Nos. 20-2117/20-2141

United States Court of Appeals

for the

Sixth Circuit

OAKBROOK LAND HOLDINGS, LLC, WILLIAM DUANE HORTON, TAX MATTERS PARTNER,

Petitioner/Appellant/Cross-Appellee,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent/Appellee/Cross-Appellant.

APPEAL FROM THE UNITED STATES TAX COURT

Docket No. 5444-13

(Hon. Mark V. Holmes)

INITIAL BRIEF OF APPELLANT

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DISCLOSURE OF CORPORATE AFFILIATIONS AND FINANCIAL INTEREST

Neither Oakbrook Land Holdings, LLC, the partnership at issue in this proceeding, nor William Duane Horton, Tax Matters Partner, is a subsidiary or affiliate of a publicly owned corporation. There is neither a publicly owned corporation nor a party to the appeal that has a financial interest in the case's outcome.

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STATEMENT IN SUPPORT OF ORAL ARGUMENT

Oakbrook Land Holdings, LLC ("Oakbrook") made a charitable donation of a valuable conservation easement to perpetually conserve the ridgeline of White Oak Mountain near Chattanooga, Tennessee (the "Easement"). Oakbrook used well-vetted and standard terms drafted by charitable land trusts that regularly accept and administer easement donations, and its donation complied with all the requirements of Internal Revenue Code § 170(h) (found in Title 26 of the United States Code). Years later, the IRS declared war on conservation easement donations to combat what it perceived as valuation abuses associated with certain "syndicated" conservation easement donations. Oakbrook is not one of the targeted syndicated conservation easement donations; it is a collateral casualty in that war.

While the conservation purposes served by the easement donations under IRS attack are rarely in question, the IRS's recent litigation strategy has been to raise technical arguments seeking wholesale denials of such charitable deductions so that it can avoid the costs of litigating fact-intensive valuation disputes. In furtherance of that strategy, eight years after Oakbrook's donation, the IRS announced, in unrelated litigation, a new interpretation of the requirements imposed by a decades-old regulation — the "Proceeds Regulation", Treasury Regulation § 1.170A-14(g)(6)(ii). This Regulation addresses a highly unlikely event — how compensation due under the Fifth Amendment, in the event of a government taking

of the easement property, should be allocated between the easement donor and donee to ensure the conservation purposes continue to be protected in perpetuity. The IRS's post-donation interpretation now requires that an easement holder (i.e., the land trust) receive proceeds attributable to property interests retained by the landowner. This new interpretation upends, and retroactively disqualifies, generally-accepted provisions in conservation easement deeds that land trusts, states, and even federal agencies (such as the Environmental Protection Agency) have widely-used for decades. As a result, the IRS has disallowed deductions claimed for hundreds of conservation easements, including Oakbrook's, for violating the Proceeds Regulation. These donors are left with no recourse to save a deduction for the undeniably valuable property rights they donated in a manner intended to comply with the IRS's requirements.

In claiming that its Regulation required this specific allocation; which is inconsistent with the standard language developed by the leading experts in conservation, and adopted by dozens of land trusts across the country, several states, and even federal agencies; the IRS brought into question the reasonableness of the Regulation. Oakbrook, in turn, asked that question: Is the Regulation reasonable and is it the product of reasoned decision-making? Turns out, it was not.

The Administrative Record produced by the IRS in the court below unequivocally demonstrates that during the notice and comment period, the

Department of Treasury ("Treasury") received 90 comments on the proposed qualified conservation contribution regulations (found in §1.170A-14 of 26 C.F.R.), over a dozen of which directly addressed proposed Proceeds Regulation. Many of those comments outlined multiple concerns with the formula that Treasury detailed in the proposed regulation and proposed a range of alternatives. Treasury did not respond to, address, or even acknowledge any of those comments.

The Tax Court judge who presided over the trial of the case — Judge Mark V. Holmes — concluded that the Proceeds Regulation is invalid because Treasury entirely failed to respond to comments challenging the proposed regulation or to consider the alternatives proposed. Op. at 118 (Holmes, J., dissenting).[1] The Tax Court majority opinion brushed aside presiding Judge Holmes's concerns, relying on a single throwaway line stating that Treasury finalized the rule "after consideration of all comments." *Id*. at 20. As Judge Holmes explained, to permit Treasury to evade the Administrative Procedure Act's ("APA") requirements in this fashion "would make commenting meaningless." Op. at 115 (Holmes, J., dissenting) (quoting *Home Box Office, Inc. v. F.C.C.*, 567 F.2d 9, 35 (D.C. Cir. 1977)).

[1] All references to the "Regulation Validity Opinion" or "Opinion" or "Op." are references to *Oakbrook Land Holdings v. Commissioner,* 154 T.C. No. 10 (2020), the opinion on appeal. Citations are to the pages in the slip opinion issued by the Tax Court. *See* Joint Appendix ("JA") at 1049-1176.

In his dissent, Judge Holmes observed, "[o]ur holding today will likely deny any charitable deduction to hundreds or thousands of taxpayers who donated the conservation easements that protect perhaps millions of acres." *Id.* at 82.[2] The Tax Court's decision has far-reaching implications beyond conservation easement donations. Under the Tax Court's decision, "the Treasury Department gets to ignore basic principles of administrative law that require an agency 'to give reasoned responses to all significant comments in a rulemaking proceeding.'" *Id.* (quoting *PPG Indus., Inc. v. Costle*, 630 F.2d 462, 466 (6th Cir. 1980)). Affording Treasury and the IRS such latitude in rulemaking is particularly troubling when the IRS "has begun to regulate an ever-expanding sphere of everyday life — from childcare and charity to healthcare and the environment." *CIC Services, LLC v. I.R.S.* 936 F.3d 501, 507 (6th Cir. 2019) (Mem.) (Thapar, J. dissenting), *cert. granted*, 140 S. Ct. 2737 (May 4, 2020) (No. 19-930). Given the significance of the issues raised and their impact on Treasury's future rulemaking, oral argument is requested.

[2] One such taxpayer has an appeal pending before the Eleventh Circuit challenging the validity of the Proceeds Regulation. *Hewitt v. Comm'r*, No. 20-13700 (11th Cir. filed Sept. 30, 2020). David Hewitt donated a conservation easement over the farm that had been passed down to him by his father. His deduction was also denied by the Tax Court based on the IRS's new interpretation of the Proceeds Regulation.

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COMMISSIONER OF INTERNAL REVENUE,
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INTIAL BRIEF OF APPELLANT

STATEMENT OF JURISDICTION

This is an appeal of the July 21, 2020 final decision of the United States Tax Court, which disallowed Oakbrook's charitable contribution deduction for its donation of a qualified conservation contribution solely because the terms of the document conveying the Easement did not comply the IRS's previously unstated and unknown interpretation of Treasury Regulation §1.170A-14(g)(6)(ii), which was issued in violation of the requirements of the APA.

The Tax Court had jurisdiction to review Oakbrook's petition for readjustment of partnership items pursuant to 26 U.S.C. §§6234 and 7442. This Court has jurisdiction to review decisions of the Tax Court pursuant to 26 U.S.C. §7482(a)(1). Venue is proper in the Sixth Circuit pursuant to 26 U.S.C. §7482(b) because Oakbrook's principal place of business was in Tennessee at the time the

petition was filed in Tax Court. Oakbrook filed a notice of appeal with the Tax Court on October 16, 2020, within 90 days from the date that the decision was issued in this case. Therefore, this appeal is timely under Tax Court Rule 190(a) and 26 U.S.C. §7483.

STATEMENT OF THE ISSUES

The issue before the Court is whether Treasury violated the APA when it issued the Proceeds Regulation without responding to relevant comments or providing the basis for its decision.[3] Judge Holmes, the trial judge in this case, said yes, and he would refuse to penalize well-intentioned taxpayers like Oakbrook, based on an invalid Regulation. In his view, the donation met the Internal Revenue Code's requirements, and the corresponding deduction could not be denied due to an invalid Regulation. The majority of the Tax Court, however, disagreed and issued an opinion that essentially vitiates Treasury's obligation to comply with the APA when issuing new rules or regulations so long as it invokes the magical phrase "after consideration of all comments" when issuing the final regulation. The Tax Court's decision undermines the APA's purposes and gives the IRS carte blanche to ignore comments in the future.

Oakbrook challenges the procedural and substantive validity of the Proceeds Regulation. The grounds for Oakbrook's two challenges overlap to a great degree. The Regulation fails to comply with the APA's procedural requirements because

[3] While Treasury is responsible for issuing the regulations interpreting the Internal Revenue Code, the IRS Office of Chief Counsel is heavily involved in the drafting process. *See* Chief Counsel Regulation Handbook, IRM 32.2 (Nov. 12, 2019). Therefore, IRS and Treasury are used interchangeably at times in discussing the Regulation's promulgation.

Treasury failed to consider and respond to relevant comments and failed to provide any reason for imposing this regulatory requirement in the basis and purpose statement accompanying the final regulations. *See* 5 U.S.C. §553(c). Treasury's failure to provide any reason for its rule, or analysis of the comments received, results in its substantive invalidity under 5 U.S.C. §706(2) because Treasury did not meet the reasoned decision-making requirements found in *State Farm* and *Chevron*. *Chevron, U.S.A., Inc. v. Nat. Res. Def. Council, Inc.*, 467 U.S. 837 (1984); *Motor Vehicle Mfrs. Ass'n of the U.S. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29 (1983). The Regulation also is substantively invalid because it imposes requirements outside the scope of the relevant statute.

The statute provides that a taxpayer is entitled to a deduction for the donation of a qualified conservation contribution when three requirements are satisfied: (1) the taxpayer donates "a qualified real property interest" (2) to a "qualified organization" (3) that is "exclusively for conservation purposes." I.R.C. §170(h)(1). A donation is exclusively for conservation purposes if "the conservation purpose is protected in perpetuity." §170(h)(5). Oakbrook's donation met all three of the statutory requirements.

The Proceeds Regulation was issued in 1986 as part of a larger regulatory project to provide guidance for qualified conservation contributions. The Proceeds Regulation concerns the unlikely event that the protected property is condemned,

resulting in the easement's extinguishment. How should the proceeds due under the Fifth Amendment's Takings Clause be allocated between the property owner and the charitable organization that holds the easement to ensure the conservation purposes are protected in perpetuity?

To address this unlikely situation, Treasury's Proceeds Regulation requires that — *at the time of donation* — the donor and donee agree, *inter alia*,:

> (1) the conservation easement "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;"
>
> (2) the proportionate value of the donee's property right remains constant; and
>
> (3) following the easement's extinguishment by judicial proceedings, "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."

Treas. Reg. §1.170A-14(g)(6)(i)-(ii).

In response to the proposed Proceeds Regulation, several commenters expressed concerns about whether the requirement that post-extinguishment proceeds be allocated according to the "proportionate value" established at the time of donation was fair, reasonable, or even practical. JA670-72, JA675, JA682, JA685, JA764-66, JA778-79, JA795, JA798. Commenters also expressed concern

that, as drafted, the Regulation did not properly account for improvements to the property made by the ***donor*** after the donation of the easement, improvements in which the land trust would have no legal or financial interest. JA670-72.

In its final regulations, Treasury neither addressed those comments nor explained whether it had considered or rejected the alternatives proposed and why. *See* Income Taxes; Qualified Conservation Contributions, 51 Fed. Reg. 1496-98 (Jan. 14, 1986) (to be codified at 26 C.F.R. pt. 1); T.D. 8069, 1986-1 C.B. 8951. In fact, the preamble to the final regulations is silent on the basis or purpose of Treasury Regulation §1.170A-14(g)(6)(ii). *Id.* In the years that followed, the IRS did not offer any additional explanation or guidance on the purpose or operation of the Proceeds Regulation.

Between 1986 and 2016, the IRS challenged dozens of conservation easement donations with proceeds provisions that operated in the same or similar manner as the provision in Oakbrook's "Conservation Easement and Declaration of Restrictions and Covenants" (the "Deed"). Not once did the IRS challenge the proceeds provision as noncompliant with the Proceeds Regulation. In 2016, eight years after Oakbrook donated the Easement, the IRS reversed course and began to use the Proceeds Regulation as a means to disallow deductions for many significant conservation donations. *See, e.g., Carroll v. Comm'r*, 146 T.C. 196, 201 n.7, 208-09, 219 (2016) (disallowing in full the taxpayers' deduction for an extensively vetted

conservation easement donation to a land trust created by Maryland's legislature to conserve Maryland's critical lands).

Judge Holmes expressed concern with the IRS's "attack on a clause commonly found in easements, particularly in the southeastern part of the country." Mem. Op.[4] at *2. Oakbrook argued that the IRS's attack on the generally-accepted proceeds provisions must fail because the IRS did not comply with the administrative law requirements governing the regulation underlying the IRS's attack. The Tax Court majority sided with the IRS, setting the stage for the IRS to forever avoid its APA obligations by merely incorporating "broad statements of purpose . . . coupled with obvious inferences." Op. at 25.

The majority's conclusion that Treasury complied with the APA's procedural requirements was incorrect. As Judge Holmes explained, "if the APA did allow comments to be disregarded with this simple magical phrase as part of a standard form, it would make commenting meaningless." *Id.* at 115 (Holmes, J., dissenting). Judge Holmes also criticized the majority's decision to excuse Treasury's failure to provide a reason for its Regulation: "The majority today comes up with as good a set of arguments as possible to justify the reasonableness of the regulatory choices

[4] Judge Holmes's memorandum opinion, 119 T.C.M (CCH) 1352 (2020), containing the Tax Court's factual findings and determination that penalties are not applicable is referred to as "Memorandum Opinion" or "Mem. Op." This brief cites the slip opinion issued by the Tax Court. *See* JA1177-1220.

that Treasury made when it was drafting this regulation. But Treasury didn't make them." *Id.* at 126. Judge Toro was likewise concerned with the majority's conclusion: "'When an administrative agency sets policy, it must provide a reasoned explanation for its action. That is not a high bar, but it is an unwavering one. Here, . . . [Treasury] has failed to meet it.'" *Id.* at 80 (Toro, J., concurring) (quoting *Judulang v. Holder*, 565 U.S. 42, 45 (2011)) (alteration in original).

Under the Tax Court's decision, Oakbrook, and many other donors who relied on generally-accepted deed provisions, will lose their deductions in full, with no opportunity or ability to reform a purportedly problematic provision that likely will never even be utilized. More concerning, the Tax Court's decision lowers the bar for APA compliance to the point where the APA's procedural safeguards become meaningless. Such a determination must not stand in this Court, which recently observed that the IRS does "not have a great history of complying with APA procedures, having claimed for several decades that their rules and regulations are exempt from those requirements." *CIC Services, LLC v. I.R.S.*, 925 F.3d 247, 258 (6th Cir. 2019) (internal quotations omitted). The questions for this Court, therefore, are as follows:

Issue 1: Did the Tax Court err in concluding that Treasury complied with the Administrative Procedure Act, 5 U.S.C. §553, in promulgating Treasury Regulation §1.170A-14(g)(6) when the Administrative Record produced by the IRS

demonstrates that: (1) more than ten commenters raised issues with the proposed regulation, including the specific issue in this case of how to allocate extinguishment proceeds attributable to improvements; and (2) Treasury failed to respond to or even address any of those concerns in the basis and purpose statement accompanying the final regulations?

Issue 2: Did the Tax Court err in concluding that Treasury Regulation §1.170A-14(g)(6) is not an arbitrary and capricious agency action under 5 U.S.C. §706(2) when Treasury offered no explanation for its decision and when the IRS's interpretation of the Regulation requires that the donor convey interests to the donee in excess of those required in I.R.C. §170(h)?

STATEMENT OF THE CASE

Conservation easement donations have drawn the IRS's ire in recent years due to perceived overvaluations by certain donors of such easements. But instead of addressing valuation issues on a case-by-case basis, as the law requires, the IRS has implemented a strategy to void these deductions *en masse* by adopting "very contestable readings of what it means for an easement to be perpetual." Op. at 127 (Holmes, J., dissenting). This blunderbuss approach, which is no doubt designed to save the IRS the administrative hassle of litigating the fact-intensive issue of easement valuation, will deny entire deductions for conservation easement donations that Congress sought to encourage — based on a hypothetical easement

extinguishment that is highly unlikely ever to happen. This approach creates vast uncertainty that Congress explicitly sought to prevent.

Oakbrook's members relinquished their rights in perpetuity to develop a valuable mountaintop located in one of Chattanooga's high growth corridors. In exchange, Oakbrook's members are entitled to the tax deduction created by Congress to incentivize this very type of donation. The rights donated will neither revert back to Oakbrook or its members nor did Oakbrook limit the Southeast Regional Land Conservancy's ("SRLC") ability to enforce the Easement's restrictions in perpetuity. Nevertheless, the IRS disallowed Oakbrook's deduction (and countless others) based on a "very contestable reading" of the Proceeds Regulation that was manufactured by the IRS nearly a decade after Oakbrook's donation.

The IRS cannot deny Oakbrook's deduction based on a regulation that Treasury issued in violation of the APA. The IRS is attempting to leverage its unexplained Regulation into hundreds of disallowed deductions by adopting new interpretations that contravene the engendered reliance interests of taxpayers and land trusts. The APA's procedural safeguards exist to preclude agencies from achieving such inequitable results, and the IRS must be held accountable for failing to meet the APA's requirements.

A Procedural History

In 2008, Oakbrook donated a conservation easement perpetually protecting 106 acres on White Oak Mountain from the growing residential and commercial development in the surrounding area. JA110-11. Oakbrook claimed a charitable contribution deduction resulting from the Easement donation on its 2008 tax return. JA137-38. The IRS selected Oakbrook's 2008 federal tax return for audit. In 2012, the IRS denied Oakbrook's charitable contribution deduction in a Notice of Final Partnership Administrative Adjustment ("FPAA"). JA104. The IRS also asserted accuracy-related penalties under I.R.C. §6662. Mem. Op. at *9. Oakbrook challenged the IRS's conclusions by timely filing a petition with the United States Tax Court. JA008.

Oakbrook's case was tried before the Honorable Judge Mark V. Holmes on October 6-7, 2016. The IRS argued that (1) the deduction must be disallowed "[b]ecause [SRLC] is not entitled to the proper proportionate share of extinguishment proceeds," and (2) the Easement's value was overstated by approximately $9 million. JA047, JA050.[5] The IRS argued that the Deed did not comply with the Proceeds Regulation for two reasons. First, the IRS claimed that

[5] The IRS also raised a second legal issue, challenging Oakbrook's four reserved homesites, which could be moved subject to SRLC's approval. Both the Fifth and Eleventh Circuits have since held that moveable homesites, subject to land trust approval, are permissible. *Pine Mountain Preserve, LLLP v. Comm'r*, 978 F.3d 1200 (11th Cir. 2020); *BC Ranch II, L.P. v. Comm'r*, 867 F.3d 547 (5th Cir. 2017).

the Deed improperly calculated the "proportionate value" based on the Easement's fair market value at the time of donation (*i.e.,* the fair market value of the property right conveyed to the land trust), and that the Regulation requires for a ratio of the Easement's value to the value of the underlying land instead. JA046. Second, the IRS asserted that Oakbrook improperly retained a right, in the unlikely event of easement extinguishment, to compensation proceeds attributable to post-donation improvements built by the landowner. The IRS asserted that land trusts must receive a portion of proceeds attributable to post-donation improvements, despite having no legal interest in (and despite having expended no funds for) those improvements. JA046-47.

During trial and in its post-trial briefs, Oakbrook challenged the IRS's reading of the Proceeds Regulation, the Regulation's validity under the APA, the imposition of accuracy-related penalties, and the IRS's Easement value determination. *See, e.g.*, JA447-83, JA495-542, JA588-601, JA604-30. In response to Oakbrook's challenge to the Proceeds Regulation's validity, Judge Holmes directed the parties to submit additional briefs solely analyzing the Proceeds Regulation's validity. JA632-33. The order also directed the IRS to submit the Administrative Record underlying Treasury Decision 8069 to the Court for review, which included all comments received. JA632-33. Both parties submitted briefs concerning whether

Treasury complied with the APA in promulgating the Proceeds Regulation. *See* JA808, JA1039.

On May 12, 2020, the Tax Court issued two opinions in the case. Judge Holmes issued the Memorandum Opinion containing the Court's factual findings. Judge Holmes explained that two opinions were necessary because there is "a difference of opinion in the Court on the question of the regulation's validity." Mem. Op. at *3. However, "there is not [a difference of opinion] on the factfinding and application of the regulation to those facts." *Id.*

The Memorandum Opinion summarized the IRS's recent onslaught of "sorties" on conservation easement donations "predicated on the requirement that such easements be 'perpetual'" in the hopes of causing "more widespread casualties" to deductions claimed for such donations. Memo Op.. at *2. The "sortie" conducted in *Oakbrook* is "an attack on a clause commonly found in easements." *Id*. These attacks are part of the IRS's ongoing efforts to combat perceived valuation abuse in transactions that the IRS has characterized as "syndicated conservation-easement transactions." *Id.* at *13. Oakbrook's Easement "is not a syndicated conservation easement," just a collateral casualty in the IRS's war. *Id*. at *13 n.8.

While finding that the language in Oakbrook's Deed violates the IRS's new interpretation of the Regulation announced in 2016 — eight years after Oakbrook donated the Easement — the Memorandum Opinion concluded that this finding does

not "necessarily doom Oakbrook's deduction" because "Oakbrook argues in the alternative that this regulation is invalid." Mem. Op. at *41. The majority of the Tax Court took a different view of the Regulation's validity, necessitating the Regulation Validity Opinion. The Tax Court's Regulation Validity Opinion was binding upon the Tax Court in the Memorandum Opinion.[6]

The Regulation Validity Opinion was authored by Judge Lauber, who concluded that Treasury complied with the APA's procedural requirements. Judge Lauber further concluded that that the Proceeds Regulation was substantively valid under *Chevron* and *State Farm.* Judge Holmes penned a lengthy dissent to the Regulation Validity Opinion. Judge Toro concurred in result only. Judge Toro's concurring opinion, joined in relevant part by two Tax Court judges, explained at length why Treasury failed to comply with the APA in promulgating the Proceeds Regulation and why that Regulation, as now interpreted by the IRS, is invalid under *Chevron.*[7]

[6] The Tax Court does not sit *en banc*, but some opinions are reviewed by the judges in conference. A reviewed opinion is binding on the Tax Court. Oakbrook challenges the conclusion in the Regulation Validity Opinion, which would necessarily alter the Memorandum Opinion's disallowance of the deduction.

[7] In a case with a similar procedural history, the Eleventh Circuit recently reversed an opinion reviewed by the full Tax Court that accepted a different IRS technical attack on standard language in conservation easement deeds. *See Pine Mountain*, 978 F.3d 1200.

Neither the Memorandum Opinion nor the Regulation Validity Opinion reached a determination as to the Easement's value because the deduction was disallowed in full, and the IRS conceded that valuation misstatement penalties do not apply. Mem. Op. at *11 n.6. The Memorandum Opinion concluded that the non-valuation penalties are not applicable because "Oakbrook's position was reasonable" and "taken entirely in good faith." *Id.* at *43.

B Rulings Presented for Review

Oakbrook appeals the Regulation Validity Opinion, as adopted by the Memorandum Opinion pursuant to which Oakbrook's deduction was disallowed. Oakbrook donated the Easement to protect White Oak Mountain from development in perpetuity. Oakbrook neither limited the land trust's ability to enforce the Easement's restrictions in perpetuity nor did Oakbrook limit the duration of the Easement's restrictions. Instead, the only issue is whether a commonly-used clause concerning the allocation of proceeds in a hypothetical judicial extinguishment of the Easement dooms Oakbrook's deduction when Treasury failed to provide even a "minimal level of analysis" to support the regulatorily-mandated allocation.

C Facts

(1) Qualified Conservation Contribution Statutory History

In 1980, Congress enacted legislation to encourage the conservation of significant land and vistas. This legislation became I.R.C. §170(h). Tax Treatment Extension Act of 1980, Pub. L. No. 96-541, §6(b), 94 Stat. 3204, 3206 (1980).

> The Committee believes that the preservation of our country's natural resources and cultural heritage is important, and the committee recognizes that conservation easements now play an important role in preservation efforts.

S. Rep. No. 96-1007, at 9 (1980), *as reprinted in* 1980 U.S.C.C.A.N. 6736, 6744. In so doing, "the Committee found it appropriate to expand the types of transfers that will qualify as deductible contributions" to include "easements and other interests in real property that under state property laws have similar attributes (e.g., a restrictive covenant)." *Id.* at 9-10.

When extending the charitable contribution deduction to conservation easements, Congress noted that it "expects that regulations under this section will be classified among those regulation projects having the highest priority" so that "potential donors [will] be secure in their knowledge that a contemplated contribution will qualify for a deduction." S. Rep. No. 96-1007, at 13. Forty years later, donors are less confident than ever that their contribution will qualify. *See* Op. at 127-28 (Holmes, J., dissenting).

(2) Treasury's Promulgation of Regulations

On May 23, 1983, the IRS issued a notice proposing regulations to clarify the statutory rules put into effect in §170(h). Qualified Conservation Contribution, 48 Fed. Reg. 22940 (proposed May 23, 1983) (to be codified at 26 C.F.R. pt. 1). In response to this notice, "Treasury received approximately 90 comments regarding the substance of the proposed section 170A regulations." Op. at 89 (Holmes, J., dissenting). Of those 90 comments, 13 directly addressed the proposed regulation that became §1.170A-14(g)(6)(ii).[8] *Id.* at 11. Some questioned whether the proposed required allocation "could be enforced against anyone other than the original donor." *Id.* at 94 (Holmes, J., dissenting). One commenter cautioned, "[t]he provisions for apportionment of proceeds in the case of extinguishment of a conservation restriction . . . contain problems of policy and practical application so pervasive as to cause us to recommend strongly the deletion of these provisions." JA670. Moreover, "[t]he question of how to treat donor improvements undertaken after the grant of the easement in the event the property was subsequently sold was put squarely before Treasury during the comment period." Op. at 70 (Toro, J., concurring). Commenters suggested that existing alternatives would preclude the donor from realizing an improper benefit from an extinguishment, such as the tax

[8] The proposed proceeds regulation is grouped among the regulations addressing the statutory requirement that "the conservation purpose is protected in perpetuity." I.R.C. § 170(h).

benefit rule and the proposed "so-remote-to-as-to-be" negligible rule. JA685, JA795.

In publishing the final regulations, Treasury did not discuss any of the comments made with respect to §1.170A-14(g)(6)(ii), including concerns about the treatment of donor improvements. Qualified Conservation Contributions, 51 Fed. Reg. at 1496-98 (*see* JA643-45). Treasury did not explain why it rejected specific suggestions, why it altered the Regulation's language, or why it made the decision to require this specific post-extinguishment allocation. In fact, Treasury did not discuss the Proceeds Regulation at all.

In its final form, the Regulation reads as follows:

> (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 give 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.

Treas. Reg. §1.170A-14(g)(6)(ii).

(3) Absence of IRS Guidance and Taxpayer Reliance

In the 30 years that followed, donors, land trusts, and many federal agencies crafted template language to allocate proceeds in the event of a judicial extinguishment for the purpose of complying with the Proceeds Regulation. Many donors, including Oakbrook, relied on template language drafted and vetted by the land trusts. Such language routinely set aside the value attributable to post-easement improvements when computing the proceeds allocable to the land trust.

In 2005, the Land Trust Alliance (the "Alliance")[9] published the second edition of the *Conservation Easement Handbook* (the "*Handbook*"). Elizabeth Byers & Karin Marchetti Ponte, *Conservation Easement Handbook* (2d ed. 2005). The *Handbook* explains that the regulations do not address "appreciation in value due to improvements, although allocation [consistent with the model deed] . . . is certainly called for as a matter of basic fairness." *Id.* at 464. When allocating proceeds, the *Handbook*'s model excludes "any increase in value after the date of this grant attributable to improvements not paid for by holder" from the value of the property

[9] The Alliance is a national land conservation organization that represents more than 1,000 member land trusts.

on the date of extinguishment. *Id.* at 463.[10] While recommending that land trusts include post-extinguishment allocation to comply with the Regulation, the *Handbook* questioned whether such provisions were enforceable: "[T]he mechanics of enforcing this provision may prove complicated, perhaps requiring the imposition, following extinguishment, of a lien." *Id*. at 464. This same concern was expressed during the notice and comment period, but Treasury did not address it. Op. at 94-95 (Holmes, J., dissenting).

The land trust community was also tasked with crafting language to properly capture the "proportionate value" of conservation easements for purposes of allocating proceeds following a condemnation. While many land trusts took the view that the language, "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" sets up a formula for a fractional "proportionate value," other land trusts, including the land trust that drafted Oakbrook's Deed, drafted deeds setting the proportionate value to be the fixed

[10] More than 30 land trusts have come forward and confirmed that they also remove donor improvements, consistent with the recommendations of the Alliance. The IRS's position here would render conservation easement deeds prepared by all of these charitable organizations noncompliant with the Proceeds Regulation's requirements. Brief for Land Trust Alliance, Inc. et al. as Amici Curiae Supporting Appellant, *PBBM-Rose Hill, Ltd. v. Comm'r*, 900 F.3d 193 (5th Cir. 2018) (No. 17-60276), 2018 WL 5087506 at *7-*10.

amount of the easement donated. *See, e.g.*, *Railroad Holdings, LLC v. Comm'r*, 119 T.C.M. (CCH) 1136 at *4 (2020). The preamble to the final regulations provided no clarification as to whether "proportionate value" modifies "fair market value" — which would mean that the amount of the proportionate value is fixed — or whether it modifies "property right," which would mean that proportionate value is a percentage. In 2018, the Fifth Circuit highlighted this ambiguity but did not disturb the consensus of the parties in that case that the Regulation called for a fraction.[11] *Rose Hill*, 900 F.3d at 205-07. When Oakbrook donated its Easement in 2008, the IRS had never challenged the use of a fixed amount as the "proportionate value" of the conservation easement to be paid in the case of condemnation.

In fact, prior to 2016, the IRS issued no guidance suggesting that removal of value attributable to donor improvements or the use of an easement's fixed fair market value to determine the land trust's allocable share was impermissible. Since 2008, the IRS has challenged several other conservation easement deductions without challenging the proceeds provisions it claims are fatal here. *See, e.g.*, *BC Ranch II*, 867 F.3d 547; *Palmer Ranch Holdings, Ltd. v. Comm'r*, 812 F.3d 982 (11th

[11] Under the last antecedent rule of construction, however, "proportionate value" modifies "fair market value," indicating a fixed amount, consistent with the manner in which SRLC drafted Oakbrook's deed. *Barnhart v. Thomas*, 520 U.S. 20, 26 (2003).

Cir. 2016); *Atkinson v. Comm'r,* 110 T.C.M. (CCH) 550 (2015); *Butler v. Comm'r,* 103 T.C.M. (CCH) 1359 (2012).

In 2016, the IRS articulated for the first time — in litigation — its position that §1.170A-14(g)(6)(ii) required an allocation of proceeds attributable to post-donation improvements to the land trust. *See PBBM-Rose Hill, Ltd. v. Comm'r*, No. 026096-14 (T.C. Oct. 11, 2016) (bench opinion) (United States Tax Court Docket Search). The IRS gave no explanation for its position change. The same year, the IRS — for the first time — challenged Oakbrook and SRLC's use of a fixed amount as the "proportionate value" of the conservation easement. JA044-46. By this time, Oakbrook's Easement had been in place for nearly eight years.

(4) Mr. Horton's Decision to Donate a Conservation Easement

Mr. Horton and his wife discovered the Oakbrook property while searching for a place to build a home. Mem. Op. at *3. They spotted a "briar-covered for-sale sign" on White Oak Mountain offering 143 acres for sale. *Id.* Though the property "was significantly larger and considerably more overgrown than what they wanted, . . . they thought it could be the diamond in the rough for which they had been prospecting." *Id.*

White Oak Mountain is located right outside Chattanooga, Tennessee, the city where Mr. Horton grew up. Mem. Op. at *4. Mr. Horton earned a construction degree at Georgia Tech and started his construction career in Chattanooga in 1998.

Id. In 2002, Mr. Horton formed his own construction company which became successful. *Id.* "In 2007 Horton and a number of his subcontractors, suppliers, and past clients formed a real-estate development company and a real estate investment fund." *Id.* The development company worked with larger land tracts "usually in high-growth sectors of the area that may have challenges . . . [such as] lack of infrastructure, access issues, rezoning issues, or topography issues" to unlock the property's potential value. *Id.* (internal quotations omitted). Due to Mr. Horton's construction background, he was uniquely able to see the overgrown property's potential. *Id.* As a result of the find, Mr. Horton "quickly contacted various investors to plan how to buy and develop it." *Id.*

Mr. Horton and the investors formed Oakbrook in August 2007 and bought the property for $1.7 million in order to develop the property into "higher-end, single-family residences with a commercial service area." Mem. Op. at *4 (internal quotations omitted). To accomplish such a plan, "Oakbrook had to overcome a number of thorny obstacles." *Id.* Oakbrook obtained the necessary, highly-regulated permits to build (and did build) a bridge across Hurricane Creek, which was needed to access approximately 80% of the previously inaccessible property. *Id.* at *5. Oakbrook also installed a high-pressure sewer pump station, and successfully rezoned a portion of the property to a C-2 Local Business and Commercial District. *Id.*

While trying to develop the Oakbrook property, Mr. Horton was also proceeding with two other mixed-use development projects near Chattanooga: Hillocks Farm and Brow Wood. JA263, JA289-300. These projects were similar to the planned Oakbrook project in size, scope, and distance from downtown Chattanooga. *Id*. Mr. Horton originally purchased the Brow Wood property for $10,000 an acre, subdivided it into 1/3 to 1 acre lots, and sold the lots for $185,000-$200,000 each. JA291-92. He also sold three acres to an assisted living group for $166,666 per acre. *Id*. Mr. Horton's work on these other successful developments limited his ability to devote the necessary attention and time to developing the Oakbrook property.

In early 2008, Mr. Horton learned of a conservation easement placed on property in nearby north Georgia. Mem. Op. at *5. Interested, Mr. Horton researched conservation easements and "started to think about placing a conservation easement on the Oakbrook property." *Id.* An easement on the Oakbrook Property would protect the White Oak Mountain ridgeline in perpetuity, in contrast to the ridgeline across the street, which had been heavily developed. *See* JA264. James Wright, the Executive Director of SRLC, further educated Mr. Horton concerning conservation easements. Mr. Wright assured Mr. Horton that SRLC's attorneys "would draft the legal paperwork should Oakbrook want to give [SRLC] an easement." Mem. Op. at *5.

When Mr. Horton brought the idea of a conservation easement to Oakbrook's members, they initially balked because they believed that the property would be much more valuable once developed. *See* JA363-65. However, Mr. Horton eventually persuaded them to agree to conserve 106 acres of the Oakbrook property. *See* Mem. Op. at *5. In October 2008, Oakbrook transferred thirty-four acres of the Oakbrook property to related entities for development and obtained a $3.2 million bank loan to develop infrastructure on the transferred acres. JA252-261, JA345-48.

On December 30, 2008 Oakbrook donated a conservation easement to SRLC on the 106 acres through the Deed. *See* JA110. Mr. Horton and all the Oakbrook investors "relied heavily on the Conservancy to draft the Easement Deed." Mem. Op. at *6. The Tax Court specifically found that "Horton, acting on behalf of Oakbrook, was reasonable in inferring that the Conservancy's experience meant that the deeds it had drafted conformed to the Code and regulations." *Id.*

The provision in the Easement Deed relevant to this appeal is Article VI, Section B(2) (the "Extinguishment Provision"). *Id.* The Extinguishment Provision follows the Proceeds Regulation, providing "[t]his Conservation Easement gives rise to a real property right and interest immediately vested in SRLC." JA121. The fair market value of that property right is:

> [T]he difference between (a) the fair market value of the Conservation Area as if not burdened by this Conservation Easement and (b) the fair market value of the Conservation Area burdened by this Conservation Easement, as such

> values are determined as of the date of this Conservation Easement.

JA121-22. The Extinguishment Provision reduces the value of SRLC's property right by:

> [A]mounts for improvements made by Owner in the Conservation Area subsequent to the date of this Conservation Easement, the amount of which will be determined by the value specified for these improvements in a condemnation award in the event all or part of the Conservation Area is taken in exercise of eminent domain.

JA121-22.

SRLC drafted this Extinguishment Provision to provide SRLC with what it was entitled to receive under the Proceeds Regulation and more. JA394-95. "According to Wright, the above language is standard among the Conservancy's conservation easements." Mem. Op. at *7. Wright was also "'pretty sure' the language was adopted from numerous other model agreements, including those produced by the Land Trust Alliance."[12] *Id.*

Wright explained that the Extinguishment Provision defines the Easement's fair market value "as the difference between the property's value without the easement and the property's value with the easement." *Id.* at *7-8. Wright understood that the language was consistent with Regulation's language and

[12] As the Tax Court notes, "According to *amici* in another case, . . . there is reason to believe thousands of conservation easements have similar language." *Id.* (citing Brief for Land Trust Alliance, Inc. et al. as Amici Curiae Supporting Petitioners, *Rose Hill*, 900 F.3d 193, 2018 WL 5087506 at *6-*7).

"secur[ed] a fixed amount" for SRLC. *Id.* at *8. The Tax Court found that "Wright credibly testified" that SRLC "did not pay for those improvements and shouldn't have a property interest in those improvements." *Id.* (internal quotations omitted).

(5) Oakbrook's Charitable Contribution Deduction

Oakbrook claimed a deduction of $9,545,000 on its Form 1065, a number that matched the Easement value set forth in the qualified appraisal that Oakbrook procured to value the Easement. *Id.* Oakbrook's deduction amount was consistent with the values that Mr. Horton was seeing in his other projects, including the Brow Wood project and the Hillocks Farm project, where Mr. Horton made an offer of $85,000 per acre for land in December 2008. JA244-49, JA294-95.

Mr. Horton hired the accounting firm Henderson Hutcherson & McCullough, PLLC to prepare Oakbrook's 2008 Form 1065. Mem. Op. at *9. The Tax Court determined that "Horton was unfamiliar with conservation easements and under intense scrutiny by Oakbrook's investors, so he discussed Oakbrook's 2008 tax return with Oakbrook's accountants multiple times" since they were familiar with the requirements for conservation easement donations. *Id.* Both Mr. Horton and another Oakbrook member, Ryan Crimmins, testified that they viewed the deduction amount as reasonable, if not less than the actual value that they might have realized if the Oakbrook property were developed. *See* JA334, JA365-66. The value determined in the qualified appraisal was consistent with the bank's willingness to

lend Oakbrook's related entity $3.2 million to develop a much smaller portion of the Oakbrook Property. *See* JA252-60.

SUMMARY OF ARGUMENT

When extending the charitable contribution deduction to include donations of partial interests in real property that further conservation (*i.e.*, conservation easements), Congress intended to incentivize such donations. Over the last several years, the IRS has thwarted this intent by conjuring new technical requirements to disallow a great number of conservation easement deductions and upset reasonable taxpayer reliance interests. The IRS's hyper-technical interpretation and application of §170(h), and the regulations issued thereunder, have been rejected by several Courts of Appeals, including this one. *See Pine Mountain*, 978 F.3d 1200; *BC Ranch II*, 867 F.3d 547; *Kaufman v. Shulman*, 687 F.3d 21 (1st Cir. 2012); *Comm'r v. Simmons*, 646 F.3d 6 (D.C. Cir. 2011); *Glass v. Comm'r*, 471 F.3d 698 (6th Cir. 2006). The IRS's disallowance of Oakbrook's deduction must likewise be rejected because it is based on a newly proffered interpretation of an invalid Regulation.

The two key facts about the regulatory history are not in dispute. First, the Administrative Record reveals that 13 of the 90 comments received by Treasury explicitly addressed the proposed Proceeds Regulation. Op. at 11; *See* JA657-700, JA712-61, 764-79, 782-801. Second, the final regulations' preamble makes no reference to those comments and contains no discussion of the issues raised

concerning the proposed allocation of post-extinguishment proceeds. *See* Qualified Conservation Contributions, 51 Fed. Reg. at 1496-98. As a result, "the six Federal Register columns that Treasury offered fail to provide 'that minimal level of analysis' required by the APA." Op. at 69-70 (Toro, J., concurring) (quoting *Encino*, 136 S. Ct. at 2125). Judge Holmes explained:

> Treasury didn't even acknowledge the relevant comments or expressly state its disagreement with them. **Instead it just ignored them.** There is not even 'a minimal level of analysis' as the Supreme Court, just a couple of years ago, insisted an agency must show if it hopes to avoid its regulation's being held procedurally invalid.

Id. at 110 (Holmes, J., dissenting) (quoting *Encino,* 136 S. Ct. at 2125) (emphasis added).

Because Treasury failed to offer any basis — let alone a reasonable one — for its decision concerning the post-extinguishment allocation of proceeds, the Proceeds Regulation is also substantively invalid. *See* 5 U.S.C. §706(2); *Chevron*, 467 U.S. at 844. Moreover, the required allocation of post-extinguishment proceeds under the Tax Court's interpretation of the Regulation is inconsistent with the rights donated under §170(h). "Requiring the donor to promise to turn over to the donee proceeds in excess of the fair market value of [the donee's qualified real property] interest is inconsistent with the statutory framework, and nothing in the 'statutory purposes' compels a different conclusion." Op. at 56-57 (Toro, J., concurring) (citations omitted). Treasury cannot demonstrate that such requirement is the

product of reasoned decision-making because Treasury offered no reason for the decision. *Id*. at 126 (Holmes, J., dissenting).

These errors require a reversal of the Tax Court's decision and reinstatement of Oakbrook's deduction.

ARGUMENT

A The Proceeds Regulation Is Invalid Because Treasury Failed to Comply with the APA's Procedural Requirements

Tax Court legal decisions concerning Internal Revenue Code provisions and Treasury regulations, including Treasury regulations challenged under the APA, are reviewed *de novo*. *See Hospital Corp. of Am. & Subsidiaries v. Comm'r*, 348 F.3d 136, 140 (6th Cir. 2003); *Nichols v. United States*, 260 F.3d 637, 642 (6th Cir. 2001) (holding that questions of law about regulations are subject to *de novo* review).

The Supreme Court recently affirmed the important role served by the APA in curbing agency overreach: "Justice Holmes famously wrote that [m]en must turn square corners when they deal with the Government. But it is also true . . . that the Government should turn square corners in dealing with the people." *Dep't of Homeland Sec. v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1909 (2020) (internal quotations omitted). Here, the IRS has denied Oakbrook's deduction for failing to comply with Treasury's rule, though Treasury failed to take the proper steps in issuing that rule.

The APA sets forth the applicable requirements for agency rulemaking. 5 U.S.C. §553.[13] Relevant here is the APA's requirement that:

> After notice . . . the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments . . . After consideration of the relevant matter presented, the agency shall incorporate in the rules adopted a concise general statement of their basis and purpose.

§553(c). These requirements serve an important role in agency rulemaking. "'The primary purpose of Congress in imposing notice and comment requirements for rulemaking' is 'to get public input so as to get the wisest rules.'" *United States. v. Cain*, 583 F.3d 408, 420 (6th Cir. 2009) (quoting *Dismas Charities, Inc. v. U.S. Dep't of Justice*, 401 F.3d 666, 680 (6th Cir. 2005)). These requirements also "ensure fair treatment for persons affected by the regulation." *Id.*

This Court has explained that the statement should clearly and fully explain the factual and legal basis for a rule, enabling a reviewing court "to see what major issues of policy were ventilated by the informal proceeding and why the agency reacted to them as it did." *Simms v. Nat'l Highway Traffic Safety Admin.*, 45 F.3d 999, 1005 (6th Cir. 1995). A court should avoid rubber-stamping an agency action, and instead, should ensure that the agency has taken a "hard look" at relevant issues and reasonable alternatives. *Id.* at 1004; 33 Charles Alan Wright & Arthur R. Miller,

[13] There is no dispute that the Proceeds Regulation is a legislative rule. Op. at 17.

Federal Practice and Procedure §8414 (2d ed. 2020) (stating that "courts made clear that they expected agencies to provide exhaustive explanations for their rules in the 'concise general statements of . . . basis and purpose' required by the APA . . .[a]nd the courts then took 'hard looks' at these explanations to ensure their rationality").

Here, Treasury was required to use the basis and purpose statement to "give reasoned responses to all significant comments in a rulemaking proceeding." *PPG Indus.*, 630 F.2d at 466. Treasury's response to significant comments on the Proceeds Regulation, however, was nothing more than the "chirping of crickets." Op. at 95 (Holmes, J., dissenting). Such silence is a blatant violation of the APA. As Judge Thapar recently observed: "In recent years, [the IRS] has begun to regulate an ever-expanding sphere of everyday life — from childcare to charity to healthcare and the environment. That might be okay if the IRS followed the basic rules of administrative law. But it doesn't."[14] *CIC Services*, 936 F.3d at 507 (Thapar, J., dissenting).

[14] *See also* Kristin E. Hickman, *Coloring Outside the Lines, Examining Treasury's (Lack of) Compliance with Administrative Procedure Act Rulemaking Requirements*, 82 Notre Dame L. Rev. 1727, 1748-50 (2007) (finding that even when Treasury issues a notice and solicits comments, it rarely complies with the APA's requirements).

(1) The Basis and Purpose Statement Fails to Explain the Proceeds Regulation

Basis and purpose statements provide courts with a mechanism to ensure that the agency has examined "the relevant data and articulate[d] a satisfactory explanation for its action including a rational connection between the facts found and the choice made." *Encino*, 136 S. Ct at 2125 (internal quotations omitted). When an agency fails "to provide even that minimal level of analysis, its action is arbitrary and capricious and so cannot carry the force of law." *Id.*

Treasury received approximately ninety comments. Op. at 11. Thirteen commenters directly addressed the Proceeds Regulation.[15] *Id.*; *see* JA657-700, JA712-61, JA764-79, JA782-801. And in response, Treasury added only two pages (six columns) addressing these eight hundred pages of comments and two hundred pages of public testimony. *See* Qualified Conservation Contributions, 51 Fed. Reg. at 1496-98.

[15] The majority said that of the thirteen commenters that addressed the Proceeds Regulation, "most devoted only a few sentences to this subject, generally at the end of a submission that emphasized other matters." Op. at 11. This observation is not a fair characterization of the comments, and in any event, is a tacit acknowledgment that numerous commenters did in fact comment on the Proceeds Regulation. As Judge Toro observed, "the Commissioner can hardly complain about NYLC's brevity in this case. The Commissioner's own position with respect to future donor improvements is based on a single sentence, and NYLC's comments on this issue were certainly longer than a sentence." *Id.* at 76 (Toro, J., concurring).

The preamble contains no discussion of (1) the Proceeds Regulation's purpose, (2) Treasury's goal in issuing the Proceeds Regulation, (3) the negative comments received, or (4) Treasury's responses to those comments. *Id.* Conversely, the final regulations contain an extensive discussion about negative comments received regarding the proposed methods of determining whether preserved open space meets the Code's requirements and the IRS's position with respect to those comments. *Id.* at 1497-98. The absence of Treasury's discussion of comments relating to the distribution of post-extinguishment proceeds is stark. *See Atrium Med. Ctr. v. U.S. Dep't of Health and Human Servs.*, 766 F.3d 560, 568 (6th Cir. 2014). Judge Toro observed that Treasury is more than capable of providing meaningful responses to comments received. Op. at 69 n.17 (Toro, J., concurring). Treasury simply failed to do so here.

Judge Holmes found that the basis and purpose statement failed to comply with the APA for multiple reasons. First "[t]he Final Rule's statement of basis and purpose shows absolutely **no mention** of the extinguishment-proceeds clause at all, much less any mention of the proportionate-share or improvements problems." Op. at 95 (Holmes, J., dissenting) (emphasis added). Second, the preamble contains "**no reasoned response to any of the public's comments on those provisions**." *Id.* at 95-96 (emphasis added). Finally, he observed, "we aren't even the first court to notice: In *Kaufman* . . . the First Circuit was forced to guess at the apparent purpose

of the section 1.170A-14(g)(6)(ii), Income Tax Regs., after noting that it 'was unexplained when first promulgated.'" *Id.* at 96.

Judge Toro likewise concluded that the lack of any discussion or explanation concerning "the donor improvements interpretation" advanced by the IRS "fail[s] to provide 'that minimum level of analysis' required by the APA." *Id.* at 69-70 (Toro, J., concurring) (quoting *Encino*, 136 S. Ct. at 2125). In sum, Treasury failed "to respond to 'significant points' and consider 'all relevant factors' raised by the public comments." *Id.* at 62 (quoting *Carlson v. Postal Regulatory Comm'n*, 938 F.3d 337, 344 (D.C. Cir. 2019) (quoting *Home Box Office*, 567 F.2d at 35-36)).

In *Simms*, the appellants claimed that the agency ignored significant facts in the record when choosing static over dynamic testing in a new regulation, especially considering that most commenters preferred dynamic testing. 45 F.3d at 1005. This Court looked to whether the agency explained the evidence available and made "a rational connection between the facts found and the choice made." *Id.* (internal quotations omitted). Importantly, this Court noted that, in the preamble to the final rules, the agency explained the benefits of using static testing and discussed the agency's rationale for rejecting dynamic testing, acknowledging the commenters' preference for dynamic testing. *Id.* at 1005-06. As a result, this Court upheld the regulation's procedural validity under the APA. *Id.* at 1006.

Treasury's shortcomings here are glaring in comparison the agency's actions in *Simms*. Treasury never even mentioned the Proceeds Regulation. There is no mention of concerns received or alternatives proposed by the 13 commenters, such as the "so-remote-as-to-be negligible" rule, the tax benefit rule, or allowing the donor and donee to negotiate an appropriate allocation on a "property by property basis." JA685, JA779, JA795. Without any discussion of the comments received, there cannot be a rational connection between the "facts found and the choice made."

In *PPG Industries*, this Court refused to affirm the EPA's "perfunctory treatment" of comments when the EPA simply stated that it "reanalyzed" the data, resulting in an administrative record from which it was "impossible to determine whether the agency's . . . designation was arbitrary and capricious." 630 F.2d at 466. Here, it is likewise impossible for the Court to take a "hard look" at Treasury's response to comments on the Proceeds Regulation and consideration of alternatives due to Treasury's complete omission of any discussion concerning those comments. As such, Treasury failed to supply the required statement of basis and purpose for its Regulation.

(2) The Comments Addressing the Proceeds Regulation Are Relevant and Significant

The comments that Treasury received about the Proceeds Regulation are significant, and Treasury was required to address them. While the measure of a

"significant" comment varies by Circuit, the comments on the Proceeds Regulation are significant under any standard.

Some courts held that an agency should address why alternative measures were rejected in the basis and purpose statement. *See, e.g., Indep. U.S. Tankers Owners Comm. v. Dole*, 809 F.2d 847, 852 (D.C. Cir. 1987). Other courts held that an agency should address significant issues of policy and explain why it chose one course over another. *See, e.g., United States v. Nova Scotia Food Prod. Corp.*, 568 F.2d 240, 252 (2d Cir. 1977) (holding that "[t]he agencies certainly have a good deal of discretion in expressing the basis of a rule, but the agencies do not have quite the prerogative of obscurantism reserved to legislatures[;] . . . [w]e cannot discharge our role adequately unless we hold [the agency] to a high standard of articulation") (internal quotations omitted); *Industrial Union Dep't, AFL-CIO v. Hodgson*, 499 F.2d 467, 475-76 (D.C. Cir. 1974); *Auto. Parts & Accessories Assoc. v. Boyd*, 407 F.2d 330, 338 (D.C. Cir. 1968). Last, some courts held that comments are significant when, if adopted, they require a change in an agency regulation. *See, e.g., Home Box Office*, 567 F.2d at 35 n.58. In other words, a comment is significant if it addresses an issue and identifies why the issue is troublesome. Op. at 102-03 (Holmes, J., dissenting).

This Court has explained that a basis and purpose statement should enable a reviewing court to "see what major issues of policy were ventilated by the informal

proceedings and why the agency reacted to them as it did." *Simms*, 45 F.3d at 1005 (citing *Boyd*, 407 F.2d at 338). Further, the agency must "give reasoned responses to all significant comments in a rulemaking proceeding." *Atrium Medical*, 766 F.3d at 568; *PPG Indus.*, 630 F.2d at 465-66. Even a single comment, if it is relevant and significant, can require an agency response. *See, e.g.*, *Carlson*, 938 F.3d at 346 (holding that the Commission should have addressed the public comments of a single commenter, Douglas Carlson, because the comments were relevant and significant).

Seven of the thirteen commenters that addressed the Proceeds Regulation expressed concern that the proposed Proceeds Regulation was unworkable, did not reflect reality, or could result in an unfair loss to the property owner and a corresponding windfall for the donee. *See* Op. at 90-95 (Holmes, J., dissenting).

For example, the New York Landmarks Conservancy ("NYLC") identified the following problems with the proposed Proceeds Regulation:

- it would deter prospective donors from donating conservation easements due to potential inequitable allocations (JA670-71);
- there was a potential conflict with the provision and state condemnation law (JA671-72); and
- the ratio fails to take into account improvements made by the landowner after donation, and it is unexplained whether those alter the ratio. (JA671-72)

Thus, NYLC suggested the Regulation's deletion due to its potential adverse effect on donations. JA670-71.

The Landmarks Preservation Council of Illinois ("LPCI") explained that the Proceeds Regulation "create[s] a potential disincentive to the donation of easements" because the Proceeds Regulation could leave a building owner in a situation where the proceeds he receives from a subsequent sale are insufficient to pay the donee and third parties, such as lenders. JA778-79. As an alternative, the LPCI suggested that the issue of post-extinguishment proceeds "should not be treated in the regulations, but should be negotiated, defined, and incorporated by the donor and donee into the conservation right document." JA779.

The Land Trust Exchange's comments identified similar problems and observed that "[t]his section may result in donors and donees having to pay real estate transfer taxes." JA685. As an alternative, the Land Trust Exchange suggested "the tax benefit rule and the remote future event rule should make this section unnecessary." JA685.

The Trust for Public Land stated "[w]e have serious doubts whether the provision for the allocation of the proceeds of a sale following extinguishment of an easement could be enforced against anyone other than the original donor of the easement, if that is what is intended." JA795. This commenter also suggested:

> [W]e think this provision goes further than the regulations need to go. The remote future event rule of §1.170A-13(g)(2) should suffice. The possibility that a conservation gift will become obsolete, although certain to be realized in some cases, must be negligible at the time a

> particular gift is made in order for it to qualify under the rule.

JA795 In sum, multiple commenters raised concerns that the proposed Proceeds Regulation was unfair, imposed a potentially unenforceable obligation, and could be substituted with better, alternative measures. Treasury offered no response to these concerns or proposed alternatives.

Treasury could not simply ignore these comments: "Commenters didn't just say, 'Delete the regulation, we don't like it.' They wrote in to propose other alternatives to achieve the Code's requirement that the conservation purpose of a donated easement be preserved 'in perpetuity.'" Op. at 104 (Holmes, J., dissenting). Even the Nature Conservancy, the Maine Coast Heritage Trust, and the Brandywine Conservancy, "thought the provision needed to be clearer." *Id.* Altogether, the comments "identified inequities with the regulation, suggested alternatives, identified potential negative effects on the willingness of donors to make donations, uncovered potential conflicts with state law, and simply asked for more clarity." *Id.* at 105. These comments are "significant" within the meaning of APA jurisprudence.

This Court made it clear that it will take a "hard look" to ensure an agency looked at all relevant issues raised by the comments, responded to significant comments, and "considered reasonable alternatives." *Simms*, 45 F.3d at 1004-05; *PPG Indus.*, 630 F.2d at 465-66. Here, Treasury failed to show any sign that it considered the significant issues raised concerning the Proceeds Regulation or the

reasonable alternatives proposed by several commenters. Particularly relevant is Treasury's failure to respond to comments raising questions about how the Proceeds Regulation would impact donor improvements, an issue that is impacting hundreds, if not thousands, of deductions now targeted by the IRS. As Judge Toro observed, "the Commissioner's actions belie any claim that the comment did not raise a significant issue." *See* Op. at 77 (Toro, J., concurring).

In sum, the comments concerning the Proceeds Regulation are significant comments because each of them addresses an issue and identifies why the issue is problematic. Treasury failed to address any of the vital questions raised by the comments or explain why it chose one course over another. Such omissions fail the APA's procedural requirements.

(3) Treasury's Cursory Statement that It Considered "All Comments" Is Insufficient to Demonstrate Compliance with the APA

Agencies must give "reasons for their actions" in a basis and purpose statement. *PPG Indus.*, 630 F.2d at 465. Courts "are not required to take the agency's word that it considered all relevant matters." *Id.* at 466.

Treasury was on notice of the APA's procedural requirements prior to the Regulation's final promulgation in 1986 because the above case (and multiple cases in other circuits) was decided prior to 1986. Yet, Treasury still gave no explanations.

Instead, Treasury summarily stated it "consider[ed] all [] comments regarding the proposed amendments," which the majority found sufficient. Op. at 20.

Judge Holmes explained why such a phrase is insufficient. "The APA . . . has no provision for agencies to use ritual incantations to ward off judicial review." Op. at 115 (Holmes, J., dissenting) (citing *Dominion Res., Inc. v. United States*, 681 F.3d 1313, 1319 (Fed. Cir. 2012)). With good reason, "because if the APA did allow comments to be disregarded with this simple magical phrase as part of a standard form, it would make commenting meaningless." *Id.*; *see Encino*, 136 S. Ct. at 2126-27 (concluding that the Secretary of Labor's use of such phrase was insufficient to establish APA compliance). The APA is not concerned with talismanic phrases, but instead, is meant to promote substantive and thoughtful analysis in promulgating rules. *See Regents of the Univ. of Cal.*, 140 S. Ct. at 1909.

In *Dominion Resources*, the Federal Circuit invalidated Treasury's regulation where the only rationale provided was "the general statement that regulations are intended to implement the avoided-cost method." 681 F.3d at 1319. This general phrase "is not sufficient to satisfy the *State Farm* requirement that the regulation must articulate a satisfactory or cogent explanation." *Id.* Likewise, here, Treasury's comment in the preamble that it considered "all comments" and that it was "providing necessary guidance" concerning "contributions . . . of partial interests in property for conservation purposes" is insufficient to meet the APA's procedural

requirements or to satisfy its obligation to offer a satisfactory explanation under *State Farm*. *See* Qualified Conservation Contributions, 51 Fed. Reg. at 1496.

(4) Minor Changes to the Proposed Regulation Are Insufficient to Demonstrate Compliance with the APA

The Tax Court also erred when it found that Treasury meaningfully responded to comments by making minor alterations to the proposed Proceeds Regulation's text before it became final. Op. at 14-15, 21. The proposed Proceeds Regulation before notice and comment reads:

> "immediately vested in the donee organization, with a fair market value that is a minimum ascertainable proportion of the fair market value to the entire property. *See* §1.170-13(h)(3)(iii). For purposes of this paragraph (g)(5)(ii), that original minimum proportionate value of the donee's property rights shall remain constant."

Qualified Conservation Contribution; Proposed Rulemaking 48 Fed. Reg. at 22946 (emphasis added). The final Proceeds Regulation reads:

> "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."

Treas. Reg. §1.170A-14(g)(6)(ii) (emphasis added). Treasury did not explain why it made these changes. Concluding that these changes responded to significant comments is simply not supported.

While the majority claims the Proceeds Regulation was "substantially revised," a comparison of the proposed regulation to the final Proceeds Regulation shows that both provisions intend to communicate the same substantive message. *See* Op. at 21. The changes were made, from all appearances, to "increase editorial clarity." *Id.* at 117 (Holmes, J., dissenting). As Judge Holmes observed, "one would be hard pressed to think of any set of facts in which the changed language would change the outcome in any particular case." *Id.* at 118.

Moreover, speculating that "Treasury clearly considered the comments" because it "substantially revised the text" of the Proceeds Regulation is not the proper standard for evaluating agency action. *Id.* at 21. Without an agency statement explaining the reason for its regulatory changes and choices, the court may not speculate as to the reasons for agency action "that the agency itself has not given." *State Farm*, 463 U.S. 29, 43 (1983) (internal quotations omitted); *see Encino*, 136 S. Ct. at 2127. In short, Treasury failed to explain the changes it made as required under the APA.[16]

In *Nova Scotia*, the court held that a basis and purpose statement failed to satisfy the APA procedural requirements due to its silence about important

[16] In making only slight revisions, Treasury did not mention any objections to the proposed Proceeds Regulation. Therefore, the general public cannot know what concerns, if any, were rejected, including those relating to donor improvements. Only the commenters specifically raising such issues could have inferred a consideration and rejection by Treasury.

comments even though the agency made minor changes to the proposed regulation and stated it considered all comments in the preamble. 568 F.2d at 244-45, 253.[17] The minor revisions here fail to show "discernable and defensible reasoning" regarding the Proceeds Regulation. *See Atrium Medical*, 766 F.3d at 568. These minor changes show minimal effort that render it impossible to see from the Proceeds Regulation whether the Regulation is arbitrary and capricious. *See PPG Indus.*, 630 F.2d at 465-66. Thus, Treasury's failure to identify any objections to the Proceeds Regulations and failure to respond to such objections is fatal to the Regulation's validity.

The Tax Court's decision essentially renders a basis and purpose statement superfluous and unnecessary if Treasury makes even a small change to the proposed regulation. The dissent wholly rejected this notion. Op. at 116-18 (Holmes, J., dissenting) (citing *Dominion*, 681 F.3d at 1319; *Nova Scotia*, 568 F.2d at 253; and *Hodgson*, 499 F.2d at 476 for support that an agency needs to at least identify

[17] The *Oakbrook* majority contends that *Nova Scotia* is inapplicable because the proposed rule's basis was a scientific decision, and Treasury's basis for the Proceeds Regulation was not a scientific decision. Op. at 22 n.3. However, when the Second Circuit held that the FDA failed to provide an adequate concise general statement of the basis and purpose, it did not rely on the proposed rule's scientific basis. *Nova Scotia*, 568 F.2d at 252-53 (holding that "the comment that to apply the proposed T-T-S requirements to whitefish would destroy the commercial product was neither discussed nor answered. We think that to sanction silence in the face of such vital questions would be to make the statutory requirement of a 'concise general statement' less than an adequate safeguard against arbitrary decision-making").

considerations it found persuasive). Slight revisions to a proposed regulation's text cannot rescue a regulation from the agency's noncompliance with the APA's requirement that the agency explain its decision.

B The Proceeds Regulation Is an Invalid Agency Action Under *State Farm* and *Chevron*

The Proceeds Regulation is an arbitrary and capricious exercise of agency rulemaking under 5 U.S.C. §706(2) because it fails to comply with the second step of *Chevron* and cannot meet the reasoned decision-making requirement in *State Farm*. Tax Court legal decisions concerning Treasury regulations, including Treasury regulations challenged under the APA and *Chevron*, are reviewed *de novo*. *See Hospital Corp.*, 348 F.3d at 140; *Nichols*, 260 F.3d at 642.

Courts follow a two-step analysis in reviewing an agency's regulatory interpretation of a statute it enforces. First, the court determines whether Congress has "directly spoken to the precise question at issue." *Chevron*, 467 U.S. at 842. If so, the inquiry ends there, and the court must give effect to Congress's expressed and unambiguous intent. *Id*. If not, the court must defer to the agency's interpretation if it is "reasonable." *Id*. at 843-44. Specifically, the court considers whether the interpretation is "arbitrary or capricious in substance, or manifestly contrary to statute." *Mayo Found. for Med. Educ. & Research v. United States*, 562 U.S. 44, 53 (2011) (applying the *Chevron* standard to Treasury regulations). A determination of whether an interpretation is arbitrary or capricious requires the

court to analyze "whether the [agency] has reasonably explained how the permissible interpretation it chose is 'rationally related to the goals of' the statute." *Village of Barrington v. Surface Transp. Bd.*, 636 F.3d 650, 665 (D.C. Cir. 2011) (quoting *AT&T Corp. v. Iowa Utils. Bd.*, 525 U.S. 366, 388 (1999)); *All. for Cmty. Media v. F.C.C.*, 529 F.3d 763, 786 (6th Cir. 2008).

The record before the Tax Court demonstrates that the Proceeds Regulation is arbitrary, capricious, and manifestly contrary to statute. Treasury failed to establish that the Proceeds Regulation was the product of reasoned decision-making and supplied no grounds upon which a court could affirm the propriety of that Regulation. Further, it imposes requirements on taxpayers that are beyond the requirements imposed by Congress. As a result, the Proceeds Regulation must be set aside as an invalid exercise of Treasury's rule-making authority.

(1) The Proceeds Regulation Is Not the Product of Reasoned Decision-Making

When applying the arbitrary and capricious standard found in step two of *Chevron*, the court "must assess, among other matters, 'whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment.'" *Judulang*, 565 U.S. at 53 (quoting *State Farm*, 463 U.S. at 43). Put another way, the court is required to "examine[] the reasons for agency decisions — or, as the case may be, the absence of such reasons." *Id.* Agency action is the product of reasoned decision-making if the agency "examine[d] the relevant data

and articulate[d] a satisfactory explanation for its action, including a rational connection between the facts found and the choices made." *Simms*, 45 F.3d at 1004 (internal quotations omitted). On the flipside, an agency action is arbitrary and capricious if:

> [T]he agency has relied on factors which Congress has not intended it to consider, entirely failed to consider an important aspect of the problem, offered an explanation for its decision that runs counter to the evidence before the agency, or is so implausible that it could not be ascribed to a difference in view.

State Farm, 463 U.S. at 43. In such case, the agency action will be invalidated by the Court under the APA. 5 U.S.C. §706(2).

In *Judulang*, the Supreme Court confirmed that its analysis of the reasonableness of the agency's action under *State Farm* "would be the same" under *Chevron* step two because "we ask whether an agency interpretation is arbitrary or capricious in substance." 565 U.S. at 52 n.7 (internal quotations omitted). This Court recognized that the *State Farm* analysis is incorporated into *Chevron*, explaining that "there is support that in review of rulemaking the second step of *Chevron* indeed amounts to the same inquiry as arbitrary or capricious review under the APA." *Citizens Coal Council v. EPA*, 447 F.3d 879, 889 n.10 (6th Cir. 2006).[18]

[18] Alternatively, some scholars have suggested that "*State Farm* more appropriately should be seen as an additional hurdle for agencies to jump after they have cleared *Chevron* step two." Matthew A. Melone, *Light on The Mayo: Recent Developments May Diminish the Impact of Mayo Foundation on Judicial Deference to Tax*

Here, where no explanation is offered, the agency's decision cannot be the product of reasoned decision-making. The reviewing court "may not supply a reasoned basis for the agency's action that the agency itself has not given." *State Farm*, 463 U.S. at 43; *SEC v. Chenery Corp.*, 332 U.S. 194, 196 (1947) (holding that "a reviewing court, in dealing with a determination or judgment which an administrative agency alone is authorized to make, must judge the propriety of such action solely by the grounds invoked by the agency. If those grounds are inadequate or improper, the court is powerless to affirm the administrative action"); *Dominon*, 681 F.3d at 1319 (invalidating a Treasury regulation under *State Farm*'s arbitrary and capricious standard when the final regulation provided no rationale for the regulation, and the IRS's only guidance "provided no rationale other than a general statement that the regulations are intended to implement the avoided-cost method"); *cf. Tenn. Hosp. Ass'n v. Azar*, 908 F.3d 1029, 1044 (6th Cir. 2018) (holding that "[w]hen a regulation is ambiguous, [courts] consult the preamble of the final rule as evidence of context of intent of the agency promulgating the regulations") (internal quotations omitted).

Regulations, 13 Hastings Bus. L.J. 149, 187 (2017). Regardless of whether the *State Farm* test is subsumed in *Chevron* step two or constitutes an additional hurdle, Treasury was required to articulate a satisfactory explanation for its action. The majority's suggestion that Treasury could avoid the reasoned decision-making requirement in *State Farm* just because the Proceeds Regulation was a "new rule" is not supported by the applicable precedent or the APA. *See* Op. at 19 n.2.

Treasury gave neither a reason for its decision to require that the donor and donee determine proportionate value in this manner, nor a reason why this proportionate value must remain constant despite the fact that Treasury knew that the relative value of their interests could change, such as when the donor makes post-donation improvements. As outlined above, several commenters expressed concerns with the proposed regulation's requirements. *See supra* Argument, Part A Section 2. Moreover, commenters proposed several alternatives. In addition, Treasury had information concerning how other entities allocated post-condemnation proceeds. *See, e.g.*, JA742 (Maryland statute providing that when property underlying an easement held by the Maryland Agricultural Land Preservation Fund ("Fund") is condemned, the amount of proceeds due to the Fund is the amount paid by the Fund for the easement and not a percentage). Why Treasury chose to impose this specific allocation remains unknown.

The Restatement of Property outlines the amounts due to a conservation easement holder after extinguishment in a manner that is wholly different from the formula in the Regulation. Restatement (Third) of Property §7.11 (Am. Law. Inst. 2000). The Restatement explains that the amount of compensation owed to a conservation easement holder varies based on the circumstances. "Damages should ordinarily be calculated to compensate the public for loss of the servitude." *Id.* However, "if the servient owner is not responsible for the changes that have made

the servitude useless" *i.e.,* a state or federal entity condemns the property, "damages sufficient to replace the servitude may be unfair. In that case, restitution, without more, may be appropriate." *Id*. Such restitution may be comprised of "tax and other governmental benefits received by the servient owner as a result of creation of the servitude." *Id*. There is no indication that Treasury considered these varying circumstances or how they should impact the allocation of proceeds.

SRLC's Executive Director testified that he believed the allocation in Oakbrook's Deed would provide the land trust with more proceeds than what it would receive under the Regulation and that the allocation certainly guarantees that the public is repaid what it invested in the conservation easement. JA405-08. No reason was provided, either by Treasury during the Regulation's promulgation, or by the IRS at trial, as to why the Regulation's formula better protects the conservation purposes than the provision in Oakbrook's Deed. By contrast, the record is clear that there are several alternative methods for allocating proceeds to the easement holder in order to carry out the conservation purposes in perpetuity. A one-size-fits-all approach in the Regulation in unworkable given the wide range of properties and conservation values protected.

It is not clear whether Treasury considered these alternatives or examined any relevant data when deciding that the Regulation's formula must be used in all circumstances. But it is clear that, when imposing this requirement, Treasury gave

no explanation for the agency's action, and provided no evidence of a rational connection between the facts found and decision made. *See* Qualified Conservation Contributions, 51 Fed. Reg. at 1496-98. In sum, Treasury offered no reason for its decision for this Court to affirm.

(2) The Tax Court Erred in Supplying a Reason for Treasury's Decision Where None Was Given

Finding no relevant factors or explanation in the record to support Treasury's decision, the Tax Court simply assumed that "Treasury's overarching goal was to guarantee that the donee, upon judicial extinguishment, would receive the full share of proceeds to which it was entitled." Op. at 31. This statement is erroneous in two respects. First, nothing in the record demonstrates that this was Treasury's goal. The judicial extinguishment provisions are not discussed in the preamble. Second, even if Treasury had stated its goal was to guarantee the donee proceeds "to which it was entitled," the Regulation does not align with that goal. As now interpreted by the IRS, the Regulation requires the donee to receive proceeds to which the donee is not entitled, *i.e.*, proceeds attributable to the donor's interest in post-donation improvements. *See id.* at 29-31.

The Tax Court also erred in assuming that Treasury's failure to examine relevant data or explain its decision was simply "a policy decision for Treasury . . . to make." *Id.* at 30. In *Dominion*, the Federal Circuit concluded that Treasury's lack of investigation or explanation could not be chalked up to "policy choice." 681 F.3d

at 1318 (holding that the Court of Federal Claims erred in concluding that Treasury's unexplained regulatory requirements were "a 'policy choice' . . . and thus permissible"). When no investigation is undertaken, the ultimate decision cannot be rationally related to the facts considered. In such cases, the agency's rule is arbitrary, capricious, and must be set aside.

In sum, Treasury could have engaged in reasoned decision-making with respect to the Proceeds Regulation's requirements, but it chose not to. The Tax Court concedes that "Treasury could have drafted a regulation that addressed the possibility of donor improvements," Op. at 30, but it failed to address those improvements in any way — either through a revision to the Regulation or by explanation in the preamble. This failure, given the specific comments concerning donor improvements and the problems with the Regulation's formula, means that Treasury did not consider important aspects of the problem its rule was to address. As such, the Proceeds Regulation fails the reasoned decision-making standard of *State Farm*, as well as the second step of *Chevron*, and constitutes an arbitrary, capricious, and invalid statutory interpretation.

(3) The Tax Court's Interpretation of the Proceeds Regulation Is Contrary to the Statute Because It Requires Donors to

Relinquish Interests that They Are Permitted to Retain Under I.R.C. § 170(h).

The Proceeds Regulation is also invalid because, as now interpreted by the Tax Court, it is manifestly contrary to the statute. Judge Toro explained this deviation from the statutory scheme in his concurrence:

> Although the statute makes clear that there can be no deduction unless the conservation purposes are "protected in perpetuity," one cannot lose track of the fact that the deduction is predicated on a "qualified real property interest" being contributed to a qualified organization. Thus, the most that a qualified organization can be entitled to receive if its "qualified real property interest" is extinguished in the future is the full value of that interest. **Whatever the purpose of a contribution, that purpose may not be invoked to require the donor to give the donee, as a precondition to receiving a deduction . . . a right to receive compensation properly attributed to the real property interest that the Code permits the donor to retain**. A regulation interpreted to require otherwise cannot be a permissible interpretation of the statutory text before us.

Id. at 56 (Toro, J., concurring) (emphasis added).

Deviating from the statutory bounds requires a regulatory invalidation even if the statute left some ambiguity to be filled. *Michigan v. EPA*, 135 S. Ct. 2699, 2707 (2015) (explaining that even under the deferential standard of *Chevron*, "agencies must operate within the bounds of reasonable interpretation"); *Mid-Am. Care Found. v. N.L.R.B.*, 148 F.3d 638, 642 (6th Cir. 1998) (holding that "when an agency's *application* of statutory interpretation . . . frustrates judicial review by 'subtly and

obliquely' revising the stated interpretation to impose a more stringent definition or a higher standard of compliance in certain factual contexts, *Chevron* deference is inappropriate"). Treasury regulations, like other regulations, are invalid if they impose requirements beyond the statutory text. *Good Fortune Shipping SA v. Comm'r*, 897 F.3d 256, 263 (D.C. Cir. 2018).

The statute requires the donation of a "qualified real property interest," which is a restriction on the use of property. §170(h)(2)(C). The statute further requires that such interest be conveyed "exclusively for conservation purposes." §170(h)(1)(C). A qualified real property interest is exclusively for conservation purposes if "the conservation purpose is protected in perpetuity." §170(h)(5)(A).

Nothing in §170(h) suggests that a qualified organization must be compensated above the value of its qualified real property interest in the event the easement is extinguished. However, the Proceeds Regulation, as interpreted by the Tax Court, requires the donor to agree to give the easement holder compensation in excess of the interest conveyed to the easement holder under §170(h).

By imposing additional regulatory obligations in 2016 with respect to post-donation improvements, the IRS has "rewritten the statutory terms" to obligate the donor to give property to the land trust beyond the interest conveyance that §170(h) requires be conveyed. As Judge Toro noted, "a rule interpreted to require the deed to allocate to the donee not only the proceeds attributable to its own real property

interest but also a share of the proceeds attributable to the interest the Code permits the donor to retain does not 'fit' with the statutory language and is unreasonable." Op. at 57-58 (Toro, J., concurring) (quoting *Good Fortune*, 897 F.3d at 262) (internal quotations omitted).

It is not clear whether Treasury wanted conservation easement donors to agree to forgo their rights to just compensation for condemned post-donation improvements. However, it is clear that Congress did not impose such a requirement, nor did Congress leave a gap for Treasury to fill with that requirement. Rather, Congress permitted donors to reserve an interest in the underlying property, including the right to improve that property. "The contribution must involve legally enforceable restrictions on the interest in the property retained by the donor." S. Rep. No. 96-1007, at 13 (emphasis added). Nothing in the text of the statute itself or the legislative history suggests, in order to protect conservation purposes in perpetuity, a landowner must agree to relinquish compensation for his interest in the property. *See United States v. Cartwright,* 411 U.S. 546, 557 (1973) (invaliding a Treasury regulation that "is manifestly inconsistent with the most elementary provisions" of the statute). Because the Proceeds Regulation is contrary the statute, it is arbitrary, capricious, and invalid.

CONCLUSION

Administrative law jurisprudence is clear. When an agency fails to consider relevant comments or address viable alternatives proposed by the regulated individuals and entities, its rules cannot have the force of law. That is exactly what happened in this case. Oakbrook's deduction cannot be doomed by an invalid rule. Therefore, the decision of the Tax Court is due to be reversed.

Respectfully submitted,

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CERTIFICATE OF COMPLIANCE

I certify that this brief complies with the type-volume limitations set forth in Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedures. This brief uses Times New Roman 14-point typeface and contains 12,947 words.

/s/MICHELLE ABROMS LEVIN
Michelle Abroms Levin

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on January 25, 2021, I electronically filed the foregoing with the Clerk of the Court using the Court's CM/ECF system. I also hereby certify that the foregoing document is being served this day on all counsel or record identified on the Service List in the manner specified, via transmission of Notices of Electronic Filing generated by CM/ECF or in some other authorized manner for those counsel or parties who are no authorized to receive electronically Notices of Electronic Filing.

s/MICHELLE ABROMS LEVIN
Michelle Abroms Levin

ADDENDUM

48 FR 22940-01, 1983-1 C.B. 910, 1983-25 I.R.B. 28, 1983 WL 131383(F.R.)

PROPOSED RULES

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Parts 1, 20, and 25

[LR-200-76]

Qualified Conservation Contribution; Proposed Rulemaking

Monday, May 23, 1983

***22940** AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to contributions of partial interests in property for conservation purposes. Changes to the applicable tax law were made by section 6 of the Tax Treatment Extension Act of 1980. This document is intended to clearify the statutory rules in effect under that Act.

DATE: Written comments and requests for a public hearing must be delivered or mailed by July 22, 1983. The amendments are proposed to be applicable for contributions made on or after December 18, 1980, and are proposed to be effective the date final regulations are published in the Federal Register.

ADDRESS: Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C. 20224, Attention: CC:LR:T (LR-200-76).

FOR FURTHER INFORMATION CONTACT: John R. Harman of the Legislation & Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments proposed to conform the Income Tax Regulations (26 CFR Part 1) under section 170 of the Internal Revenue Code of 1954 (Code) relating to contributions not in trust of partial interests in property to section 6 of the Tax Treatment Extension Act of 1980.

The Tax Reform Act of 1969 and the regulations promulgated thereunder limited the deductibility of the donation of easements generally to charitable contributions of perpetual open space easements in gross, (section 170(f)(3)(B)(ii) of the Code and § 1.170A-7(b)(1)(ii) of the Income Tax Regulations). Although subsequent revenue rulings held that a variety of easements were deductible under the limitation of the 1969 Act (See, e.g., Rev. Rul. 75-358, 1975-2 C.B. 76), Congress in 1976 added further legislative authority for the deductibility of easement donations.

Section 2124(e) of the Tax Reform Act of 1976 (Pub. L. 94-455, 90 Stat. 1919) provided, for the first time, specific statutory authority under section 170 of the Code for the deductibility of the donation to a qualified organization of easements, remainder interests, and certain other partial interests in property. The 1976 Act allowed the deduction for partial interests donated for a term of 30 years or more, but required that the donation be made "for conservation purposes." Conservation purposes was defined in section 170(f)(3)(C).

Section 309 of the Tax Reduction and Simplification Act of 1977 (Pub. L. 95-30, 91 Stat. 154) made two changes in the statutory language codified by the 1976 Act. The first change eliminated the deductibility of term easements for conservation purposes and required that such easements be perpetual in order to qualify for a deduction under section 170. The second change set the expiration date of these provisions at June 14, 1981.

Section 6 of the Tax Treatment Extension Act of 1980 made extensive changes in the existing statute, eliminated the expiration date, and incorporated the relevant language into a new section 170(h). The House and Senate Committee reports accompanying the legislation also provided, for the first time, an in-depth statement of congressional intent concerning the donation of partial interests for conservation purposes (H.R. Rep. No. 96-1278, S. Rep. No. 96-1007). The regulations reflect the major policy decisions made by the Congress and expressed in these committee reports.

Additional Information

Generally, the donation of an easement to preserve open space is deductible under section 170(h)(4)(A)(iii) if such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or its pursuant to a clearly delineated governmental policy. The most difficult problem posed in this regulation was how to provide a workable framework for donors, donees, and the Internal Revenue Service to judge the deductibility of open space easements.

Defining "Significant public benefit" with any degree of precision is impossible. Any attempt to reduce the test to a mathematical formula would be arbitrary. The factors included at § 1.170A-13(d)(4)(iv) are not intended to be exclusive; however, a longer list of ***22941** factors would always fall short of being all-inclusive. The same statements can be made concerning the list of factors proposed under § 1.170A-13(d)(4)(ii) with respect to "scenic enjoyment."

It is believed, however, that the "sliding scale" approach proposed in § 1.170A-13(d)(4)(vi) that establishes a relationship between the requirements of "significant public benefit" and "clearly delineated governmental policy" will eliminate much of the uncertainty that surrounds this part of the statute. Additionally, by including prior state and local governmental determinations of specific resources to be protected as a criteria for meeting the "significant public benefit" and "scenic enjoyment" tests, a degree of certainty will be available to taxpayers in jurisdictions that have carefully articulated preservation policies. In the end, of course, some exercise of judgment and of responsibility is ultimately required by both donors and donees.

Comments and Requests for a Public Hearing

Before adopting these proposed regulations, consideration will be given to any written comments that are submitted (preferably seven copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

Executive Order 12291 and Regulatory Flexibility Act

The Commissioner of Internal Revenue has determined that this proposed rule is not a major rule as defined in Executive Order 12291. Accordingly, a Regulatory Impact Analysis is not required. The Internal Revenue Service has concluded that although this document is a notice of proposed rulemaking that solicits public comments, the regulations proposed herein are interpretative and the notice and public procedure requirements of 5 U.S.C. 553 do not apply. Accordingly, no Regulatory Flexibility Analysis is required for this rule.

Drafting Information

The principal authors of this regulation are John R. Harman and Stephen J. Small of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

List of Subjects

26 CFR 1.61-1-1.281-4
Income taxes, Taxable income, Deductions, Exemptions.

26 CFR Part 20
Estate taxes.

26 CFR Part 25
Gift taxes.

Proposed Amendments to the Regulations
The proposed amendments to 26 CFR Parts 1, 20, and 25 are as follows:

PART 1—[AMENDED]
26 CFR § 1.167

§ 1.167(a)-5 [Amended].
Paragraph 1. Section 1.167(a)-5 is amended by adding at the end thereof the following new sentence: "For the adjustment to the basis of a structure in the case of a donation of a qualified conservation contribution under section 170(h), see § 1.170A-13(h)(3)(iii)."

Par. 2. Paragraph (a)(2)(ii) of § 1.170A-1 is amended by adding at the end thereof the following new paragraph:
26 CFR § 1.170A

§ 1.170A-1 Charitable, etc., contributions and gifts; allowance of deduction.
(a) In general. * * *

(a)(2) Information required in support of deductions. * * *

(ii) Contribution by individual of property other than money. * * *

(j) In the case of a "qualified conservation contribution" under section 170(h), see § 1.170A-13(i).
26 CFR § 1.170A
Par. 3. Section 1.170A-7 is amended as follows:

a. The first sentence of paragraph (b)(1)(ii) is revised to begin with the phrase "With respect to contributions made on or before December 17, 1980,".

b. Paragraph (b)(1)(ii) is revised by adding at the end the following new sentence: "For the deductibility of a qualified conservation contribution, see § 1.170A-13.".

c. Paragraph (b)(3) is revised by adding at the end the following new sentence: "For the deductibility of the donation of a remainder interest in real property exclusively for conservation purposes, see § 1.170A-13.".

d. Paragraph (b)(4) is revised by adding at the end the following new sentence: "For the deductibility of the donation of a remainder interest in real property exclusively for conservation purposes, see § 1.170A-13.".

e. A new paragraph (b)(5) is added immediately after paragraph (b)(4), as set forth below.

f. The first sentence of paragraph (c) is revised to begin with the phrase "Except as provided in § 1.170A-13,".

g. Paragraph (e) is revised as set forth below.
26 CFR § 1.170A

§ 1.170A-7 Contributions not in trust of partial interests in property.
* * * * *
(b) Contributions of certain partial interests in property for which a deduction is allowed. * * *

(b)(5) Qualified conservation contribution. A deduction is allowed under section 170 for the value of a qualified conservation contribution. For the definition of a qualified conservation contribution, see § 1.170A-13.
* * * * *
(e) Effective date. This section applies only to contributions made after July 31, 1969. The deduction allowable under § 1.170A-7(b)(1)(ii) shall be available only for contributions made on or before December 17, 1980. The deduction allowable under § 1.170A-7(b)(5) shall be available for contributions made on or after December 18, 1980.
26 CFR § 1.170A
Par. 4. A new § 1.170A-13 is added after § 1.170A-12 to read as set forth below.
26 CFR § 1.170A

§ 1.170A-13 Qualified conservation contributions.
(a) Qualified conservation contributions. A deduction under section 170 is generally not allowed for a charitable contribution of any interest in property that consists of less than the donor's entire interest in the property other than certain transfers in trust (see § 1.170A-6 relating to charitable contributions in trust and § 1.170A-7 relating to contributions not in trust of partial interests in property). However, a deduction may be allowed under section 170(f)(3)(B)(iii) for the value of a qualified conservation contribution if the requirements of this section are met. A qualified conservation contribution is the contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. To be eligible for a deduction under this section, the conservation purpose must be protected in perpetuity.

(b) Qualified real property interest—(b)(1) Entire interest of donor other than qualified mineral interest. The entire interest of the donor other than a qualified mineral interest is a qualified real property interest. A qualified mineral interest is the taxpayer's interest in subsurface oil, gas, or other ***22942** minerals and the right of access to such minerals. A property interest shall not be treated as a qualified real property interest by reason of section 170(h)(2)(A) or this paragraph (b)(1), if any time over the entire term of the taxpayer's interest in such property the taxpayer transferred any portion of that interest (except in the case of a donation of a perpetual conservation restriction under paragraph (b)(3) of this section) to any other person (except for minor interests, such as rights-of-way, that will not interfere with the conservation purposes of the donation).

(b)(2) Remainder interest in real property. A remainder interest in real property is a qualified real property interest. A property interest shall not be treated as a qualified real property interest by reason of section 170(h)(2)(B) or this paragraph (b)(2), if at any time over the entire term of the taxpayer's interest in such property the taxpayer transferred any portion of that interest (except in the case of a donation under paragraph (b)(3) of this section) to any other person (except for minor interests, such as rights-of-way, that will not interfere with the conservation purposes of the donation).

(b)(3) Perpetual conservation restriction. 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 convenant or equitable servitude). For purposes of this section, the terms "easement", "conservation restriction", and "perpetual conservation restriction" have the same meaning. The definition of "perpetual conservation restriction" under this paragraph (b)(3) is not intended to preclude the deductibility of a donation of affirmative rights to use a land or water area under § 1.170A-13(d)(2). Any rights reserved by the donor in the donation of a perpetual conservation restriction must conform to the requirements of this section. See e.g., paragraphs (d)(4)(ii), (d)(5)(i), (e)(3), and (g)(4) of this section.

(c) Qualified organization—(c)(1) Eligible donee. To be considered an eligible donee under this section, an organization must have the resources to enforce the restrictions and must be able to demonstrate a commitment to protect the conservation purposes of the donation. An established group organized exclusively for conservation purposes, for example, would meet this test. A qualified organization need not set aside funds, however, to enforce the restrictions that are the subject of the contribution. For purposes of this section, the term "qualified organization" means:

(i) A governmental unit described in section 170(b)(1)(A)(v);

(ii) An organization described in section 170(b)(1)(A)(vi);

(iii) A charitable organization described in section 501(c)(3) that meets the public support test of section 509(a)(2);

(iv) A charitable organization described in section 501(c)(3) that meets the requirements of section 509(a)(3) and is controlled by an organization described in paragraphs (c)(1) (i), (ii), or (iii) of this section.

(c)(2) Transfers by donee. A deduction shall be allowed for a contribution under this section only if in the instrument of conveyance the donor prohibits the donee from subsequently transferring the easement (or, in the case of a remainder interest or the reservation of a qualified mineral interest, the property), whether or not for consideration, unless the donee organization, as a condition of the subsequent transfer, requires that the conservation purposes which the contribution was originally intended to advance continue to be carried out. Moreover, subsequent transfers must be restricted to organizations qualifying, at the time of the subsequent transfer, as an eligible donee under paragraph (c)(1) of this section. When a later unexpected change in the conditions surrounding the property that is the subject of a donation under paragraph (b) (1), (2), or (3) of this section makes impossible or impractical the continued use of the property for conservation purposes, the requirement of this paragraph will be met if the property is sold or exchanged and any proceeds are used by the donee organization in a manner consistent with the conservation purposes of the original contribution. In the case of a donation under paragraph (b)(3) of this section to which the preceding sentence applies, see also paragraph (g)(5)(ii) of this section.

(d) Conservation purposes—(d)(1) In general. For purposes of section 170(h) and this section, the term "conservation purposes" means—

(i) The preservation of land areas for outdoor recreation by, or the education of, the general public, within the meaning of paragraph (d)(2) of this section,

(ii) The protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem, within the meaning of paragraph (d)(3) of this section,

(iii) The preservation of certain open space (including farmland and forest land) as described in paragraph (d)(4) of this section, or

(iv) The preservation of a historically important land area or a certified historic structure, within the meaning of paragraph (d)(5) of this section.

(d)(2) Recreation or education —(d)(2)(i) In general. The donation of a qualified real property interest to preserve land areas for the outdoor recreation of the general public or for the education of the general public will meet the conservation purposes test of this section. Thus, conservation purposes would include, for example, the preservation of a water area for the use of the public for boating or fishing, or a nature or hiking trail for the use of the public.

(d)(2)(ii) Public use. The preservation of land areas for recreation or education will not meet the test of this section unless the recreation or education is for the substantial and regular use of the general public or the community.

(d)(3) Protection of environmental system—(d)(3)(i) In general. The donation of a qualified real property interest to protect a significant relatively natural habitat in which a fish, wildlife, or plant community, or similar ecosystem, normally lives will meet the conservation purposes test of this section. The fact that the habitat or environment has been altered to some extent by human activity will not result in a deduction being denied under this section if the fish, wildlife, or plants continue to exist there in a relatively natural state. For example, the preservation of a lake formed by a man-made dam or a salt pond formed by a man-made dike would meet the conservation purposes test if the lake or pond were a nature feeding area for a wildlife community that included rare, endangered, or threatened native species.

(d)(3)(ii) Significant habitat or ecosystem. Significant habitats and ecosystems include, but are not limited to, habitats for rare, endangered, or threatened species of animal, fish, or plants; natural areas that represent high quality examples of a terrestrial community or aquatic community, such as islands that are undeveloped or not intensely developed where the coastal ecosystem is relatively intact; and natural areas which are include in, or which contribute to, the ecological viability of a local, state, or national park, nature preserve, wildlife refuge, wilderness area, or other similar conservation area.

***22943** (d)(4) Preservation of open space—(d)(4)(i) In general. The donation of a qualified real property interest to preserve open space (including farmland and forestland) will meet the conservation purposes test of this section if such preservation is—
(A) Pursuant to a clearly delineated Federal, state, or local governmental polic and will yield a significant public benefit, or

(B) For the scenic enjoyment of the general publicv and will yield a significant public benefit.

An open space easement donated on or after December 18, 1980, must meet the requirements of this section in order to be deductible under section 170. See § 1.170A-7(b)(1)(ii).

(d)(4)(ii) Scenic enjoyment —(d)(4)(ii)(A) Factors. A contribution made for the preservation of open space may be for the scenic enjoyment of the general public. “Scenic enjoyment” will be evaluated by considering all pertinent facts and circumstances germane to the contribution. Regional variations in topography, geology, biology, and cultural and economic conditions require flexibility in the application of this test, but do not lessen the burden on the taxpayer to demonstrate the scenic characteristics of a donation under this paragraph. The application of a particular objective factor to help define a view as “scenic” in one setting may in fact be entirely inappropriate in another setting. Among the factors to be considered are:
(1) The compatibility of the land use with other land in the vicinity;

(2) The degree of contrast and variety provided by the visual scene;

(3) The openness of the land (which would be a more significant factor in an urban or densely populated setting or in a heavily wooded area);

(4) Relief from urban closeness;

(5) The harmonious variety of shapes and textures;

(6) The degree to which the land use maintains the scale and character of the urban landscape to preserve open space, visual enjoyment, and sunlight for the surrounding area;

(7) The consistency of the proposed scenic view with a methodical state scenic identification program, such as a state landscape inventory; and

(8) The consistency of the proposed scenic view with a regional or local landscape inventory made pursuant to a sufficiently regorous review process, especially if the donation is endorsed by an appropriate state agency.

(B) Preservation of a view. To satisfy the requirement of scenic enjoyment by the general public, visual (rather than physical) access to or across the property by the general public is sufficient. This, preservation of land may be for the scenic enjoyment of the general public if development of the property would impair the scenic charcter of the local rural or urban landscape or would interfere with a scenic panorama that can be enjoyed from a park, nature preserve, road, waterbody, trail, or historic structure or land area, and such area or transportation way is open to, or utilized by, the public.

(C) Visible to public. Under the terms of an open space easement on scenic property, the entire property need not be visible to the public for a donation to qualify under this section, although the public benefit from the donation may be insufficient if only a small portion of the property is visible to the public.

(d)(4)(iii) Governmental conservation policy—(d)(4)(iii)(A) In general. The requirement that the preservation of open space be pursuant to a clearly delineated Federal, state, or local governmental policy is intended to protect the types of property identified by representatives of the general public as worthy of preservation or conservation. A general declaration of conservation goals by a single official or legislative body is not sufficient. This requirement will be met by donations that further a specific, identified conservation project, such as the preservation of land within a state or local landmark district that is locally recognized as being significant to that district; the preservation of a wild or scenic river; the preservaton of farmland pursuant to a state program for flood prevention and control; or the protection of the scenic, ecological, or historic character of land that is contiguous to, or an integral part of, the surroundings of existing recreation or conservation sites. For example, the donation of a perpetual conservation restriction to a qualified organization pursuant to a formal declaration (in the form of, for example, a resolution or certification) by a local governmental agency established under state law specifically ientifying the subject property as worthy of protection for conservation purposes will meet the requirement of this paragraph. A program need not be funded to satisfy this requirement, but the program must involve a significant commitment by the government with respect to the conservation project. (B) Effect of acceptance by governmental agency. Acceptance of an easement by an agency of the Federal Government or by an agency of a state or local government (or by a commission, authority, or similar body duly constituted by the state or local government and acting on behalf of the state or local government) tends to establish the requisite clearly delineated governmental policy, although such acceptance, without more, is not sufficient. The more rigorous the review process by the governmental agency, the more the acceptance of the easement tends to establish the requisite clearly delineated governmental policy.

(d)(4)(iv) Significant public benefit—(d)(4)(iv)(A) Factors. All contributions made for the preservation of open space must yield a significant public benefit. Public benefit will be evaluated by considering all pertinent facts and circumstances germane to the contribution. Factors germane to the evaluation of public benefit from one contribution may be irrelevant in determining public benefit from another contribution. No single factor will necessarily be determinative. Among the factors to be considered are: (1) The uniqueness of the property to the area;

(2) The intensity of land development in the vicinity of the property (both existing development and foreseeable trends of development);

(3) The consistency of the proposed open space use with public programs (whether Federal, state or local) for conservation in the region, including programs for outdoor recreation, irrigation or water supply protection, water quality maintenance or

enhancement, flood prevention and control, erosion control, shoreline protection, and protection of land areas included in, or related to, a government approved master plan or land management area;

(4) The consistency of the proposed open space use with existing private conservation programs in the area, as evidenced by other land, protected by easement or fee ownership by organizations referred to in § 1.170A-13(c)(1), in close proximity to the property;

(5) The likelihood that development of the property would lead to or contribute to degradation of the scenic, natural, or historic character of the area;

(6) The opportunity for the general public to use the property or to appreciate its scenic values;

(7) The importance of the property in preserving a local or regional landscape or resource that attracts tourism or commerce to the area;

(8) The likelihood that the donee will acquire equally desirable and valuable substitute property or property rights;

(9) The cost to the donee of enforcing the terms of the conservation restriction;

(10) The population density in the area of the property; and

***22944** (11) The consistency of the proposed open space use with a legislatively mandated program identifying particular parcels of land for future protection.

(B) Illustrations. The preservation of an ordinary tract of land would not in and of itself yield a significant public benefit, but the preservation of ordinary land areas in conjunction with other factors that demonstrate significant public benefit or the preservation of a unique land area for public enjoyment would yield a significant public benefit. For example, the preservation of a vacant downtown lot would not by itself yield a significant public benefit, but the preservation of the downtown lot as a public garden would, absent countervailing factors, yield a significant public benefit. The following are other examples of contributions which would, absent countervailing factors, yield a significant public benefit: the preservation of farmland pursuant to a state program for flood prevention and control; the preservation of a unique natural land formation for the enjoyment of the general public; the preservation of woodland along a Federal highway pursuant to a government program to preserve the appearance of the area so as to maintain the scenic view from the highway; and the preservation of a stretch of undeveloped property located between a public highway and the ocean in order to maintain the scenic ocean view from the highway.

(d)(4)(v) Limitation. A deduction will not be allowed for the preservation of open space under section 170(h)(4)(A)(iii), if the terms of the easement permit a degree of intrusion or future development that would interfere with the essential scenic quality of the land or with the governmental conservation policy that is being furthered by the donation.

(d)(4)(vi) Relationship of requirements—(d)(4)(vi)(A) Clearly delineated governmental policy and significant public benefit. Although the requirements of "clearly delineated governmental policy" and "significant public benefit" must be met independently, for purposes of this section the two requirements may also be related. The more specific the governmental policy with respect to the particular site to be protected, the more likely the governmental decision, by itself, will tend to establish the significant public benefit associated with the donation. For example, while a statute in State X permitting preferential assessment for farmland is, by definition, governmental policy, it is distinguishable from a state statute, accompanied by appropriations, naming the X River as a valuable resource and articulating the legislative policy that the X River and the relatively natural quality of its surrounding be protected. On these facts, an open space easement on farmland in State X would have to demonstrate additional factors to establish "significant public benefit." The specificity of the legislative mandate to protect the X River,

however, would by itself tend to establish the significant public benefit associated with an open space easement on land fronting the X River.
(B) Scenic enjoyment and significant public benefit. With respect to the relationship between the requirements of "scenic enjoyment" and "significant public benefit," since the degrees of scenic enjoyment offered by a variety of open space easements are subjective and not as easily delineated as are increasingly specific levels of governmental policy, the significant public benefit of preserving a scenic view must be independently established in all cases.

(C) Donations may satisfy more than one test. In some cases, open space easements may be both for scenic enjoyment and pursuant to a clearly delineated governmental policy. For example, the preservation of a particular scenic view identified as part of a scenic landscape inventory by a rigorous governmental review process will meet the tests of both paragraphs (d)(4)(i)(A) and (d)(4)(i)(B) of this section.

(d)(5) Historic preservation—(d)(5)(i) In general. The donation of a qualified real property interest to preserve an historically important land area or a certified historic structure will meet the conservation purposes test of this section. When restrictions to preserve a building or land area within a registered historic district permit future development on the site, a deduction will be allowed under this section only if the terms of the restrictions require that such development conform with appropriate local, state, or Federal standards for construction or rehabilitation within the district. See also, § 1.170A-13(h)(3)(ii).

(d)(5)(ii) Historically important land area. The term "historically important land area" includes:
(A) An independently significant land area (for example, an archaeological site or a Civil War battlefield) that substantially meets the National Register Criteria for Evaluation in 36 CFR 60.4 (Pub. L. 89-665, 80 Stat. 915);

(B) Any building or land area within a registered historic district (except buildings that cannot reasonably be considered as contributing to the significance of the district); and

(C) Any land area adjacent to a property listed individually in the National Register of Historic Places (but not within a registered historic district) in a case where the physical or environmental features of the land area contribute to the historic or cultural integrity of the structure.

(d)(5)(iii) Certified Historic structure—(d)(5)(iii)(A) Definition. The term "certified historic structure," for purposes of this section, generally has the same meaning as in section 191(d)(1) (as it existed prior to the Economic Recovery Tax Act of 1981, relating to 5-year amortization of expenditures incurred in the rehabilitation of certified historic structures). However, a "structure" for purposes of this section means any structure, whether or not it is depreciable. Accordingly, easements on private residences may qualify under this section. In addition, a structure would be considered to be a certified historic structure if it were certified either at the time the transfer was made or at the due date (including extensions) for filing the donor's return for the taxable year in which the contribution was made.
(B) Interior and exterior easements. A deduction under this section will not be allowed for the donation of an interior or exterior easement prohibiting destruction or alteration of architectural characteristics inside or on the outside of a certified historic structure unless there is substantial and regular opportunity for the general public to view the architectural characteristics that are the subject of the easement.

(e) Exclusively for conservation purposes. (1) In general. To meet the requirements of this section, a donation must be exclusively for conservation purposes. See paragraphs (c)(1) and (g)(1) through (g)(5)(ii) of this section. A deduction will not be denied under this section when incidental benefit inures to the donor merely as a result of conservation restrictions limiting the uses to which the donor's property may be put.

(e)(2) Access. Any limitation on public access to property that is the subject of a donation under this section shall not render the donation nondeductible if such limitation is necessary for protection of the conservation interests that are the basis of the deduction. For example, a restriction on all public access to the habitat of a threatened native animal species protected by a donation under paragraph (d)(3) of this section would be appropriate if such ***22945** restriction were necessary for the survival of the species.

(e)(3) Inconsistent use. Except as provided in paragraph (e)(4) of this section, a deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests. For example, the preservation of farmland pursuant to a State program for flood prevention and control would not qualify under paragraph (d)(4) of this section if under the terms of the contribution a significant naturally occurring ecosystem could be injured or destroyed by the use of pesticides in the operation of the farm. A donor is not required to demonstrate that all possible conservation interests associated with the property will be protected; rather, the terms of the donation must not permit destruction of significant conservation interests.

(e)(4) Inconsistent use permitted. A use that is destructive of conservation interests will be permitted only if such use is necessary for the protection of the conservation interests that are the subject of the contribution. For example, a deduction for the donation of an easement to preserve an archaeological site that is listed on the National Register of Historic Places will not be disallowed if site excavation consistent with sound archaeological practices may impair a scenic view of which the land is a part. A donor may continue a pre-existing use of the property that does not conflict with the conservation purposes of the gift.
(f) Examples. The provisions of this section relating to conservation purposes may be illustrated by the following examples.

Example (1). State S contains many large track forests that are desirable recreation and scenic areas for the general public. The forests' scenic values attract millions of people to the State. However, due to the increasing intensity of land development in State S, the continued existence of forestland parcels greater than 45 acres is threatened. J grants a perpetual easement on a 100-acre parcel of forestland that is part of one of the State's scenic areas to a qualifying organization. The easement imposes restrictions on the use of the parcel for the purpose of maintaining its scenic values. The restrictions include a requirement that the parcel be maintained forever as open space devoted exclusively to conservation purposes and wildlife protection, and that there be no commercial, industrial, residential, or other development use of such parcel. The law of State S recognizes a limited public right to enter private land, particularly for recreational pursuits, unless such land is posted or the landowner objects. The easement specifically restricts the landowner from posting the parcel, thereby maintaining public access to the parcel according to the custom of the State. J's parcel is regarded by the local community as providing the opportunity for the public to enjoy the use of the property and appreciate its scenic values. Accordingly, J's donation qualifies for a deduction under this section.

Example (2). A qualified conservation organization owns Greenacre in fee as a nature preserve. Greenacre contains a high quality example of a tall grass prairie ecosystem. Farmacre, an operating farm, adjoins Greenacre and is a compatible buffer to the nature preserve. Conversion of Farmacre to a more intense use, such as a housing development, would adversely affect the continued use of Greenacre as a nature preserve because of human traffic generated by the development. The owner of Farmacre donates an easement preventing any future development on Farmacre to the qualified conservation organization for conservation purposes. Normal agricultural uses will be allowed on Farmacre. Accordingly, the donation qualifies for a deduction under this section.

Example (3). H owns Greenacre, a 900-acre parcel of woodland, rolling pasture, and orchards on the crest of a mountain. All of Greenacre is clearly visible from a nearby national park. Because of the strict enforcement of an applicable zoning plan, the highest and best use of Greenacre is as a subdivision of 40-acre tracts. H wishes to donate a scenic easement on Greenacre to a qualifying conservation organization, but H would like to reserve the right to subdivide Greenacre into 90-acre parcels with no more than one single-family home allowable on each parcel. Random building on the property, even as little as one home for each 90 acres, would destroy the scenic character of the view. Accordingly, no deduction would be allowable under this section.

Example (4). Assume the same facts as in example (3), except that not all of Greenacre is visible from the park and the deed of easement allows for limited cluster development of no more than five nine-acre clusters (with four houses on each cluster) located in areas generally not visible from the national park and subject to site and building plan approval by the donee organization in order to preserve the scenic view from the park. The donor and the donee have already identified sites where limited cluster development would not be visible from the park or would not measurably impair the view. Owners of homes in the clusters will not have any rights which respect to the surrounding Greenacre property that are not also available to the general public. Accordingly, the donation qualifies for a deduction under this section.

Example (5). State S has experienced a marked decline in open acreage well suited for agricultural use. In the parts of the State where land is highly productive in agricultural use, substantially all active farms are small, family-owned enterprises under increasing development pressures. In response to those pressures, the legislature of State S passed a statute authorizing the purchase of "agricultural land development rights" from farm owners and the placement of "agricultural preservation restrictions" on their land, in order to preserve the State's open space and farm resources. Agricultural preservation restrictions prohibit or limit construction or placement of buildings except those used for agricultural purposes or dwellings used for family living by the farmer and his family and employees; removal of mineral substances in any manner that adversely affects the land's agricultural potential; or other uses detrimental to retention of the land for agricultural use. Money has been appropriated for this program and some landowners have in fact sold their "agricultural land development rights" to State S. K owns and operates a small dairy farm in State S. K desires to preserve his farm for agricultural purposes in perpetuity. Rather than selling the development rights to State S, K grants to a qualifying conservation organization an agricultural preservation restriction on his property in the form of a conservation easement. K reserves to himself, his heirs and assigns the right to manage the farm consistent with sound agricultural and management practices. K's farm is located in one of the more agriculturally productive areas within State S. Accordingly, a deduction is allowed under this section.

(g) Enforceable in perpetuity —(g)(1) In general. In the case of any donation under this section, the interest in the property retained by the donor (and the donor's successors in interest) must be subject to legally enforceable restrictions that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation. In the case of a contribution of a remainder interest, the contribution will not qualify if the tenants, whether they are tenants for life or a term of years, can use the property in a manner that diminishes the conservation values which are intended to be protected by the contributions.

(g)(2) Remote future event. A deduction shall not be disallowed under section 170(f)(3)(B)(iii) and this section 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 paragraph (e) of § 1.170A-1. For example, a state's statutory requirement that use restrictions must be rerecorded every 30 years to remain enforceable shall not, by itself, render an easement nonperpetual.

(g)(3) Retention of qualified mineral interest —(g)(3)(i) In general. The requirements of this section are not met and no deduction shall be allowed in the case of a contribution of any interest when there is a retention of a qualified mineral interest if at any time there may be extractions or removal of minerals by ***22946** any surface mining method. Moreover, in the case of a qualified mineral interest gift, the requirement that the conservation purposes be protected in perpetuity is not satisfied if any method of mining that is inconsistent with the particular conservation purposes of a contribution is permitted at any time. See also § 1.170A-13(e)(3). However, a deduction under this section will not be denied in the case of certain methods of mining that may have limited, localized impact on the real property but that are not irremediably destructive of significant conservation interests. For example, a deduction will not be denied in a case where production facilities are concealed or compatible with existing topography and landscape and when surface alteration is to be restored to its original state.

(g)(3)(ii) Examples. The provisions of paragraph (g)(3)(i) of this section may be illustrated by the following examples:
Example (1). K owns 5,000 acres of bottomland hardwood property along a major watershed system in the southern part of the United States. Agencies within the Department of the Interior have determined that southern bottomland hardwoods are a rapidly diminishing resource and a critical ecosystem in the south because of the intense pressure to cut the trees and convert the

land to agricultural use. These agencies have further determined (and have indicated in correspondence with K) that bottomland hardwoods provide a superb habitat for numerous species and play an important role in controlling floods and in purifying rivers. K donates to a qualifying conservation organization all his interest in this property other than his interest in the gas and oil deposits that have been identified under K's property. K covenants and can ensure that, although drilling for gas and oil on the property may have some temporary localized impact on the real property, the drilling will not interfere with the overall conservation purpose of the gift, which is to protect the unique bottomland hardwood ecosystem. Accordingly, the donation qualifies for a deduction under this section.

Example (2). Assume the same facts as in example (1), except that K does not own the mineral rights (or the right of access to those minerals) on the 5,000 acres and can not ensure that the mining and drilling will not interfere with the overrall conservation purpose. Accordingly, a deduction for the donation of the easement would not be allowable under this section. The same rule would apply to disallow a deduction by K for the donation of a remainder interest in the land for conservation purposes. A different result would follow if under applicable State law the qualifying organization had sufficient rights to protect the conservation purpose of the gift. Additionally, a donation of K's entire interest in the 5,000 acres to an eligible organization would qualify for a deduction under section 170(f)(3)(A) without regard to this section.

Example (3). Assume the same facts as in example (1), except that K sell the mineral rights to an unrelated party in an arm's length transaction, subject to a recorded prohibition on the removal of any minerals by any surface mining method and a recorded prohibition against any mining technique that will harm the bottomland hardwood ecosystem. After the sale, K donates an easement for conservation purposes to a qualifying organization to protect the bottomland hardwood ecosystem. Since K can ensure in the easement that the mining of minerals on the property will not interfere with the conservation purposes of the gift, the donation qualifies for a deduction under this section.

(g)(4) Protection of conservation purpose where taxpayer reserves certain rights. (i) Documentation. In the case of a donation made after (the date final regulations are published in the Federal Register) of any qualified real property interest when the donor reserves rights the exercise of which may have an adverse impact on the conservation interests associated with the property, for a deduction to be allowable under this section the donor must make available to the donee, prior to the time the donation is made, documentation sufficient to establish the condition of the property at the time of the gift. Such documentation may include:
(A) The appropriate survey maps from the United States Geological Survey, showing the property line and other contiguous or nearby protected areas;

(B) A map of the area drawn to scale showing all existing man-made improvements or incursions (such as roads, buildings, fences, or gravel pits), vegetation and identification of flora and fauna (including, for example, rare species locations, animal breeding and roosting areas, and migration routes), land use history (including present uses and recent past disturbances), and distinct natural features (such as large trees and aquatic areas);

(C) An aerial photograph of the property at an appropriate scale taken as close as possible to the date the donation is made; and

(D) On-site photographs taken at appropriate locations on the property.

If the terms of the donation contain restrictions with regard to a particular natural resource to be protected, such as water quality or air quality, the condition of the resource at or near the time of the gift must be established. The documentation, including the maps and photographs, must be accompanied by a statement signed by the donor and a representative of the donee clearly referencing the documentation and in substance saying “This natural resources inventory is an accurate representation of [the protected property] at the time of the transfer.”.

(ii) Donee's right to inspection and legal remedies. In the case of any donation referred to in paragraph (g)(4)(i) of this section, the donor must agree to notify the donee, in writing, before exercising any reserved right, e.g., the right to extract certain minerals

which may have an adverse impact on the conservation interests associated with the property. The terms of the donation must provide a right of the donee to enter the property at reasonable times for the purpose of inspecting the property to determine if there is compliance with the terms of the donation. Additionally, the terms of the donation must provide a right of the donee to enforce the conservation restrictions by appropriate legal proceedings, including but not limited to, the right to require the restoration of the property to its condition at the time of the donation.

(ii)(5) Extinguishment. (i) In general. If a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation under this paragraph can make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee's proceeds (determined under paragraph (g)(5)(ii) of this section) from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original contribution.

(ii) Proceeds. In case of a donation made after (the date final regulations are published in the Federal Register), 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 a minimum ascertainable proportion of the fair market value to the entire property. See § 1.170A-13(h)(3)(iii). For purposes of this paragraph (g)(5)(ii), that original minimum proportionate value ot the donee's property rights shall remain constant. Accordingly, when a change in conditions give rise to the extinguishment of a perpetual conservation restriction under paragraph (g)(5)(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 the original proportionate value of the perpetual ***22947** 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.
(h) Valuation—(h)(1) Entire interest of donor other than qualified mineral interest. The value of the contribution under section 170 in the case of a contribution of a taxpayer's entire interest in property other than a qualified mineral interest is the fair market value of the surface rights in the property contributed. The value of the contribution shall be computed without regard to the mineral rights. See paragraph (h)(4), example (1), of this section.

(h)(2) Remainder interest in real property. In the case of a contribution of any remainder interest in real property, section 170(f)(4) provides that in determining the value of such interest for purposes of section 170, depreciation and depletion of such property shall be taken into account. See § 1.170A-12. In the case of the contribution of a remainder interest for conservation purposes, the current fair market value of the property (against which the limitations of § 1.170A-12 are applied) must take into account any pre-existing or contemporaneously recorded rights limiting, for conservation purposes, the use to which the subject property may be put.

(h)(3) Perpetual conservation restriction—(i)(i) In general. The value of the contribution under section 170 in the case of a charitable contribution of a perpetual conservation restriction is the fair market value of the perpetual conservation restriction at the time of the contribution. See § 1.170A-7(c). If no substantial record of market-place sales is available to use as a meaningful or valid comparison, as a general rule (but not necessarily in all cases) the fair market value of a perpetual conservation restriction is equal to the difference between the fair market value of the land it encumbers before the granting of the restriction and the fair market value of the encumbered land after the granting of the restriction. The amount of the deduction in the case of a charitable contribution of a perpetual conservation restriction covering a portion of the contiguous land owned by a taxpayer and the taxpayer's family (see section 267(c)(4)) is the difference between the fair market value of the entire contiguous tract before and after the granting of the restriction. Accordingly, in the case of the donation of a perpetual conservation restriction in all or a portion of the contiguous land owned by a taxpayer and the taxpayer's family (see section 267(c)(4)), if the donor or the donor's family receives, or can reasonably expect to receive, financial or economic benefits that are greater than those that will inure to the general public from the transfer, no deduction is allowable under this section. However, if the transferor receives, or can reasonably expect to receive, a financial or economic benefit that is substantial, but it is clearly shown that the benefit is less than the amount of the transfer, then a deduction under this section is allowable for the excess of the amount transferred

over the amount of the financial or economic benefit received or reasonably expected to be received by the transferor. (See example (11) of paragraph (h)(4) of this section.)

(ii) Fair market value of property before and after restriction. If before and after valuation is used, the fair market value of the property before contribution of the conservation restriction must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property's potential highest and best use. Further, there may be instances where the grant of a conservation restriction may have no material effect on the value of the property or may in fact serve to enhance, rather than reduce, the value of property. In such instances no deduction would be allowable. 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. Additionally, if before and after valuation is used, an appraisal of the property after contribution of the restriction must take into account the effect of restrictions that will result in a reduction of the potential fair market value represented by highest and best use but will, nevertheless, permit uses of the property that will increase its fair market value above that represented by the property's current use. The value of a perpetual conservation restriction shall not be reduced by reason of the existence of restrictions on transfer designed solely to ensure that the conservation restriction will be dedicated to conservation purposes. See § 1.170A-13(c)(2).

(ii)(iii) Allocation of basis. In the case of the donation of a qualified real property interest for conservation purposes, the basis of the property retained by the donor must be adjusted by the elimination of that part of the total basis of the property that is properly allocable to the qualified real property interest granted. The amount of the basis that is allocable to the qualified real property interest shall bear the same ratio to the total basis of the property as the fair market value of the qualified real property interest bears to the fair market value of the property before the granting of the qualified real property interest. When a taxpayer donates to a qualifying conservation organization an easement on a structure with respect to which deductions are taken for depreciation, the reduction required by this paragraph (h)(3)(ii) in the basis of the property retained by the taxpayer must be allocated between the structure and the underlying land.

(ii)(iii)(4) Examples. The provisions of this section may be illustrated by the following examples. In examples illustrating the value or deductibility of donations, the applicable restrictions and limitations of § 1.170A-4, with respect to reduction in amount of charitable contributions of certain appreciated property, and § 1.170A-8, with respect to limitations on charitable deductions by individuals, must also be taken into account.
Example (1). A owns Goldacre, a property adjacent to a state park. A wants to donate Goldacre to the state to be used as part of the park, but A wants to reserve a qualified mineral interest in the property, to exploit currently and to devise at death. The fair market value of the surface rights in Goldacre is $200,000 and the fair market value of the mineral rights is $100,000. In order to ensure that the quality of the park will not be degraded, restrictions must be imposed on the right to extract the minerals that reduce the fair market value of the mineral rights to $80,000. Under this section, the value of the contribution is $200,000 (the value of the surface rights).

Example (2). Assume the same facts as in example (1), except that A would like to retain a life estate in Goldacre. A donates a remainder interest in Goldacre to the county government to use Goldacre as a park after A's death, but reserves the mineral rights in Goldacre (with restrictions on extraction similar to those in example (1)). A's gift does not meet the requirements of § 1.170A-7, with respect to contributions not in trust of partial interests in property, of § 1.170A-13(b)(1), with respect to qualified mineral interests, or of § 1.170A-13(b)(2), with respect to remainder interests in real property. Accordingly, no income tax deduction is allowable under this section.

Example (3). In 1982, B, who is 62, donates a remainder interest in Greenacre to a qualifying organization for conservation purposes. Greenacre is a tract of 200 acreas ***22948** of undeveloped woodland that is valued at $200,000 at its highest and best use. Under § 1.170A-12(b), the value of a remainder interest in real property following one life is determined under § 25.2512-9 of the Gift Tax Regulations. Accordingly, the value of the remainder interest, and thus the amount eligible for an income tax deduction under section 170(f), is $95,358 ($200,000x.47679).

Example (4). Assume the same facts as in example (3), except that Greenacre is B's 200-acre estate with a home built during the colonial period. Some of the acreage around the home is cleared; the balance of Greenacre, except for access roads, is wooded and undeveloped. See § 170(f)(3(E)(i). However, B would like Greenacre to be maintained in its current state after his death, so he donates a remainder interest in Greenacre to a qualifying organization for conservation purposes pursuant to sections 170(f)(3)(B)(iii) and (h)(2)(B). At the time of the gift the land has a value of $200,000 and the house has a value of $100,000. The value of the remainder interest, and thus the amount eligible for an income tax deduction under section 170(f), is computed pursuant to § 1.170A-12. See § 1.170A-12(b)(3).

Example (5). Assume the same facts as in example (3), except that at age 62 instead of donating a remainder interest B donates an easement in Greenacre to a qualifying organization for conservation purposes. The fair market value of Greenacre after the donation is reduced to $110,000. Accordingly, the value of the easement, and thus the amount eligible for a deduction under section 170(f), is $90,000 ($200,000 less $110,000).

Example (6). Assume the same facts as in example (5), and assume that three years later, at age 65, B decides to donate a remainder interest in Greenacre to a qualifying organization for conservation purposes. Increasing real estate values in the area have raised the fair market value of Greenacre (subject to the easement) to $130,000. Accordingly, the value of the remainder interest, and thus the amount eligible for a deduction under section 170(f), is $67,324 ($130,000x.51788).

Example (7). Assume the same facts as in example (3), except that at the time of the donation of a remainder interest in Greenacre, B also donates an easement to a different qualifying organization for conservation purposes. Based on all the facts and circumstances, the value of the easement is determined to be $100,000. Therefore, the value of the property after the easement is $100,000 and the value of the remainder interest, and thus the amount eligible for deduction under section 170(f), is $47,679 ($100,000 x.47679).

Example (8). C owns Greenacre, a 200-acre estate containing a house built during the colonial period. At its highest and best use, for home development, the fair market value of Greenacre is $300,000. C donates an easement (to maintain the house and Greenacre in their current state) to a qualifying organization for conservation purposes. The fair market value of Greenacre after the donation is reduced to $125,000. Accordingly, the value of the easement and the amount eligible for a deduction under section 170(f) is $175,000 ($300,000 less $125,000).

Example (9). Assume the same facts as in example (8) and assume that three years later, C decides to donate a remainder interest in Greenacre to a qualifying organization for conservation purposes. Increasing real estate values in the area have raised the fair market value of Greenacre to $180,000. Assume that because of the perpetual easement prohibiting any development of the land, the value of the house is $120,000 and the value of the land is $60,000. The value of the remainder interest, and thus the amount eligible for an income tax deduction under section 170(f), is computed pursuant to § 1.170A-12. See § 1.170A-12(b)(3).

Example (10). D owns property with a basis of $20,000 and a fair market value of $80,000. D donates to a qualifying organization an easement for conservation purposes that is determined under this section to have a fair market value of $60,000. The amount of basis allocable to the easement is $15,000 ($60,000/$80,000=$15,000/$20,000). Accordingly, the basis of the property is reduced to $5,000 ($20,000 minus $15,000).

Example (11). E owns 10 one-acre lots that are currently woods and parkland. The fair market value of each of E's lots is $15,000 and the basis of each lot is $3,000. E grants to the county a perpetual easement for conservation purposes to use and maintain eight of the acres as a public park and to restrict any future development on those eight acres. As a result of the restrictions, the value of the eight acres is reduced to $1,000 an acre. However, by perpetually restricting development on this portion of the land, E has ensured that the two remaining acres will always be bordered by parkland, thus increasing their fair market value to $22,500 each. If the eight acres represented all of E's land, the fair market value of the easement would be $112,000, an amount equal to the fair market value of the land before the granting of the easement (8x$1,000)+(2x$22,500)) the granting of

the easement (8x$15,000=$120,000) minus the fair market value of the encumbered land after (8x$1,000=$8,000). However, because the easement only covered a portion of the taxpayer's contiquous land, the amount of the deduction under section 170 is reduced to $97,000 ($150,000-$53,000), that is, the difference between the fair market value of the entire tract of land before ($150,000) and after ((8x $1,000)+(2x$22,500)) the granting of the easement.

Example (12). Assume the same facts as in example (11). Since the easement covers a portion of E's land, only the basis of that portion is adjusted. Therefore, the amount of basis allocable to the easement is $22,400 ((8x$3,000) x($112,000/$120,000)). Accordingly, the basis of the eight acres encumbered by the easement is reduced to $1,600 ($24,000-$22,400), or $200 for each acre. The basis of the two remaining acres is not affected by the donation.

Example (13). F owns and uses as professional offices a two-story building that lies within a registered historic district. F's building is an outstanding example of period architecture with a fair market value of $125,000. Restricted to its current use, which is the highest and best use of the property without making changes to the facade, the building and lot would have a fair market value of $100,000, of which $80,000 would be allocable to the building and $20,000 would be allocable to the lot. F's basis in the property is $50,000, of which $40,000 is allocable to the building and $10,000 is allocable to the lot. F's neighborhood is a mix of residential and commercial uses, and it is possible that F (or another owner) could enlarge the building for more extensive commercial use, which is its highest and best use. However, this would require changes to the facade. F would like to donate to a qualifying preservation organization an easement restricting any changes to the facade and promising to maintain the facade in perpetuity. The donation would qualify for a deduction under this section. The fair market value of the easement is $25,000 (the fair market value of the property before the easement, $125,000, minus the fair market value of the property after the easement, $100,000). Pursuant to § 1.170A-13(h)(3)(iii), the basis allocable to the easement is $10,000 and the basis of the underlying property (building and lot) is reduced to $40,000.

(ii)(iii)(4)(i) Substantiation requirement. If a taxpayer makes a qualified conservation contribution and claims a deduction, the taxpayer must maintain written records of the fair market value of the underlying property before and after the donation and the conservation purpose furthered by the donation and such information shall be stated in the taxpayer's income tax return if required by the return or its instructions.

(j) Effective date. This section applies only to contributions made on or after December 18, 1980.

PART 20—[AMENDED]

Par. 5. Paragraph (e)(2) of § 20.2055-2 is amended as follows:

a. The sixth sentence of paragraph (e)(2)(i) is revised to read: “However, except as provided in paragraphs (e)(2) (ii), (iii), and (iv) of this section, for purposes of this subdivision a charitable contribution of an interest in property not in trust where the decedent transfers some specific rights to one party and transfers other substantial rights to another party will not be considered a contribution of an undivided portion of the decedent's entire interest in property.”.

b. The eighth sentence of paragraph (e)(2)(i) is revised to read: “A bequest to charity made on or before December 17, 1980, of an open space easement in gross in perpetuity shall be considered the transfer to charity of an undivided portion of the decedent's entire interest in the property.”.

c. Paragraphs (e)(2)(iv), (e)(2)(v), and (e)(2)(vi) are redesignated (e)(2)(v), (e)(2)(vi), and (e)(2)(vii), respectively.

***22949** d. A new paragraph (e)(2)(iv) is inserted after paragraph (e)(2) (iii) to read as set forth below.

26 CFR § 20.2055

§ 20.2055-2 Transfers not exclusively for charitable purposes.

* * * * *

(e) Limitations applicable to decedents dying after December 31, 1969. * * *

(e)(2) Deductible interests. * * *

(e)(2)(iv) Qualified conservation contribution. The charitable interest is a qualified conservation contribution. For the definition of a qualified conservation contribution, see § 1.170A-13.

PART 25—[AMENDED]

Par. 6. Paragraph (c)(2) of § 25.2522(c)-3 is amended as follows:

a. The sixth sentence of paragraph (c)(2)(i) is revised to read: "However, except as provided in paragraphs (e)(2) (ii), (iii), and (iv) of this section, for purposes of this subdivision a charitable contribution of an interest in property not in trust where the decedent transfers some specific rights to one party and transfers other substantial rights to another party will not be considered a contribution of an undivided portion of the decedent's entire interest in property.".

b. The eighth sentence of paragraph (c)(2)(i) is revised to read: "A bequest to charity made on or before December 17, 1980, of an open space easement in gross in perpetuity shall be considered the transfer to charity of an undivided portion of the decedent's entire interest in property.".

c. Paragraphs (c)(2)(iv), (c)(2)(v), and (c)(2)(vi) are redesignated (c)(2)(v), (c)(2)(vi), and (c)(2)(vii), respectively.

d. A new paragraph (c)(2)(iv) is inserted after paragraph (c)(2)(iii), to read as set forth below.

26 CFR § 25.2522

§ 25.2522(c)-3 Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

* * * * *

(c) Transfers of partial interest in property. * * *

(c)(2) Deductible interest. * * *

(c)(2)(iv) Qualified Conservation Contribution. The charitable interest is a qualified conservation contribution. For the definition of a qualified conservation contribution, see § 1.170A-13.

Roscoe L. Egger, Jr.,

Commissioner of Internal Revenue.

[FR Doc. 83-13693 Filed 5-20-83; 8:45 am]

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End of Document

51 FR 1496-01, 1986 WL 715917(F.R.)
RULES and REGULATIONS
DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 20, 25, and 602
[T.D. 8069]

Income Taxes; Qualified Conservation Contributions

Tuesday, January 14, 1986

***1496** AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to contributions not in trust of partial interests in property for conservation purposes. Changes to the applicable law made by the Temporary Tax Provisions, Extension and the Tax Reform Act of 1984 are reflected in this document. These regulations provide necessary guidance to the public for compliance with the law and affect donors and donees of qualified conservation contributions.
DATES: Except as otherwise provided in § 1.170A-14(g)(4)(ii), the regulations apply to contributions made on or after December 18, 1980, and are effective on December 18, 1980.

FOR FURTHER INFORMATION CONTACT: Ada S. Rousso of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC 20224 (Attention: CC:LR:T), Telephone 202-566-3287 (not a toll free call).

SUPPLEMENTARY INFORMATION:

Background

On May 23, 1983, the Federal Register (48 FR 22940) published proposed amendments to the Income Tax Regulations (26 CFR Part 1) and Estate and Gift Tax Regulations (26 CFR Parts 20 and 25) under sections 170(h), 2055 and 2522 of the Internal Revenue Code of 1954 (Code). The amendments were proposed to conform the regulations to section 6 of the Temporary Tax Provisions, Extension (Pub. L. 96-541, 96 Stat. 3206). A public hearing was held on September 15, 1983. Subsequent to the hearing, section 170(h)(5) of the Code was amended by section 1035(a) of the Tax Reform Act of 1984 (Pub. L. 98-369, 98 Stat. 1042). On December 10, 1984, the Service issued a news release (IR-84-125) reminding taxpayers claiming deductions for donations of conservation easements that such deductions are limited to the fair market value of the easement at the time of the contribution. The news release further indicated that if the donation of the easement does not decrease the value of the property on which the easement is granted, the fair market value of the easement, and thus, the deduction, is zero.

After consideration of all comments regarding the proposed amendments and of the revision made by the Tax Reform Act of 1984, those amendments are adopted as revised by this Treasury decision.

***1497 Summary of Comments**

Qualified Contribution of Entire Interest of Donor Other Than Qualified Mineral Interest

In response to many comments regarding the donation of an entire interest of the donor other than a qualified mineral interest, proposed § 1.170A-14(b) has been revised to provide that section 170(h) will not disallow a deduction for a conservation contribution where the donor has previously transferred a portion of the entire interest unless the donor has purposefully reduced his interest before the contribution is made, for example, by transferring a portion to a related person in order to retain control of more than a qualified mineral interest.

Access

The final regulations have been revised to clarify the extent of public access required for each type of qualified conservation contribution under section 170(h). Thus, in order to qualify for a deduction under section 170(h), donations of property to preserve land areas for outdoor recreation by or for the education of the general public, for the preservation of a view, for the preservation of land pursuant to a governmenal conservation policy, or for the preservation of historic structures or land areas must provide for either physical or visual access. Examples have been included to clarify the public access requirement in specific circumstances.

Inconsistent Use

Section 1.170A-14(e)(2) provides that a deduction will not be allowed if a contribution would accomplish one of the enumerated conservation purposes but would permit impairment of other enumerated conservation interests. However, inconsistent use of the property is permitted if that use is necessary for the protection of the conservation interests that are the subject of the contribution. Commenters felt that the proposed regulations were not specific enough regarding permitted inconsistent uses. Therefore, the final regulations have been revised to include examples of certain uses that are not prohibited if, under the circumstances, they do not impair significant conservation interests. See § 1.170A-14(e)(2).

Third Party Mineral Rights

The proposed regulations provided that the interest in property that is retained by the donor (and the donor's successor in interest) must be subject to legally enforceable restrictions that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation. In addition, there was a prohibition against any method of mining on property that is the subject of a gift that would be inconsistent with the conservation purposes of the donation. Furthermore, a contribution was disallowed if at any time there may be surface mining on the property.

Many comments were received requesting relief from this rule because in many areas of the country, the mineral rights are not and may never have been owned by the donor; thus the donor cannot ensure that a third party owner of the mineral rights will not engage in surface mining on the property that is the subject of the gift.

Subsequent to publication of the proposed regulations, section 1035(a) of the Tax Reform Act of 1984 amended section 170(h)(5)(B) (relating to surface mining) to provide an exception to the general rule precluding a deduction for a conservation contribution if there is any likelihood of surface mining occurring at any time on the property to which the contribution relates. For conservation contributions made after July 18, 1984, the general rule with respect to surface mining will not apply to preclude a deduction if the surface estate and mineral interests were separated before June 13, 1976, remain so separated up to and including the time of the gift, and the probability of surface mining occurring on the property is so remote as to be negligible. Factors that may be considered in determining if the probability of surface mining is so remote as to be negligible are provided in the final regulations. In addition, the regulations provide that no deduction for a conservation contribution of the surface estate is permitted under this exception if the present owner is related to the owner of the surface estate at the time of the gift. Finally, these regulations clarify that any person may retain the mineral interest so long as the donor can guarantee observance of the restrictions to protect the conservation interests. See § 1.170A-14(g)(4) and the example thereunder.

Preservation of Open Space

In general, the statute provides that a donation of real property to preserve open space for conservation purposes (including farmland and forestland) will qualify as a deductible contribution if either of two tests are met: (1) The preservation must be pursuant to a clearly delineated governmental policy and must yield a significant public benefit, or (2) the preservation must be for the scenic enjoyment of the general public and must yield a significant public benefit. In connection with the first test, the final regulations retain the "sliding scale" approach adopted in the proposed regulations which is used to establish a relationship between the two requirements. Thus, although the requirements of governmental policy and public benefit must be met independently, the more specific the governmental policy with respect to a particular site to be protected, the more likely the governmental decision, by itself, will tend to establish the significant public benefit associated with the donation.

Commenters felt the regulations did not sufficiently clarify the standards under which deductions are allowed for the preservation of open space. Many of the comments received suggested revisions in the final regulations to provide donors with procedural "safe harbors" to avoid uncertainty regarding the deductibility of their donations. Commentators believed that without safe harbors, donors either will have to bear the expense of seeking advance rulings, or will risk additional tax liability if their deductions are later disallowed. Generally, the commenters suggested the following:

(1) A declaration by a unit of government identifying a particular property as worthy of protection should meet the clearly delineated governmental policy test and thus be sufficient to eliminate the need to meet the significant public benefit test.

(2) Acceptance of a donation by a unit of government (federal, state or local) or a duly constituted commission of such unit of government, should establish both a clearly delineated governmental policy and significant public benefit.

(3) A sliding scale approach should be extended to the relationship between scenic enjoyment of the general public and significant public benefit. Thus, the more scenic the view and the more people who see it, the more it tends to confer a significant public benefit.

(4) The regulations should encourage donations of farmland for agricultural uses by expanding references to the preservation of farmland to uses other than just the preservation of farmland pursuant to a state program for flood prevention and control. See § 1.170A-14(d)(4)(iv)(B). Commenters believed the reference was misleading because it implied that such is the only use for which there can be a deductible donation of farmland.

(5) Acceptance of a donation by a qualified conservation organization should be conclusive evidence of deductibility. Because the Internal ***1498** Revenue Service lacks the expertise to make the subjective determinations of " significant public benefit" and "scenic enjoyment", that responsibility should be delegated to either a private organization or to another governmental agency with acknowledged expertise in this area.

In general, the rules in the proposed regulations relating to open space easements have been retained in the final regulations. However, in response to the comments, some clarifications have been made regarding such easements. First, the fact that a unit of government has identified a particular property as worthy of protection does not by itself show the existence of a clearly delineated governmental policy, and thus, the significant public benefit associated with the donation must be independently demonstrated. Second, when there is a rigorous review of a donation by a unit of government or a duly constituted commission of a unit of government, the acceptance of a donation by such unit or commission of government tends to establish the clearly delineated governmental policy.

An example of a rigorous review process has been included in the final regulations. The more specific the governmental policy with respect to a particular site to be protected, the more likely it is that the governmental decision to accept the donation will tend, by itself, to establish the significant public benefit associated with the donation. A degree of certainty is available to donors in jurisdictions that have clearly articulated preservation policies, but as with any subjective test, there must ultimately be some exercise of judgment and responsibility by both donors and donees. Third, the terms "significant public benefit" and "scenic enjoyment" necessarily require a case-by-case factual determination and hence cannot be defined precisely. The list of

factors included at § 1.170A-14(d)(4)(iv) with respect to "significant public benefit" and § 1.170A-14(d)(4)(ii) with respect to "scenic enjoyment" are intended to be illustrative, rather than all-inclusive. In a particular case, other facts and circumstances may be relevant. Fourth, the regulations clarify that farmland, as recognized by the statute, is merely a category of open space that must meet either of the two prescribed tests in order to be a deductible contribution. Finally, acceptance of a donation by a qualified organization is not conclusive evidence of the deductibility of a donation. The Internal Revenue Service has the responsibility for making final determinations as to the deductibility of donations. That responsibility cannot be delegated to a private organization or to another governmental agency, although the Service accords substantial weight to the determinations of qualified organizations and governmental agencies in its decision-making process.

Donations of Mortgaged Property

Section 170(h)(5) provides that the conservation purposes of the donation must be protected in perpetuity. The proposed regulations did not specifically address how this requirement applies to mortgaged property.

In response to comments received, the final regulations clarify that when a contribution of mortgaged property is made to a qualified organization, the mortgagee must subordinate its rights under the mortgage to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity. However, since certain donees, unaware of this clarification, accepted (or will have accepted) contributions of mortgaged property prior to February 12, 1986, without requiring subordination of the mortgagee's rights in the property, a donor will be allowed a deduction for such a contribution provided that the donor can demonstrate that the conservation purposes of the gift are protected in perpetuity absent subordination.

Valuation

Section 1.170A-14(h)(3)(i) of the final regulations has been revised to indicate that increases in the value of any property owned by the donor or a related person—not just contiguous property—resulting from the granting of a perpetual conservation restriction must be taken into account in determining the amount of the deduction.

Paperwork Reduction Act

The collection of information requirements contained in these regulations have been submitted to the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1980. These requirements have been approved by OMB.

Special Analyses

The Commissioner of Internal Revenue has determined that this final rule is not a major rule as defined in Executive Order 12291 and that a Regulatory Impact Analysis is therefore not required. Although a notice of proposed rulemaking which solicited public comments was issued, the Internal Revenue Service concluded when the notice was issued that the regulations are interpretative and that the notice and public comment procedure requirement of 5 U.S.C. 553 did not apply. Accordingly, the final regulations do not constitute regulations subject to the Regulatory Flexibility Act (5 U.S.C. chapter 6).

Drafting Information

The principal author of these regulations is Ada S. Rousso of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

List of Subjects

26 CFR 1.61-1—1.281-4

Income taxes, Taxable income, Deductions, Exemptions.

26 CFR Part 20
Estate taxes.

26 CFR Part 25
Gift taxes.

26 CFR Part 602
Reporting and recordkeeping requirements.

Adoption of Amendments to the Regulations
Accordingly, 26 CFR Parts 1, 20, 25, and 602 are amended as follows:

PART 1—[AMENDED]
Paragraph 1. The authority for Part 1 continues to read in part:

Authority: 26 U.S.C. 7805. * * *
26 CFR § 1.167(a)-5

§ 1.167(a)-5 [Amended]
26 CFR § 1.167(a)-5
Par. 2. Section 1.167(a)-5 is amended by adding at the end thereof the following new sentence: "For the adjustment to the basis of a structure in the case of a donation of a qualified conservation contribution under section 170(h), see § 1.170A-14(h)(3)(iii)."
26 CFR § 1.170A-7
Par. 3. Section 1.170A-7 is amended as follows:

a. The first sentence of paragraph (b)(1)(ii) is amended to begin with the phrase "With respect to contributions made on or before December 17, 1980.".

b. Paragraph (b)(1)(ii) is amended by adding at the end the following new sentence: "For the deductibility of a qualified conservation contribution, see § 1.170A-14".

***1499** c. A new paragraph (b)(5) is added immediately after paragraph (b) (4), as set forth below.

d. The first sentence of paragraph (c) is amended to begin with the phrase "Except as provided in § 1.170A-14.".

e. Paragraph (e) is revised as set forth below.
26 CFR § 1.170A-7

§ 1.170A-7 Contributions not in trust of partial interests in property.
* * * * *
(b) Contributions of certain partial interests in property for which a deduction is allowed. * * *

(5) Qualified conservation contribution. A deduction is allowed under section 170 for the value of a qualified conservation contribution. For the definition of a qualified conservation contribution, see § 1.170A-14.

* * * * *

(e) Effective date. This section applies only to contributions made after July 31, 1969. The deduction allowable under § 1.170A-7(b)(1)(ii) shall be available only for contributions made on or before December 17, 1980. Except as otherwise provided in § 1.170A-14(g)(4)(ii), the deduction allowable under § 1.170A-7(b)(5) shall be available for contributions made on or after December 18, 1980.

26 CFR § 1.170A-14 26 CFR § 1.170A-13T

Par. 4. A new § 1.170A-14 is added after § 1.170A-13T to read as set forth below.

26 CFR § 1.170A-14

§ 1.170A-14 Qualified conservation contributions.

(a) Qualified conservation contributions. A deduction under section 170 is generally not allowed for a charitable contribution of any interest in property that consists of less than the donor's entire interest in the property other than certain transfers in trust (see § 1.170A-6 relating to charitable contributions in trust and § 1.170A-7 relating to contributions not in trust of partial interests in property). However, a deduction may be allowed under section 170(f)(3)(B)(iii) for the value of a qualified conservation contribution if the requirements of this section are met. A qualified conservation contribution is the contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. To be eligible for a deduction under this section, the conservation purpose must be protected in perpetuity.

(b) Qualified real property interest—(1) Entire interest of donor other than qualified mineral interest. (i) The entire interest of the donor other than a qualified mineral interest is a qualified real property interest. A qualified mineral interest is the donor's interest in subsurface oil, gas, or other minerals and the right of access to such minerals.

(ii) A real property interest shall not be treated as an entire interest other than a qualified mineral interest by reason of section 170(h)(2)(A) and this paragraph (b)(1) if the property in which the donor's interest exists was divided prior to the contribution in order to enable the donor to retain control of more than a qualified mineral interest or to reduce the real property interest donated. See Treasury regulations § 1.170A-7(a)(2)(i). An entire interest in real property may consist of an undivided interest in the property. But see section 170(h)(5)(A) and the regulations thereunder (relating to the requirement that the conservation purpose which is the subject ot the donation must be protected in perpetuity). Minor interests, such as rights-of-way, that will not interfere with the conservation purposes of the donation, may be transferred prior to the conservation contribution without affecting the treatment of a property interest as a qualified real property interest under this paragraph (b)(1).

(2) Perpetual conservation restriction. 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). For purposes of this section, the terms “easement”, “conservation restriction”, and “perpetual conservation restriction” have the same meaning. The definition of “perpetual conservation restriction” under this paragraph (b)(3) is not intended to preclude the deductibility of a donation of affirmative rights to use a land or water area under § 1.170A-13(d)(2). Any rights reserved by the donor in the donation of a perpetual conservation restriction must conform to the requirements of this section. See e.g., paragraph (d)(4)(ii), (d)(5)(i), (e)(3), and (g)(4) of this section.

(c) Qualified organization—(1) Eligible donee. To be considered an eligible donee under this section, an organization must be a qualified organization, have a commitment to protect the conservation purposes of the donation, and have the resources to enforce the restrictions. A conservation group organized or operated primarily or substantially for one of the conservation purposes specified in section 170(h)(4)(A) will be considered to have the commitment required by the preceding sentence. A qualified organization need not set aside funds to enforce the restrictions that are the subject of the contribution. For purposes of this section, the term “qualified organization” means:

(i) A governmental unit described in section 170(b)(1)(A)(v);

(ii) An organization described in section 170(b)(1)(A)(vi);

(iii) A charitable organization described in section 501(c)(3) that meets the public support test of section 509(a)(2);

(iv) A charitable organization described in section 501(c)(3) that meets the requirements of section 509(a)(3) and is controlled by an organization described in paragraphs (c)(1) (i), (ii), or (iii) of this section.

(2) Transfers by donee. A deduction shall be allowed for a contribution under this section only if in the instrument of conveyance the donor prohibits the donee from subsequently transferring the easement (or, in the case of a remainder interest or the reservation of a qualified mineral interest, the property), whether or not for consideration, unless the donee organization, as a condition of the subsequent transfer, requires that the conservation purposes which the contribution was originally intended to advance continue to be carried out. Moreover, subsequent transfers must be restricted to organizations qualifying, at the time of the subsequent transfer, as an eligible donee under paragraph (c)(1) of this section. When a later unexpected change in the conditions surrounding the property that is the subject of a donation under paragraph (b)(1), (2), or (3) of this section makes impossible or impractical the continued use of the property for conservation purposes, the requirement of this paragraph will be met if the property is sold or exchanged and any proceeds are used by the donee organization in a manner consistent with the conservation purposes of the original contribution. In the case of a donation under paragraph (b)(3) of this section to which the preceding sentence applies, see also paragraph (g)(5)(ii) of this section.

(d) Conservation purposes—(1) In general. For purposes of section 170(h) and this section, the term "conservation purposes" means—

(i) The preservation of land areas for outdoor recreation by, or the education of, the general public, within the meaning of paragraph (d)(2) of this section,

(ii) The protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem, within the ***1500** meaning of paragraph (d)(3) of this section,

(iii) The preservation of certain open space (including farmland and forest land) within the meaning of paragraph (d)(4) of this section, or

(iv) The preservation of a historically important land area or a certified historic structure, within the meaning of paragraph (d)(5) of this section.

(2) Recreation or education—(i) In general. The donation of a qualified real property interest to preserve land areas for the outdoor recreation of the general public or for the education of the general public will meet the conservation purposes test of this section. Thus, conservation purposes would include, for example, the preservation of a water area for the use of the public for boating or fishing, or a nature or hiking trail for the use of the public.

(ii) Access. The preservation of land areas for recreation or education will not meet the test of this section unless the recreation or education is for the substantial and regular use of the general public.

(3) Protection of environmental system—(i) In general. The donation of a qualified real property interest to protect a significant relatively natural habitat in which a fish, wildlife, or plant community, or similar ecosystem normally lives will meet the conservation purposes test of this section. The fact that the habitat or environment has been altered to some extent by human activity will not result in a deduction being denied under this section if the fish, wildlife, or plants continue to exist there in a relatively natural state. For example, the preservation of a lake formed by a man-made dam or a salt pond formed by a man-made dike would meet the conservation purposes test if the lake or pond were a nature feeding area for a wildlife community that included rare, endangered, or threatened native species.

(ii) Significant habitat or ecosystem. Significant habitats and ecosystems include, but are not limited to, habitats for rare, endangered, or threatened species of animal, fish, or plants; natural areas that represent high quality examples of a terrestrial community or aquatic community, such as islands that are undeveloped or not intensely developed where the coastal ecosystem is relatively intact; and natural areas which are included in, or which contribute to, the ecological viability of a local, state, or national park, nature preserve, wildlife refuge, wilderness area, or other similar conservation area.

(iii) Access. Limitations on public access to property that is the subject of a donation under this paragraph (d)(3) shall not render the donation nondeductible. For example, a restriction on all public access to the habitat of a threatened native animal species protected by a donation under this paragraph (d)(3) would not cause the donation to be nondeductible.

(4) Preservation of open space—(i) In general. The donation of a qualified real property interest to preserve open space (including farmland and forest land) will meet the conservation purposes test of this section if such preservation is—

(A) Pursuant to a clearly delineated Federal, state, or local governmental conservation policy and will yield a significant public benefit, or

(B) For the scenic enjoyment of the general public and will yield a significant public benefit.

An open space easement donated on or after December 18, 1980, must meet the requirements of section 170(h) in order to be deductible.
(ii) Scenic enjoyment—(A) Factors. A contribution made for the preservation of open space may be for the scenic enjoyment of the general public. Preservation of land may be for the scenic enjoyment of the general public if development of the property would impair the scenic character of the local rural or urban landscape or would interfere with a scenic panorama that can be enjoyed from a park, nature preserve, road, waterbody, trail, or historic structure or land area, and such area or transportation way is open to, or utilized by, the public. “Scenic enjoyment” will be evaluated by considering all pertinent facts and circumstances germane to the contribution. Regional variations in topography, geology, biology, and cultural and economic conditions require flexibility in the application of this test, but do not lessen the burden on the taxpayer to demonstrate the scenic characteristics of a donation under this paragraph. The application of a particular objective factor in to help define a view as “scenic” in one setting may in fact be entirely inappropriate in another setting. Among the factors to be considered are:

(1) The compatibility of the land use with other land in the vicinity;

(2) The degree of contrast and variety provided by the visual scene;

(3) The openness of the land (which would be a more significant factor an urban or densely populated setting or in a heavily wooded area);

(4) Relief from urban closeness;

(5) The harmonious variety of shapes and textures;

(6) The degree to which the land use maintains the scale and character of the urban landscape to preserve open space, visual enjoyment, and sunlight for the surrounding area;

(7) The consistency of the proposed scenic view with a methodical state scenic identification program, such as a state landscape inventory; and

(8) The consistency of the proposed scenic view with a regional or local landscape inventory made pursuant to a sufficiently rigorous review process, especially if the donation is endorsed by an appropriate state or local governmental agency.

(B) Access. To satisfy the requirement of scenic enjoyment by the general public, visual (rather than physical) access to or across the property by the general public is sufficient. Under the terms of an open space easement on scenic property, the entire property need not be visible to the public for a donation to qualify under this section, although the public benefit from the donation may be insufficient to qualify for a deduction if only a small portion of the property is visible to the public.

(iii) Governmental conservation policy—(A) In general. The requirement that the preservation of open space be pursuant to a clearly delineated Federal, state, or local governmental policy is intended to protect the types of property identified by representatives of the general public as worthy of preservation or conservation. A general declaration of conservation goals by a single official or legislative body is not sufficient. However, a governmental conservation policy need not be a certification program that identifies particular lots or small parcels of individually owned property. This requirement will be met by donations that further a specific, identified conservation project, such as the preservation of land within a state or local landmark district that is locally recognized as being significant to that district; the preservation of a wild or scenic river, the preservation of farmland pursuant to a state program for flood prevention and control; or the protection of the scenic, ecological, or historic character of land that is contiguous to, or an integral part of, the surroundings of existing recreation or conservation sites. For example, the donation of a perpetual conservation restriction to a qualified organization pursuant to a formal resolution or certification by a local governmental agency established under state law specificalty identifying the subject properly as worthy of protection for conservation purposes will meet the requirement of this paragraph. A ***1501** program need not be funded to satisfy this requirement, but the program must involve a significant commitment by the government with respect to the conservation project. For example, a governmental program according preferential tax assessment or preferential zoning for certain property deemed worthy of protection for conservation purposes would constitute a significant commitment by the government.

(B) Effect of acceptance by governmental agency. Acceptance of an easement by an agency of the Federal Government or by an agency of a state or local government (or by a commission, authority, or similar body duly constituted by the state or local government and acting on behalf of the state or local government) tends to establish the requisite clearly delineated governmental policy, although such acceptance, without more, is not sufficient. The more rigorous the review process by the governmental agency, the more the acceptance of the easement tends to establish the requisite clearly delineated governmental policy. For example, in a state where the legislature has established an Environmental Trust to accept gifts to the state which meet certain conservation purposes and to submit the gifts to a review that requires the approval of the state's highest officials, acceptance of a gift by the Trust tends to establish the requisite clearly delineated governmental policy. However, if the Trust merely accepts such gifts without a review process, the requisite clearly delineated governmental policy is not established.

(C) Access. A limitation on public access to property subject to a donation under this paragraph (d)(4)(iii) shall not render the deduction nondeductible unless the conservation purpose of the donation would be undermined or frustrated without public access. For example, a donation pursuant to a governmental policy to protect the scenic character of land near a river requires visual access to the same extent as would a donation under paragraph (d)(4)(ii) of this section.

(iv) Significant public benefit—(A) Factors. All contributions made for the preservation of open space must yield a significant public benefit. Public benefit will be evaluated by considering all pertinent facts and circumstances germane to the contribution. Factors germane to the evaluation of public benefit from one contribution may be irrelevant in determining public benefit from another contribution. No single factor will necessarily be determinative. Among the factors to be considered are:

(1) The uniqueness of the property to the area;

(2) The intensity of land development in the vicinity of the property (both existing development and foreseeable trends of development);

(3) The consistency of the proposed open space use with public programs (whether Federal, state or local) for conservation in the region, including programs for outdoor recreation, irrigation or water supply protection, water quality maintenance or

enhancement, flood prevention and control, erosion control, shoreline protection, and protection of land areas included in, or related to, a government approved master plan or land management area;

(4) The consistency of the proposed open space use with existing private conservation programs in the area, as evidenced by other land, protected by easement or fee ownership by organizations referred to in § 1.170A-14(c)(1), in close proximity to the property;

(5) The likelihood that development of the property would lead to or contribute to degradation of the scenic, natural, or historic character of the area;

(6) The opportunity for the general public to use the property or to appreciate its scenic values;

(7) The importance of the property in preserving a local or regional landscape or resource that attracts tourism or commerce to the area;

(8) The likelihood that the donee will acquire equally desirable and valuable substitute property or property rights;

(9) The cost to the donee of enforcing the terms of the conservation restriction;

(10) The population density in the area of the property; and

(11) The consistency of the proposed open space use with a legislatively mandated program identifying particular parcels of land for future protection.

(B) Illustrations. The preservation of an ordinary tract of land would not in and of itself yield a significant public benefit, but the preservation of ordinary land areas in conjunction with other factors that demonstrate significant public benefit or the preservation of a unique land area for public employment would yield a significant public benefit.

For example, the preservation of a vacant downtown lot would not by itself yield a significant public benefit, but the preservation of the downtown lot as a public garden would, absent countervailing factors, yield a significant public benefit. The following are other examples of contributions which would, absent countervailing factors, yield a significant public benefit: The preservation of farmland pursuant to a state program for flood prevention and control; the preservation of a unique natural land formation for the enjoyment of the general public; the preservation of woodland along a public highway pursuant to a government program to preserve the appearance of the area so as to maintain the scenic view from the highway; and the preservation of a stretch of undeveloped property located between a public highway and the ocean in order to maintain the scenic ocean view from the highway.

(v) Limitation. A deduction will not be allowed for the preservation of open space under section 170(h)(4)(A)(iii), if the terms of the easement permit a degree of intrusion or future development that would interfere with the essential scenic quality of the land or with the governmental conservation policy that is being furthered by the donation. See § 1.170A-14(e)(2) for rules relating to inconsistent use.

(vi) Relationship of requirements—(A) Clearly delineated governmental policy and significant public benefit. Although the requirements of “clearly delineated governmental policy” and “significant public benefit” must be met independently, for purposes of this section the two requirements may also be related. The more specific the governmental policy with respect to the particular site to be protected, the more likely the governmental decision, by itself, will tend to establish the significant public benefit associated with the donation. For example, while a statute in State X permitting preferential assessment for farmland is, by definition, governmental policy, it is distinguishable from a s state statute, accompanied by appropriations, naming the X River as a valuable resource and articulating the legislative policy that the X River and the relatively natural quality of its surrounding be protected. On these facts, an open space easement on farmland in State X would have to demonstrate additional

factors to establish "significant public benefit." The specificity of the legislative mandate to protect the X River, however, would by itself tend to establish the significant public benefit associated with an open space easement on land fronting the X River.

(B) Scenic enjoyment and significant public benefit. With respect to the relationship between the requirements of "scenic enjoyment" and "significant public benefit," since the degrees of scenic enjoyment offered by a variety of open space easements are subjective and not as easily delineated as are ***1502** increasingly specific levels of governmental policy, the significant public benefit of preserving a scenic view must be independently established in all cases.

(C) Donations may satisfy more than one test. In some cases, open space easements may be both for scenic enjoyment and pursuant to a clearly delineated governmental policy. For example, the preservation of a particular scenic view identified as part of a scenic landscape inventory by a rigorous governmental review process will meet the tests of both paragraphs (d)(4)(i)(A) and (d)(4)(i)(B) of this section.

(5) Historic preservation—(i) In general. The donation of a qualified real property interest to preserve an historically important land area or a certified historic structure will meet the conservation purposes test of this section. When restrictions to preserve a building or land area within a registered historic district permit future development on the site, a deduction will be allowed under this section only if the terms of the restrictions require that such development conform with appropriate local, state, or Federal standards for construction or rehabilitation within the district. See also, § 1.170A-14(h)(3)(ii).

(ii) Historically important land area. The term "historically important land area" includes:

(A) An independently significant land area including any related historic resources (for example, an archaeological site or a Civil War battlefield with related monuments, bridges, cannons, or houses) that meets the National Register Criteria for Evaluation in 36 CFR 60.4 (Pub. L. 89-665, 80 Stat. 915);

(B) Any land area within a registered historic district including any buildings on the land area that can reasonably be considered as contributing to the significance of the district; and

(C) Any land area (including related historic resources) adjacent to a property listed individually in the National Register of Historic Places (but not within a registered historic district) in a case where the physical or environmental features of the land area contribute to the historic or cultural integrity of the property.

(iii) Certified historic structure. The term "certified historic structure," for purposes of this section, means any building, structure or land area which is—

(A) Listed in the National Register, or

(B) Located in a registered historic district (as defined in section 48(g)(3)(B)) and is certified by the Secretary of the Interior (pursuant to 36 CFR 67.4) to the Secretary of the Treasury as being of historic significance to the district.

A "structure" for purposes of this section means any structure, whether or not it is depreciable. Accordingly easements on private residences may qualify under this section. In addition, a structure would be considered to be a certified historic structure if it were certified either at the time the transfer was made or at the due date (including extensions) for filing the donor's return for the taxable year in which the contribution was made.
(iv) Access. (A) In order for a conservation contribution described in section 170(h)(4)(A)(iv) and this paragraph (d)(5) to be deductible, some visual public access to the donated property is required. In the case of an historically important land area, the entire property need not be visible to the public for a donation to qualify under this section. However, the public benefit from the donation may be insufficient to qualify for a deduction if only a small portion of the property is so visible. Where the historic land area or certified historic structure which is the subject of the donation is not visible from a public way (e.g., the

structure is hidden from view by a wall or shrubbery, the structure is too far from the public way, or interior characteristics and features of the structure are the subject of the easement), the terms of the easement must be such that the general public is given the opportunity on a regular basis to view the characteristics and features of the property which are preserved by the easement to the extent consistent with the nature and condition of the property.

(B) Factors to be considered in determining the type and amount of public access required under paragraph (d)(5)(iv)(A) of this section include the historical significance of the donated property, the nature of the features that are the subject of the easement, the remoteness or accessibility of the site of the donated property, the possibility of physical hazards to the public visiting the property (for example, an unoccupied structure in a dilapidated condition), the extent to which public access would be an unreasonable intrusion on any privacy interests of individuals living on the property, the degree to which public access would impair the preservation interests which are the subject of the donation, and the availability of opportunities for the public to view the property by means other than visits to the site.

(C) The amount of access afforded the public by the donation of an easement shall be determined with reference to the amount of access permitted by the terms of the easement which are established by the donor, rather than the amount of access actually provided by the donee organization. However, if the donor is aware of any facts indicating that the amount of access that the donee organization will provide is significantly less than the amount of access permitted under the terms of the easement, then the amount of access afforded the public shall be determined with reference to this lesser amount.

(v) Examples. The provisions of paragraph (d)(5)(iv) of this section may be illustrated by the following examples:

Example (1). A and his family live in a house in a certified historic district in the State of X. The entire house, including its interior, has architectural features representing classic Victorian period architecture. A donates an exterior and interior easement on the property to a qualified organization but continues to live in the house with his family. A's house is surrounded by a high stone wall which obscures the public's view of it from the street. Pursuant to the terms of the easement, the house may be opened to the public from 10:00 a.m. to 4:00 p.m. on one Sunday in May and one Sunday in November each year for house and garden tours. These tours are to be under the supervision of the donee and open to members of the general public upon payment of a small fee. In addition, under the terms of the easement, the donee organization is given the right to photograph the interior and exterior of the house and distribute such photographs to magazines, newsletters, or other publicly available publications. The terms of the easement also permit persons affiliated with educational organizations, professional architectural associations, and historical societies to make an appointment through the donee organization to study the property. The donor is not aware of any facts indicating that the public access to be provided by the donee organization will be significantly less than that permitted by the terms of the easement. The 2 opportunities for public visits per year, when combined with the ability of the general public to view the architectural characteristics and features that are the subject of the easement through photographs, the opportunity for scholarly study of the property, and the fact that the house is used as an occupied residence, will enable the donation to satisfy the requirement of public access.

Example (2). B owns an unoccupied farmhouse built in the 1840's and located on a property that is adjacent to a Civil War battlefield. During the Civil War the farmhouse was used as quarters for Union troops. The battlefield is visited year round by the general public. The condition of the farmhouse is such that the safety of visitors will not be jeopardized and opening it to the public will not result in significant deterioration. The farmhouse is not visible from the battlefield or any public way. It is accessible only by way of a private road ***1503** owned by B. B donates a conservation easement on the farmhouse to a qualified organization. The terms of the easement provide that the donee organization may open the property (via B's road) to the general public on four weekends each year from 8:30 a.m. to 4:00 p.m. The donation does not meet the public access requirement because the farmhouse is safe, unoccupied, and easily accessible to the general public who have come to the site to visit Civil War historic land areas (and related resources), but will only be open to the public on four weekends each year. However, the donation would meet the public access requirement if the terms of the easement permitted the donee organization to open the property to the public every other weekend during the year and the donor is not aware of any facts indicating that the donee organization will provide significantly less access than that permitted.

(e) Exclusively for conservation purposes. (1) In general. To meet the requirements of this section, a donation must be exclusively for conservation purposes. See paragraphs (c)(1) and (g)(1) through (g)(6)(ii) of this section. A deduction will not be denied under this section when incidental benefit inures to the donor merely as a result of conservation restrictions limiting the uses to which the donor's property may be put.

(2) Inconsistent use. Except as provided in paragraph (e)(4) of this section, a deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests. For example, the preservation of farmland pursuant to a State program for flood prevention and control would not qualify under paragraph (d)(4) of this section if under the terms of the contribution a significant naturally occurring ecosystem could be injured or destroyed by the use of pesticides in the operation of the farm. However, this requirement is not intended to prohibit uses of the property, such as selective timber harvesting or selective farming if, under the circumstances, those uses do not impair significant conservation interests.

(3) Inconsistent use permitted. A use that is destructive of conservation interests will be permitted only if such use is necessary for the protection of the conservation interests that are the subject of the contribution. For example, a deduction for the donation of an easement to preserve an archaeological site that is listed on the National Register of Historic Places will not be disallowed if site excavation consistent with sound archaeological practices may impair a scenic view of which the land is a part. A donor may continue a pre-existing use of the property that does not conflict with the conservation purposes of the gift.

(f) Examples. The provisions of this section relating to conservation purposes may be illustrated by the following examples.

Example (1). State S contains many large tract forests that are desirable recreation and scenic areas for the general public. The forests' scenic values attract millions of people to the State. However, due to the increasing intensity of land development in State S, the continued existence of forestland parcels greater than 45 acres is threatened. J grants a perpetual easement on a 100-acre parcel of forestland that is part of one of the State's scenic areas to a qualifying organization. The easement imposes restrictions on the use of the parcel for the purpose of maintaining its scenic values. The restrictions include a requirement that the parcel be maintained forever as open space devoted exclusively to conservation purposes and wildlife protection, and that there be no commercial, industrial, residential, or other development use of such parcel. The law of State S recognizes a limited public right to enter private land, particularly for recreational pursuits, unless such land is posted or the landowner objects. The easement specifically restricts the landowner from posting the parcel, or from objecting, thereby maintaining public access to the parcel according to the custom of the State. J's parcel provides the opportunity for the public to enjoy the use of the property and appreciate its scenic values. Accordingly, J's donation qualifies for a deduction under this section.

Example (2). A qualified conservation organization owns Greenacre in fee as a nature preserve. Greenacre contains a high quality example of a tall grass prairie ecosystem. Farmacre, an operating farm, adjoins Greenacre and is a compatible buffer to the nature preserve. Conversion of Farmacre to a more intense use, such as a housing development, would adversely affect the continued use of Greenacre as a nature preserve because of human traffic generated by the development. The owner of Farmacre donates an easement preventing any future development on Farmacre to the qualified conservation organization for conservation purposes. Normal agricultural uses will be allowed on Farmacre. Accordingly, the donation qualifies for a deduction under this section.

Example (3). H owns Greenacre, a 900-acre parcel of woodland, rolling pasture, and orchards on the crest of a mountain. All of Greenacre is clearly visible from a nearby national park. Because of the strict enforcement of an applicable zoning plan, the highest and best use of Greenacre is as a subdivision of 40-acre tracts. H wishes to donate a scenic easement on Greenacre to a qualifying conservation organization, but H would like to reserve the right to subdivide Greenacre into 90-acre parcels with no more than one single-family home allowable on each parcel. Random building on the property, even as little as one home for each 90 acres, would destroy the scenic character of the view. Accordingly, no deduction would be allowable under this section.

Example (4). Assume the same facts as in example (3), except that not all of Greenacre is visible from the park and the deed of easement allows for limited cluster development of no more than five nine-acre clusters (with four houses on each cluster) located in areas generally not visible from the national park and subject to site and building plan approval by the donee organization in order to preserve the scenic view from the park. The donor and the donee have already identified sites where limited cluster development would not be visible from the park or would not impair the view. Owners of homes in the clusters will not have any rights with respect to the surrounding Greenacre property that are not also available to the general public. Accordingly, the donation qualifies for a deduction under this section.

Example (5). In order to protect State S's declining open space that is suited for agricultural use from increasing development pressure that has led to a marked decline in such open space, the Legislature of State S passed a statute authorizing the purchase of "agricultural land development rights" on open acreage. Agricultural land development rights allow the State to place agricultural preservation restrictions on land designated as worthy of protection in order to preserve open space and farm resources. Agricultural preservation restrictions prohibit or limit construction or placement of buildings except those used for agricultural purposes or dwellings used for family living by the farmer and his family and employees; removal of mineral substances in any manner that adversely affects the land's agricultural potential; or other uses detrimental to retention of the land for agricultural use. Money has been appropriated for this program and some landowners have in fact sold their "agricultural land development rights" to State S. K owns and operates a small dairy farm in State S located in an area designated by the Legislature as worthy protection. K desires to preserve his farm for agricultural purposes in perpetuity. Rather than selling the development rights to State S, K grants to a qualified organization an agricultural preservation restriction on his property in the form of a conservation easement. K reserves to himself, his heirs and assigns the right to manage the farm consistent with sound agricultural and management practices. The preservation of K's land is pursuant to a clearly delineated governmental policy of preserving open space available for agricultural use, and will yield a significant public benefit by preserving open space against increasing development pressures.

(g) Enforceable in perpetuity.—(1) In general. In the case of any donation under this section, any interest in the property retained by the donor (and the donor's successors in interest) must be subject to legally enforceable restrictions (for example, by recordation in the land records of the jurisdiction in which the property is located) that will prevent uses of the retained interest ***1504** inconsistent with the conservation purposes of the donation. In the case of a contribution of a remainder interest, the contribution will not qualify if the tenants, whether they are tenants for life or a term of years, can use the property in a manner that diminishes the conservation values which are intended to be protected by the contribution.

(2) Protection of a conservation purpose in case of donation of property subject to a mortgage. In the case of conservation contributions made after February 13, 1986, no deducion 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. For conservation contributions made prior to February 12, 1986, the requirement of section 170 (h)(5)(A) is satisfied in the case of mortgaged property (with respect to which the mortgagee has not subordinated its rights) only if the donor can demonstrate that the conservation purpose is protected in perpetuity without subordination of the mortgagee's rights.

(3) Remote future event. A deduction shall not be disallowed under section 170(f)(3)(B)(iii) and this section 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 paragraph (e) of § 1.170A-1. For example, a state's statutory requirement that use restrictions must be rerecorded every 30 years to remain enforceable shall not, by itself, render an easement nonperpetual.

(4) Retention of qualified mineral interest—(i) In general. Except as otherwise provided in paragraph (g)(4)(ii) of this section, the requirements of this section are not met and no deduction shall be allowed in the case of a contribution of any interest when there is a retention by any person of a qualified mineral interest (as defined in paragraph (b)(1)(i) of this section) if at any time there may be extractions or removal of minerals by any surface mining method. Moreover, in the case of a qualified mineral

interest gift, the requirement that the conservation purposes be protected in perpetuity is not satisfied if any method of mining that is inconsistent with the particular conservation purposes of a contribution is permitted at any time. See also § 1.170A-14(e)(2). However, a deduction under this section will not be denied in the case of certain methods of mining that may have limited, localized impact on the real property but that are not irremediably destructive of significant conservation interests. For example, a deduction will not be denied in a case where production facilities are concealed or compatible with existing topography and landscape and when surface alteration is to be restored to its original state.

(ii) Exception for qualified conservation contributions after July 1984. (A) A contribution made after July 18, 1984, of a qualified real property interest described in section 170(h)(2)(A) shall not be disqualified under the first sentence of paragraph (g)(4)(i) of this section if the following requirements are satisfied.

(1) The ownership of the surface estate and mineral interest were separated before June 13, 1976, and remain so separated up to and including the time of the contribution.

(2) The present owner of the mineral interest is not a person whose relationship to the owner of the surface estate is described at the time of the contribution in section 267(b) of section 707(b), and

(3) The probability of extraction or removal of minerals by any surface mining method is so remote as to be negligible.

Whether the probability of extraction or removal of minerals by surface mining is so remote as to be negligible is a question of fact and is to be made on a case by case basis. Relevant factors to be considered in determining if the probability of extraction or removal of minerals by surface mining is so remote as to be negligible include: Geological, geophysical or economic data showing the absence of mineral reserves on the property, or the lack of commercial feasibility at the time of the contribution of surface mining the mineral interest.

(B) If the ownership of the surface estate and mineral interest first became separated after June 12, 1976, no deduction is permitted for a contribution under this section unless surface mining on the property is completely prohibited.

(iii) Examples. The provisions of paragraph (g)(4)(i) and (ii) of this section may be illustrated by the following examples:

Example. (1) K owns 5,000 acres of bottomland hardwood property along a major watershed system in the southern part of the United States. Agencies within the Department of the Interior have determined that southern bottomland hardwoods are a rapidly diminishing resource and a critical ecosystem in the south because of the intense pressure to cut the trees and convert the land to agricultural use. These agencies have further determined (and have indicated in correspondence with K) that bottomland hardwoods provide a superb habitat for numerous species and play an important role in controlling floods and purifying rivers. K donates to a qualified organization his entire interest in this property other than his interest in the gas and oil deposits that have been identified under K's property. K covenants and can ensure that, although drilling for gas and oil on the property may have some temporary localized impact on the real property, the drilling will not interfere with the overall conservation purpose of the gift, which is to protect the unique bottomland hardwood ecosystem. Accordingly, the donation qualifies for a deduction under this section.

Example (2). Assume the same facts as in example (1), except that in 1979, K sells the mineral interest to A, an unrelated person, in an arm's-length transaction, subject to a recorded prohibition on the removal of any minerals by any surface mining method and a recorded prohibition against any mining technique that will harm the bottomland hardwood ecosystem. After the sale to A, K donates a qualified real property interest to a qualified organization to protect the bottomland hardwood ecosystem. Since at the time of the transfer, surface mining and any mining technique that will harm the bottomland hardwood ecosystem are completely prohibited, the donation qualifies for a deduction under this section.

(5) Protection of conservation purpose where taxpayer reserves certain rights. (i) Documentation. In the case of a donation made after February 13, 1986, of any qualified real property interest when the donor reserves rights the exercise of which may impair the conservation interests associated with the property, for a deduction to be allowable under this section the donor must make available to the donee, prior to the time the donation is made, documentation sufficient to establish the condition of the property at the time of the gift.

Such documentation is designed to protect the conservation interests associated with the property, which although protected in perpetuity by the easement, could be adversely affected by the exercise of the reserved rights. Such documentation may include:

(A) The appropriate survey maps from the United States Geological Survey, showing the property line and other contiguous or nearby protected areas;

(B) A map of the area drawn to scale showing all existing man-made improvements or incursions (such as roads, buildings, fences, or gravel pits), vegetation and identification of flora and fauna (including, for example, rare species locations, animal breeding and roosting areas, and migration routes), land use history (including present uses ***1505** and recent past disturbances), and distinct natural features (such as large trees and aquatic areas);

(C) An aerial photograph of the property at an appropriate scale taken as close as possible to the date the donation is made; and

(D) On-site photographs taken at appropriate locations on the property. If the terms of the donation contain restrictions with regard to a particular natural resource to be protected, such as water quality or air quality, the condition of the resource at or near the time of the gift must be established. The documentation, including the maps and photographs, must be accompanied by a statement signed by the donor and a representative of the donee clearly referencing the documentation and in substance saying “This natural resources inventory is an accurate representation of [the protected property] at the time of the transfer.”.

(ii) Donee's right to inspection and legal remedies. In the case of any donation referred to in paragraph (g)(5)(i) of this section, the donor must agree to notify the donee, in writing, before exercising any reserved right, e.g. the right to extract certain minerals which may have an adverse impact on the conservation interests associated with the qualified real property interest. The terms of the donation must provide a right of the donee to enter the property at reasonable times for the purpose of inspection the property to determine if there is compliance with the terms of the donation. Additionally, the terms of the donation must provide a right of the donee to enforce the conservation restrictions by appropriate legal proceedings, including but not limited to, the right to require the restoration of the property to its condition at the time of the donation.

(6) Extinguishment. (i) In general. If a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation under this paragraph can make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee's proceeds (determined under paragraph (g)(6)(ii) of this section) from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original contribution.

(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 give 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.

(h) Valuation—(1) Entire interest of donor other than qualified mineral interest. The value of the contribution under section 170 in the case of a contribution of a taxpayer's entire interest in property other than a qualified mineral interest is the fair market value of the surface rights in the property contributed. The value of the contribution shall be computed without regard to the mineral rights. See paragraph (h)(4), example (1), of this section.

(2) Remainder interest in real property. In the case of a contribution of any remainder interest in real property, section 170(f)(4) provides that in determining the value of such interest for purposes of section 170, depreciation and depletion of such property shall be taken into account. See § 1.170A-12. In the case of the contribution of a remainder interest for conservation purposes, the current fair market value of the property (against which the limitations of § 1.17A-12 are applied) must take into account any pre-existing or contemporaneously recorded rights limiting, for conservation purposes, the use to which the subject property may be put.

(3) Perpetual conservation restriction—(i) In general. The value of the contribution under section 170 in the case of a charitable contribution of a perpetual conservation restriction is the fair market value of the perpetual conservation restriction at the time of the contribution. See § 1.170A-7(c). If there is a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a governmental program), the fair market value of the donated easement is based on the sales prices of such comparable easements. If no substantial record of market-place sales is available to use as a meaningful or valid comparison, as a general rule (but not necessarily in all cases) the fair market value of a perpetual conservation restriction is equal to the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property after the granting of the restriction. The amount of the deduction in the case of a charitable contribution of a perpetual conservation restriction covering a portion of the contiguous property owned by a donor and the donor's family (as defined in section 267(c)(4)) is the difference between the fair market value of the entire contiguous parcel of property before and after the granting of the restriction. If the granting of a perpetual conservation restriction after January 14, 1986, has the effect of increasing the value of any other property owned by the donor or a related person, the amount of the deduction for the conservation contribution shall be reduced by the amount of the increase in the value of the other property, whether or not such property is contiguous. If, as a result of the donation of a perpetual conservation restriction, the donor or a related person receives, or can reasonably expect to receive, financial or economic benefits that are greater than those that will inure to the general public from the transfer, no deduction is allowable under this section. However, if the donor or a related person receives, or can reasonably expect to receive, a financial or economic benefit that is substantial, but it is clearly shown that the benefit is less than the amount of the transfer, then a deduction under this section is allowable for the excess of the amount transferred over the amount of the financial or economic benefit received or reasonably expected to be received by the donor or the related person. For purposes of this paragraph (h)(3)((i), related person shall have the same meaning as in either section 267(b) or section 707(b). (See example (10) of paragraph (h)(4) of this section.)

(ii) Fair market value of property before and after restriction. If before and after valuation is used, the fair market value of the property before contribution of the conservation restriction must take into account not only the current use of the property but ***1506** also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property's potential highest and best use. Further, there may be instances where the grant of a conservation restriction may have no material effect on the value of the property or may in fact serve to enhance, rather than reduce, the value of property. In such instances no deduction would be allowable. In the case of a conservation restriction that allows for any development, however limited, on the property to be protected, the fair maket value of the property after contribution of the restriction must take into account the effect of the development. In the case of a conservation easement such as an easement on a certified historic structure, the fair market value of the property after contribution of the restriction must take into account the amount of access permitted by the terms of the easement. Additionally, if before and after valuation is used, an appraisal of the property after contribution of the restriction must take into account the effect of restrictions that will result in a reduction of the potential fair

market value represented by highest and best use but will, nevertheless, permit uses of the property that will increase its fair market value above that represented by the property's current use. The value of a perpetual conservation restriction shall not be reduced by reason of the existence of restrictions on transfer designed solely to ensure that the conservation restriction will be dedicated to conservation purposes. See § 1.170A-14 (c)(3).

(iii) Allocation of basis. In the case of the donation of a qualified real property interest for conservation purposes, the basis of the property retained by the donor must be adjusted by the elimination of that part of the total basis of the property that is properly allocable to the qualified real property interest granted. The amount of the basis that is allocable to the qualified real property interest shall bear the same ratio to the total basis of the property as the fair market value of the qualified real property interest bears to the fair market value of the property before the granting of the qualified real property interest. When a taxpayer donates to a qualifying conservation organization an easement on a structure with respect to which deductions are taken for depreciation, the reduction required by this paragraph (h)(3)(ii) in the basis of the property retained by the taxpayer must be allocated between the structure and the underlying land.

(4) Examples. The provisions of this section may be illustrated by the following examples. In examples illustrating the value or deductibility of donations, the applicable restrictions and limitations of § 1.170A-4, with respect to reduction in amount of charitable contributions of certain appreciated property, and § 1.170A-8, with respect to limitations on charitable deductions by individuals. must also be taken into account.

Example (1). A owns Goldacre, a property adjacent to a state park. A wants to donate Goldacre to the state to be used as part of the park, but A wants to reserve a qualified mineral interest in the property, to exploit currently and to devise at death. The fair market value of the surface rights in Goldacre is $200,000 and the fair market value of the mineral rights in $100.000. In order to ensure that the quality of the park will not be degraded, restrictions must be imposed on the right to extract the minerals that reduce the fair market value of the mineral rights to $80,000. Under this section, the value of the contribution is $200,000 (the value of the surface rights).

Example (2). In 1984 B, who is 62, donates a remainder interest in Greenacre to a qualifying organization for conservation purposes. Greenacre is a tract of 200 acres of undeveloped woodland that is valued at $200,000 at its highest and best use. Under § 1.170A-12(b), the value of a remainder interest in real property following one life is determined under § 25.2512-5 of the Gift Tax Regulations. (See § 25.2512-9 with respect to the valuation of annuities, life estates, terms for years, remainders, and reversions transferred after December 31, 1970 and before December 1, 1983. With respect to the valuation of annuities, life estates, terms for years, remainders, and reversions transferred before January 1, 1971, see T.D. 6334, 23 FR 8904, November 15, 1958, as amended by T.D. 7077, 35 FR 18464, December 4, 1970). Accordingly, the value of the remainder interest, and thus the amount eligible for an income tax deduction under sections 170(f), is $55,996 ($200,000 x.27998).

Example (3). Assume the same facts as in example (2), except that Greenacre is B's 200-acre estate with a home built during the colonial period. Some of the acreage around the home is cleared; the balance of Greenacre, except for access roads, is wooded and undeveloped. See section 170(f)(3)(B)(i). However, B would like Greenacre to be maintained in its current state after his death, so he donates a remainder interest in Greenacre to a qualifying organization for conservation purposes pursunt to section 170 (f)(3)(B)(iii) and (h)(2)(B). At the time of the gift the land has a value of $200,000 and the house has a value of $100,000. The value of the remainder interest, and thus the amount eligible for an income tax deduction under section 170(f), is computed pursuant to § 1.170A-12. See § 1.170A-12(b)(3).

Example (4). Assume the same facts as in example (2), except that at age 62 instead of donating a remainder interest B donates an easement in Greenacre to a qualifying organization for conservation purposes. The fair market value of Greenacre after the donation is reduced to $110,000. Accordingly, the value of the easement, and thus the amount eligible for a deduction under section 170(f), is $90,000 ($200,000 less $110,000).

Example (5). Assume the same facts as in example (4), and assume that three years later, at age 65, B decides to donate a remainder interest in Greenacre to a qualifying organization for conservation purposes. Increasing real estate values in the area have raised the fair market value of Greenacre (subject to the easement) to $130,000. Accordingly, the value of the remainder interest, and thus the amount eligible for a deduction under section 170(f), is $41,639 ($130,000x.32030).

Example (6). Assume the same facts as in example (2), except that at the time of the donation of a remainder interest in Greenacre, B also donates an easement to a different qualifying organization for conservation purposes. Based on all the facts and circumstances, the value of the easement is determined to be $100,000. Therefore, the value of the property after the easement is $100,000 and the value of the remainder interest, and thus the amount eligible for deduction under section 170(f), is $27,998 ($100,000 x.27998).

Example (7). C owns Greenacre, a 200-acre estate containing a house built during the colonial period. At its highest and best use, for home development, the fair market value of Greenacre is $300,000. C donates an easement (to maintain the house and Green acre in their current state) to a qualifying organization for conservation purposes. The fair market value of Greenacre after the donation is reduced to $125,000. Accordingly, the value of the easement and the amount eligible for a deduction under section 170(f) is $175.000 ($300,000 less $125,000).

Example (8). Assume the same facts as in example (7) and assume that three years later, C decides to donate a remainder interest in Greenacre to a qualifying organization for conservation purposes. Increasing real estate values in the area have raised the fair market value of Greenacre to $180.000. Assume that because of the perpetual easement prohibiting any development of the land, the value of the house is $120,000 and the value of the land is $60,000. The value of the remainder interest, and thus the amount eligible for an income tax deduction under section 170(f), is computed pursuant to § 1.170A-12. See § 1.170A-12(b)(3).

Example (9). D owns property with a basis of $20,000 and a fair market value of $80,000. D donates to a qualifying organization an easement for conservation purposes that is determined under this section to have a fair market value of $60,000. The amount of basis allocable to the easement is $15,000 ($60,000/$80,000=$15,000/$20,000). Accordingly, the basis of the property is reduced to $5,000 ($20,000 minus $15,000).

***1507** Example (10). E owns 10 one-acre lots that are currently woods and parkland. The fair market value of each of E's lots is $15,000 and the basis of each lot is $3,000. E grants to the county a perpetual easement for conservation purposes to use and maintain eight of the acres as a public park and to restrict any future development on those eight acres. As a result of the restrictions, the value of the eight acres is reduced to $1,000 an acre. However, by perpetually restricting development on this portion of the land, E has ensured that the two remaining acres will always be bordered by parkland, thus increasing their fair market value to $22,500 each. If the eight acres represented all of E's land, the fair market value of the easement would be $112,000, an amount equal to the fair market value of the land before the granting of the easement

(8x$15,000=$120,000) minus the fair market value of the encumbered land after the granting of the easement (8x$1,000= $8,000). However, because the easement only covered a portion of the deduction under section 170 is reduced to $97,000 ($150,000-$53,000), that is, the difference between the fair market value of the entire tract of land before ($150,000) and after ((8x$1,000)+(2x $22,500)) the granting of the easement.
Example (11). Assume the same facts as in example (10). Since the easement covers a portion of E's land, only the basis of that portion is adjusted. Therefore, the amount of basis allocable to the easement is $22,400 ((8x$3,000) x($112,000/$120,000)). Accordingly, the basis of the eight acres encumbered by the easement is reduced to $1,600 ($24,000-$22,400), or $200 for each acre. The basis of the two remaining acres is not affected by the donation.

Example (12). F owns and uses as professional offices a two-building that lies within a registered historic district F's building is an outstanding example of period architecture with a fair market value of $125,000. Restricted to its current use, which is the highest and best use of the property without making changes to the facade, the building and lot would have a fair market value of $100,000, of which $80,000 would be allocable to the building and $20,000 woud be allocable to the lot. F's basis

in the property is $50,000, of which $40,000 is allocable to the building and $10,000 is allocable to the lot. F's neighborhood is a mix or residential and commercial uses, and it is possible that F (or another owner) could enlarge the building for more extensive commercial use, which is its highest and best use. However, this would require changes to the facade. F would like to donate to a qualifying preservation organization and easement restricting any changes to the facade and promissing to maintain the facade in perpetuity. the donation would qualify for a deduction under this section. The fair market value of the easement is $25,000 (the fair market value of the property before the easement, $125,000, minus the fair market value of the property after the easement, $100,000). Pursuant to § 1.170A-14(h)(3)(iii), the basis allocable to the easement is $10,000 and the basis of the underlying property (building and lot) is reduced to $40,000.

(i) Substantiation requirement. If a taxpayer makes a qualified conservation contribution and claims a deduction, the taxpayer must maintain written records of the fair market value of the underlying property before and after the donation and the conservation purpose furthered by the donation and such information shall be stated in the taxpayer's income tax return if required by the return or its instructions. See also § 1.170A-13T(c) (relating to substantiation requirements for deductions in excess of $5,000 for charitable contributions made after 1984), and section 6659 (relating to additions to tax in the case of valuation overstatements).

(j) Effective date. Except as otherwise provided in § 1.170A-14(g)(4)(ii), this section applies only to contributions made on or after December 18, 1980.

PART 20—[AMENDED]

Par. 5. The authority for Part 20 continues to read in part:

Authority: 26 U.S.C. 7805. * * *

26 CFR § 20.2055-2

Par. 6. Paragraph (e)(2) of § 20.2055-2 is amended as follows:

a. The sixth sentence of paragraph (e)(2)(i) is revised to read: “However, except as provided in paragraphs (e)(2) (ii), (iii), and (iv) of this section, for purposes of this subdivision a charitable contribution of an interest in property not in trust where the decedent transfers some specific rights to one party and transfers other substantial rights to another party will not be considered a contribution of an undivided portion of the decedent's entire interest in property.”.

b. The eight sentence of paragraph (e)(2)(i) is revised to read; “A bequest to chartiy made on or before December 17, 1980, of an open space easement in gross in perpetuity shall be considered the transfer to charity of an undivided portion of the decedent's entire interest in the property.”.

c. Paragraphs (e)(2)(iv), (e)(2)(v), and (e)(2)(vi) and redesignated (e)(2)(v), (e)(2)(vi), and (e)(2)(vii), respectively.

d. A new paragraph (e)(2)(iv) is inserted after paragraph (e)(2)(iii) to read as set forth below.

26 CFR § 20.2055-2

§ 20.2055-2 Transfers not exclusively for charitable purposes.

* * * * *

(e) Limitations applicable to decedents dying after December 31, 1969. * * *

(2) Deductible interests. * * *

(iv)Qualified conservation contribution. The charitable interest is a qualified conservation contribution. For the definition of a qualified conservation contribution, see § 1.170A-14

PART 25—[AMENDED]

Par. 7. The authority for Part 25 continues to read in part:

Authority: 26 U.S.C. 7805. * * *

26 CFR § 25.2522

Par. 8. Paragraph (c)(2) of § 25.2522(c)—3 is amended as follows:

a. The sixth sentence of paragraph (c)(2)(i) is revised to read; "However, except as provided in paragraphs (e)(2)(ii), (iii), and (iv) of this section, for purposes of this subdivision of charitable contribution of an interest in property not in trust where the decedent transfers some specific rights to one party and transfers other substantial rights to another party will not be considered a contribution of a undivided portion of the decedent's entire interest in property.".

b. The eight sentence of paragraph (c)(2)(i) is revised to read; "A bequest to charity made on or before December 17, 1980, of open space easement in gross in perpetuity shall be considered the transfer to charity of an undivided portion of the decedent's entire interest in property.".

c. Paragraphs (c)(2)(iv), (c)(2)(v), and (c)(2)(vi) are redesignated (c)(2)(v), (c)(2)(vi), and (c)(2)(viii), respectively.

d. A new paragraph (c)(2)(iv) is inserted after paragraph (c)(2)(iii), to read as set forth below.

26 CFR § 25.2522(c)-3

§ 25.2522(c)-3 Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

* * * * *

(c) Transfers of partial interest in property.

(2) Deductible interest. * * *

(iv) Qualified Conservation Contribution. The charitable interest is a qualified conservation contribution. For the definition of a qualified conservation contribution, see § 1.170A-14.

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PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 9. The authority for Part 602 continues to read in part:

Authority: 26 U.S.C. 7805. * * *

26 CFR § 602.101

Par. 10. Section 602.101(c) is amended by inserting in the appropriate place in the table "§ 1.170A-14 . . . 1545-0763".

Roscoe L. Egger, Jr.,

Commissioner of Internal Revenue.

Approved: December 20, 1985.

Ronald A Pearlman,

Assistant Secretary of the Treasury.

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