(h)(2) qualified real property interest rule in conjunction with the conservation purpose regulations under Reg. §1.170A-14(g)(1) rather than the regulations modifying that section. The court used similar language in *Simmons v. Commissioner*[91] and in *Glass v. Commissioner*[92] seeming to suggest that Reg. §1.170A-14(g)(1) of the conservation purpose regulations may be used to interpret the meaning of qualified real property interest.

The court surprised the parties and others when it issued a division opinion[93] in *Belk* that revised its own positions and considered for the first time what constitutes a qualified real property interest. Noting the break with its own precedents,[94] the court drew a distinction between the perpetuity requirement for conservation purposes and the perpetuity requirement for ''qualified real property interest.'' The court held that despite its prior pronouncements, the perpetuity restriction for a qualified property interest was separate and distinct from that for conservation purpose, and the satisfaction of one had no bearing on the other.[95] The court relied on its reading of the plain language of the statute to reach this conclusion.[96]

The court found that, because a use restriction existed only so long as the substitution provision in the agreement was not exercised, the encumbered property itself was not subject to an independent perpetual restriction on use. The fact that ''the conservation easement agreement permits petitioners to change what property is subject to the conservation easement'' meant that the use restriction over the real property was not granted in perpetuity.[97] The court dismissed the taxpayer's arguments that the conservation purpose was still preserved, that the donee had to approve any substitutions, and that the savings clause in the agreement did not allow for amendments that would violate §170(h). As such, *Belk* established the rule that there are two perpetuity requirements that must be met for a qualified conservation contribution: one relates to a qualified real property interest under §170(h)(2), and the other relates to conservation purpose under §170(h)(5).

The taxpayer appealed to the Fourth Circuit Court of Appeals, which employed its own plain reading of the statute to affirm the Tax Court's position on the perpetuity requirement of a qualified real property interest.[98] The taxpayer argued that even if the Fourth Circuit followed the Tax Court's construction of the statute, the conservation easement agreement included a savings clause that would preclude the approval by the recipient organization of any amendments ''that would result in this Conservation Easement failing to qualify . . . as a qualified conservation contribution under Section 170(h) of the Internal Revenue Code and applicable regulations.''[99]

The appellate court rejected the application of this clause to save the deduction, reasoning that it was an inapplicable condition subsequent even though it did not hinge on a specific event such as a determination by the IRS or a court.

CONCLUSION

The landscape for conservation and façade easement tax deductions is rapidly changing. Thoughtfully executed donations are being subject to unexpected scrutiny, and pending donations are facing newly announced restrictions and requirements even as they are being drafted. The intent of Congress is awash in all of this.

We have focused on four new rules governing the perpetuity requirement for conservation purposes and qualified real property interest. These rules have largely emerged from precedent-setting division opinions of the Tax Court. In *Mitchell*, the Tax Court announced a timing rule on the subordination of mortgages that, by its own admission, is not expressed in the regulation. In *Carroll*, it declared the strict construction of the proceeds distribution rule in the conservation purpose regulations. And in *Belk*, the court turned away from its prior precedents to unveil a new perpetuity requirement specific to qualified real property interests. The New York City façade easement

[87] *Id.* at 8 n. 11.

[88] The court did not reach the questions of conservation purpose or valuation because it found that the donation did not constitute a qualified real property interest.

[89] *Belk*, 140 T.C. at 11 n. 17.

[90] 126 T.C. 299 (2006).

[91] T.C. Memo 2009-208.

[92] 124 T.C. 258 (2005).

[93] ''Division opinions officially published by the court are those in which a legal issue of first impression is decided, a legal principle is applied or extended to a recurring factual pattern, a significant exception to a previously announced general rule is created, or there are similarly significant and precedentially valuable cases.'' Judge Mary Ann Cohen, *How to Read Tax Court Opinions*, 2 Houston Bus. Law J. 1, 7 (2001).

[94] *Belk*, 140 T.C. at 12. (citing *Turner v. Commissioner*, 126 T.C. 299 (2006); *Glass v. Commissioner*, 124 T.C. 258 (2005); *Simmons v. Commissioner*, T.C. Memo 2009-208).

[95] *Id.*

[96] *Id.* at 10.

[97] *Id.*

[98] *Belk v. Commissioner*, 774 F.3d 221 (4th Cir. 2014).

[99] *Id.* at 228.

ISSN 8755-0628

cases on recordation are non-precedential opinions, but they also are all factually bound to the local law of that jurisdiction. Those cases nonetheless demonstrate the importance of recording conservation deeds in the same year as the donation in order to safeguard tax deductions in that year (another rule not explicitly stated in the regulations).

These new rules are not alone. The IRS continues to challenge technical requirements of the qualified conservation contribution other than the perpetuity requirement. Those challenges have resulted in adverse taxpayer decisions in the last 12 months on contemporaneous written acknowledgement[100] and qualified appraisals.[101]

The qualified conservation contribution will survive. Its most important advocate and its author, Congress, continues to stand behind it. Yet the extent to which it retains its current promise may rely largely on the early and effective involvement of tax practitioners in both drafting and defense.

---

[100] *French v. Commissioner*, T.C. Memo 2016-53.

[101] *Costello v. Commissioner*, T.C. Memo 2015-87.

ISSN 8755-0628