No. 20-13700

IN THE UNITED STATES COURT OF APPEALS
FOR THE ELEVENTH CIRCUIT

DAVID F. HEWITT AND TAMMY K. HEWITT,

Petitioners - Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent - Appellee.

On Appeal from the United States Tax Court
Docket No. 23809-17;
(Hon. Joseph Robert Goeke)

Brief of *Amicus Curiae* North American Land Trust in Support of Petitioners-Appellants Brief

George Asimos
1620 Baltimore Pike
Chadds Ford, PA 19317
(484) 716-2057

Harry D. Shapiro
SAUL EWING ARNSTEIN & LEHR LLP
500 E. Pratt Street, 9th Floor
Baltimore, MD 21202
(410)332-8658

CONSENT TO FILE

All parties have consented to the filing of this brief.

CERTIFICATE OF INTERESTED PERSONS AND CORPORATE DISCLOSURE STATEMENT

There are hundreds of land trusts located throughout the United States that have an interest in the outcome of this case.

There is no parent corporation, and there is no corporation that owns 10% or more of the Amicus' stock. The Amicus is a non-stock corporation.

Counsel for Amicus Curiae:

George Asimos
Attorney at Law
1620 Baltimore Pike
P.O. Box 1067
Chadds Ford, PA 19317
(484) 716-2057
georgeasimos@gmail.com

Harry D. Shapiro
Saul Ewing Arnstein & Lehr LLP
500 E. Pratt Street, 9th Floor
Baltimore, MD 21202
(410) 332-8658
Harry.Shapiro@saul.com

Respectfully submitted, this 17th day of December, 2020

/s/ *George Asimos*
George Asimos
Pennsylvania Bar No. 49275
Attorneys for North American Land Trust

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I. INTERESTS OF THE AMICUS

North American Land Trust (NALT) is a non-profit corporation and a public charity dedicated to the conservation and stewardship of natural resources through land conservation, with a special focus on accepting charitable donations of conservation easements, which it then monitors and enforces. It is a "qualified organization" that can be the holder of donated conservation easements that are tax deductible gifts under 26 U.S.C. §170(h)(3).

Incorporated in 1992, NALT accepted its first conservation easement donation in 1996 and since then has conserved more than 130,000 acres of land in more than 540 conservation easement donations on land in 23 states. To fulfill this purpose NALT has a Board of Directors of individuals with professional experience in land conservation, business and government and a staff of professionals trained in such disciplines as land use planning, botany, geology, geography, and cartography.

If a conservation easement is donated and completed according to the requirements of Internal Revenue Code Section 170(h) ("Section 170(h)") and the Treasury Regulations in §1.170A-14, the donor is entitled to an income tax deduction, as a charitable gift, for the value of the conservation easement. After accomplishing the donation, the donee qualified organization (colloquially and herein called a "land trust") then has a statutory monitoring and enforcement role"

along with the necessary role of interpreting the easement over a very long period of time and of maintaining the long term relationship with the donor and successive owners of the conserved property.

Congress has long held that the conservation of land through the donation of conservation easements is an important public policy, having incentivized them by allowing income tax deductions for this charitable activity since 1969. The tax incentive was enhanced in 2006 to allow a deduction of up to 50% of Adjusted Gross Income (100% for certain agricultural use properties) and a 15 year carryforward of deductions that cannot be used by the taxpayer (donor) in the year of the donation. Congress recently reinforced its support for conservation easements when it made permanent the enhanced deduction and carryforward period by enacting the 2015 Protecting Americans from Tax Hikes Act. Section 170(h) is a popular, bipartisan law.

There are likely more than 1,700 conservation organizations in the United States. According to the last Land Trust Alliance census in 2010, conservation organizations that operate within a state or local region (rather than nationally) conserved more than 2.8 million acres of land by conservation easements between 2005 and 2010.

NALT – like its peer land trusts - is continuously working with land owners who are interested in donating conservation easements on their land. NALT,

therefore, has a strong interest in promoting the clear and practical interpretation of the Section 170(h) and §1.170A-14. The application of law to the grant of conservation easements has a significant impact on land owners' willingness to restrict their land by donating such easements - and on the accomplishment of the conservation benefits that Congress encouraged by enacting Section 170(h).

NALT believes that the Tax Court's ruling in this case, if allowed to stand, will reduce landowners' interest in the charitable donation of conservation easements and will disallow not only this taxpayer's deduction but also, due to widespread use of the challenged easement text, many more such deductions for well-conceived and well-executed conservation projects. The Tax Court's reading of the word "proceeds" is inconsistent with the remainder of the Regulations' text and with the limited interest that is donated to and vested in land trusts, and contributes nothing to the perpetual protection of the conserved land. For these reasons NALT advocates here for interpretations that promote a fair and harmonious reading of the Regulations – and that does not compromise the statute's ambitious conservation goals.

II. STANDARD OF REVIEW.

This is a case requiring the Court to decide the fair meaning of a regulatory requirement, based on statute, for deductibility of the charitable donation of a conservation easement and to determine if that requirement was satisfied. The

standard of review is *de novo*. *United States v. Veal*, 153 F.3d 1233, 1245 (11th Cir. 1998).

III. SUMMARY OF THE ARGUMENT.

The Tax Court erred in applying one of the requirements for a conservation easement tax deduction, in §1.170A-14(g)(6)(ii) (the "Regulations"). It defined the term "proceeds" that is to be paid to a land trust after condemnation or other judicial extinguishment of a conservation easement to include the value of reserved rights that were (1) never donated to the land trust and (2) not included in the amount of the donor's tax deduction; the result of which will be (3) to unjustly enrich the land trust for the value of improvements added to the property solely at the owner's expense and that was one of the donor's reserved rights under the easement. The result of the decision is that, for a deduction to be allowed, the easement must require that the proportionate value of undonated reserved rights must be awarded to the land trust if the easement is ever extinguished.

The effect of this error is to (A) create a windfall in favor of land trusts, (B) pit land trusts against owners by compelling them to make unreasonable and illogical claims against the assets of their donors in the case of a judicial extinguishment such as condemnation by a government agency and (C) thereby discouraging land owners from donating conservation easements because of the

risk of losing the potentially enormous value of their own improvements upon the unforeseeable event of a condemnation or other judicial extinguishment.

While condemnation of conserved property is not common, it does happen, and the effect of the error is not harmless because its negative effects will bear on many past and all future potential donations – contrary to Congress' clear intention to promote conservation.

What is a conservation easement?

A conservation easement is a recorded real estate agreement (sometimes called a deed) in which an owner donates a partial interest in real estate. It is not a donation of fee simple title. The owner retains all rights of possession, and the right to use and even build on the land, but only to the extent allowed in the easement restrictions. The rights to use or build on the land that is retained by the owner are usually called "reserved rights". These are uses improvements that can be done without destroying the conservation purposes of the easement. The right that is donated to the land trust, and that the Regulations require be "vested" in the land trust, is only the right to enforce the restrictions in the conservation easement, for conservation purposes, not the reserved rights.

What has the Tax Court failed to consider?

The Tax Court seems to have overlooked this rather practical point – that the Regulations, the entire conservation scheme and the real estate law on which it is

based, is the result of the fact that a conservation easement is a specific partial interest in real estate. It is a donation of development rights, except for the reserved rights.

In deciding that the exclusion of permitted, post-easement improvements (which are reserved rights) from extinguishment proceeds results in a failure to meet the requirements of §1.170A-14(g)(6)(ii), the Tax Court upends that scheme and asserts that the land trust must be awarded, upon condemnation or other judicial extinguishment of the easement, the value of the reserved rights that were never donated to it and for which no tax deduction was allowed.

Apart from the Tax Court decision, according to the Regulations, if the conserved property is ever condemned by the government such that the easement is extinguished, or if the easement is judicially extinguished for some other reason, the land trust must receive the original proportionate value of proceeds from the extinguishment, which must "remain constant".

But - and this is the crux of the matter - what if the taxpayer subsequently builds a home on the property and all the property (including the home) is condemned? What happens to the taxpayer's equity in the home? Neither the Commissioner nor the Tax Court addressed the real-world application of their definition of "proceeds"; nor did they address the relationship of the term "proceeds" with the unique property interest being extinguished.

What is the value of the land trust's interest that should be paid to the land trust as "proceeds"?

When a taxpayer donates a conservation easement on property, for that donation to qualify as a charitable donation under Section 170(h) and §1.170A-14, one among many requirements is that the land trust be deemed to have received a property right.[1] This is not in dispute. The property right donated to the land trust is, as stated above, simply the legal right to restrict the uses and building on the land according to the terms of the donated easement.

The Regulations require that this property right - owned by the land trust- must have "a fair market value that is at least equal to the proportionate value that

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[1] §1.170A-14(g)(6)(ii) requires:

> (ii) Proceeds. - In case of a donation made after February 13, 1986, for a deduction to be allowed under this section, at the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, 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. See §1.170A-14(h)(3)(iii) relating to the allocation of basis. For purposes of this paragraph (g)(6)(ii), that proportionate value of the donee's property rights shall remain constant. Accordingly, when a change in conditions gives rise to the extinguishment of a perpetual conservation restriction under paragraph (g)(6)(i) of this section, the donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction."

the perpetual conservation restriction at the time of the gift bears to the value of the property as a whole at that time." The value of the land trust's interest is determined by simple math: the unrestricted value of the land minus the restricted value of the land is the value of land trust's interests at the time of the gift. This is determined by appraisal at the time of the donation. And the proportionate value owned by the land trust is a fraction the numerator of which is the value of the land trust's property right (the difference described above) divided by a denominator which is the unrestricted value of the land. A mathematical example is provided below at pages 10 - 11.

The value of the reserved rights retained by the owner and not donated to the land trust – such as the right to build a house – is not part of the proportionate value of the land trust's perpetual conservation restriction. For example, if the donor had constructed a residence on the property, or reserved the right to do so after donation, the value of that reserved right would be excluded from the contribution to the land trust. The value of the reserved rights is simply not part of the value of the perpetual conservation restrictions at the time of the gift.

<u>The Tax Court definition of "proceeds" is inconsistent with the calculation of the tax deduction.</u>

The Tax Court decision is also inconsistent with the valuation of the conservation easement that determines the amount of the tax deduction. Since the taxpayer receives no deduction for the value of the right to make post-easement

improvements, much less the value of the improvements actually made, the donor received no deduction for the reserved rights. This is implicit in the "before and after" appraisal required in § 1.170A-14(h)(3).[2] The Regulations should not be interpreted to be inconsistent with the very scheme, a calculated income tax deduction, that it is intended to regulate.

By excluding the value of the reserved right to build a house, the easement results in a proportionate value calculation that matches §1.170A-14(g)(6)(ii). This formula can be represented as:

$$\text{Holder is paid: Proceeds} \times \frac{\text{Value of the Conservation Easement}}{\text{Value of the Property}}$$

And:

> Value of the Conservation Easement = Value of the Property Before the Easement – Value of the Property After the Easement.

This is the same division of fair market value provided in an easement donor's appraisal which determines the value of the gift to the holder.

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[2] See also *Carroll v. Commissioner of Internal Revenue*, 146 T.C. 196 (2016), in which the Tax Court did not question the definition of proceeds that excluded "(any amount attributable to the value of additional improvements made by the Grantors after the effective date of this Conservation Easement, which amount is reserved to Grantors)." 146 T.C. at 216. This supports the language used in the easement. Since the land trust should not be paid for the value of something it did not own and for which no tax deduction would have been allowed, the easement conforms to §1.170A-14(g)(6)(ii).

The amount deductible for an easement gift is the difference between the appraised value of the property before and after imposition of the easement. This valuation determines both the dollar amount of the tax deduction and the "proportionate value" mentioned in the Regulations. The value of the donor's reserved building rights must be included in the appraised value of the property "after" the easement is donated; therefore that value of the reserved rights is excluded from the value of the easement itself and so reduces the donation amount.[3]

If a land trust receives the proportionate value of all of the proceeds from a sale of the subject property, including the value of post-donation improvements made by the owner, the land trust is being compensated for the value of the reserved rights that were not given to the land trust in the first place. And, the valuation of the conservation easement for purposes of determining the tax deduction allowed under Section 170(h) excluded the value of the reserved rights.

A realistic example illustrates the point. The taxpayer's appraisal at the time of the donation finds the value of the unrestricted property to be

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[3] "In the case of a conservation restriction that allows for any development, however limited, on the property to be protected, the fair market value of the property after contribution of the restriction must take into account the effect of the development." §1.170A-14(h)(3)(ii).

$5,000,000 (the "before" value") and an "after" value of $1,000,000, resulting in a value of $4,000,000 for the easement. Thus the proportionate value of the land trust's property rights in the easement would be a fraction, i.e., 4/5 or 80/100. This is the "proportionate value of the perpetual conservation restriction" to which the Regulations refer and which must "remain constant". Later, if the easement is extinguished without any improvements having been made, the land trust would be entitled to receive 80/100 of the entire proceeds of sale of the property after extinguishment – an amount which rises if the market value of the conserved property has gone up or falls if the market value has gone down. However, if this hypothetical easement allows the owner to improve the property with a residence -- a reserved right, as many do, the example changes. Assume the owner improved the property with a residence that added $1.0 million in value to the property and the easement was later extinguished. Under the Tax Court's reasoning, the land trust would be entitled to receive both 80/100 of the current value of the land; and 80/100 of the value of the residence because the Tax Court says it must not be excluded – yielding an additional $800,000 more than the land trust would have received if the property had not been improved (80/100 of $1,000.000). The owner would receive only $200,000 of the $1,000,000 value of his own house even though the easement allowed the owner to build it, the owner built at his expense

the house that added $1,000,000 of value and, more importantly, for which the owner received no tax deduction**.**

Clearly, the Tax Court's requirement, if upheld, would produce a windfall for land trusts - and deprive owners of the same amount - by mandating the transfer of 80/100 of the value of improvements never owned by, paid for by, or donated to the land trust.

Custom and Practice

None of the parties to conservation easements expect the land trust to receive a share of the proceeds that would include an interest in the donor's home or any other structure or improvement that the conservation easement allows him to construct at his own expense. This is evidenced by the long history of interpretation of the Regulations by the land trust community.

According to the Land Trust Alliance, most conservation easement templates and models used by the Land Trust Alliance,[4] individual land trusts,

[4] The Land Trust Alliance, Inc., (the "Alliance") is a Massachusetts nonprofit corporation based in Washington, D.C.. Founded in 1982, the Alliance is a national land conservation organization that represents approximately 1,000 member land trusts supported by more than 200,000 volunteers and 4.6 million financial supporters nationwide. Together, national, state and local land trusts hold 42,425 conservation easements throughout the United States, covering approximately 16.8 million acres of land as of 2015. The Alliance speaks on behalf of all of this country's land trusts, their supporters, and conservation easement donors.

and federal and state governmental agencies incorporate language used by Appellants in their deed of trust ("Improvements Clause"). Appellant's Brief at pg. 19. According to the Land Trust Alliance in 2018, during the period at and before the time that this Appellant's Easement was donated, the Environmental Protection Agency, the National Park Service and the United States Army Corps of Engineers as well as assorted state agencies and land trust statewide coalitions, used the Improvements Clause; an informal survey of state land trust coalitions and regional and statewide land trusts at that time showed that most organizations use the Improvements Clause in their templates, including organizations in California, Colorado, Connecticut, Maine, New Hampshire, New Mexico, New York, North Carolina, South Carolina, and Texas; and other state or county agencies, at the time of the Appellant's Easement, had adopted the Improvements Clause including Colorado, Kentucky, Michigan, New Jersey, Vermont, and Virginia. As this demonstrates, the use of the Improvements Clause has been quite common at all levels of government and throughout the land trust community.

The *Conservation Easement Handbook*, published by the Land Trust Alliance and generally considered the most authoritative nationally recognized source of sound conservation easement drafting practices, recommends use of

the Improvements Clause "as a matter of basic fairness."[5] The Handbook's advice was first enunciated in 1988 and has remained consistent through more recent editions. Consequently, as discussed above, the Improvements Clause has been widely adopted by the land trust community and by governmental easement holders, both temporally and geographically. Another often-referenced authority for practitioners, *A Tax Guide to Conservation Easements*, after providing an example of how the Extinguishment Regulations work, states that when additional improvements are permitted under the terms of an easement they should not be included in the proceeds calculation.[6] In short, the Improvements Clause has been established as the national standard for tax-deductible conservation easements for over 30 years.

The Effect on Pending Easement Deductions

Based on current information from the Land Trust Alliance members, NALT believes that land trusts hold hundreds of similarly worded conservation

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5 Elizabeth Byers and Karin Marchetti Ponte, *The Conservation Easement Handbook* at 464, (The Trust for Public Land and Land Trust Alliance, 2d ed., 2005) (the "Handbook"). The Handbook authors also expressed a concern that an overly generous, windfall allocation to a land trust would financially reward poorly funded land trusts for cooperating in extinguishment, even though land trust's should resist extinguishment. See Handbook at p. 200.

6 Timothy Lindstrom, *A Tax Guide to Conservation Easements* at 137 (Land Trust Alliance, 2d ed., 2016)

easements donated within the past three years alone, and in light of the carryover period from earlier gifts allowed under I.R.C. §§ 170(b)(1)(D)(ii) and 170(b)(1)(E), the number would easily reach thousands of easements. The Commissioner's assertion that the Improvements Clause now, after many years of use, does not comply with the Regulations has thrust these easement donors, who are still within the general federal income tax statute of limitations, into a position of incurring additional income taxes, interest and penalties. Furthermore, conservation easements do not expire if a tax deduction is disallowed. Thus, owners will have charitably donated their property rights, received no deduction and yet their land will remain devalued by the easement. The repercussions of the Tax Court's decision redound not just to the taxpayer in this litigation, but to all recent easement donors, within the Eleventh Circuit's jurisdiction.[7]

How does the Improvements Clause work in practice – apart from the Tax Court decision – at the time of a condemnation or other judicial extinguishment?

In practical application, when a conserved property has been improved and the easement later extinguished, the "proceeds" obviously cannot be

[7] It is also possible that land trusts may be obligated, upon condemnation or other extinguishment of an easement, to claim the value of allowed improvements even if their easement lacks the Improvements Clause because of a need to comply with the Regulations, creating costly conflict and potentially conflict with state law pertaining to property rights.

determined by simply looking at the gross sale price, which typically will not allocate the purchase price between land and improvements. An appraisal would be used to determine that allocation, similar to what was done at the time of the gift. Then, the proceeds amount (after subtracting the allocated value of the improvements) would be multiplied by the original "constant" proportionate value of the easement and that amount would be paid to the land trust. This ensures that the land trust will be fully compensated and thus be able to perpetuate the conservation purposes of the easement as required by the Regulations. It will also ensure that neither the owner nor the land trust reaps a windfall, satisfying the court's understanding of the Regulations expressed in *Kaufman v. Schulman*, 687 F.3d 21, 26 (1st Cir. 2012), protecting the conservation purposes in perpetuity and fulfilling the Congressional requirement expressed in Section 170(h)(5)(A). Thus, there is no administrative problem for the Commissioner should this Court adopt NALT's interpretation of the Regulations.

Conclusion

In summary, the Tax Court erred because it misapprehended the extent of the real property interests that are embedded in the regulatory scheme: A conservation easement is only a partial interest in real property, the vested real property interest is comprised only of value of the restrictions and enforcement rights, not rights reserved to the donor. NALT argues that this Court ought not

consider the Regulations detached from the common legal understanding of the owner's valuable property rights. Improvements allowed by the easement and made to the property after the donation were never a part of the property right that was granted to and "vested in the donee organization" as stated in the Regulations. The "proceeds" should only be those derived from the right vested in the land trust. The Appellant's Easement, like most if not all conservation easements, did not convey to the land trust an ownership interest in the donor's permitted improvements; just the right to enforce the limitations on the improvements stated in the Easement. This principle is embedded in the Regulations which refers to the land trust's "vested right" as "the perpetual conservation restriction."

It is inconceivable to NALT and other land trusts that they would be entitled to share in the value of owner improvements, allowed as reserved rights under the easement document, upon a condemnation or other judicial extinguishment of the easement. This belief on the part of NALT and other land trusts is consistent with the calculation of the tax deduction (the donor having received no deduction for the reserved building rights) and the extent of the partial real property that is, by the Regulations, vested in the land trust. The land trust should not be paid upon condemnation or other judicial extinguishment for the value of something which reduced the allowed deduction, namely the reserved rights which were not conveyed to the land trust.

IV. CONCLUSION

The decision of the Tax Court, having adopted an erroneous definition of the term "proceeds", should be reversed.

Respectfully submitted,
By: */s/ George Asimos*
George Asimos, Esq.

Harry D. Shapiro
SAUL EWING ARNSTEIN & LEHR LLP
500 E. Pratt Street, 9th Floor
Baltimore, MD 21202

Counsel for *North American Land Trust*

CERTIFICATE OF COMPLIANCE

1. This document complies with the word limit of F.R. APP. P. 32(a)(7)(B)(i) and 29(a)(5) because:

   a. this document contains 4102 words, excluding the parts of the brief exempted by F.R. APP. P. 32(f) and 11 Cir. R. 32-4.

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/s/ George Asimos
George Asimos
Counsel for North American Land Trust

December 17, 2020

STATEMENT PURSUANT TO F.R. APP. P. 9(C)(5)

Amicus certifies that no party's counsel authored this brief in whole or in part; that no counsel or party contributed money that was intended to fund preparing or submitting the brief; and no person-other than the amicus curiae, its members, or its counsel-contributed money that was intended to fund preparing or submitting the brief.

/s/ George Asimos
George Asimos
Counsel for North American Land Trust

December 17, 2020

CERTIFICATE OF SERVICE

The undersigned certifies that on December 17, 2020, the foregoing Brief of *Amicus Curiae* North American Land Trust in Support of Petitioners-Appellants Urging Reversal was electronically filed with the Clerk of the Court for the United States Court of Appeals for the Eleventh Circuit by using the Appellee CM-ECF System. Participations in this case who are registered CM-ECF users will be served electronically by the Appellate CM-ECF System. Other participants will be served by e-mail.

/s/ George Asimos
George Asimos