



CONSERVATION EASEMENTS: TWO RECENT CASES

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MITCHELL v. COMM., 775 F.3d (10th Cir. 2015)

- ▶ Mitchell purchased 105 acres of ranchland in Colorado in 1998 and 351 acres encumbered by a deed of trust (seller financing) in 2001. Mitchell contributed the property to a family limited partnership in 2002.
- ▶ 2003: Partnership grants conservation easement to Montezuma Land Conservancy. No subordination of the debt to the conservation easement.
- ▶ 2003: Taxpayers take deduction for gift of conservation easement.
- ▶ 2005: Debt is subordinated to the conservation easement.

IRS ISSUE

- ▶ Violation of **perpetuity** requirement because the conservation easement was subject to the unsubordinated mortgage at the time of the donation.

APPLICABLE TREASURY REGULATION SECTION

- ▶ No deduction will be permitted under this section for an interest in property which is subject to a mortgage unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity.
 - Treas. Reg. section 1.170A-14(g)(2)

TAXPAYER'S ARGUMENTS: PERPETUITY MET

- ▶ There is no explicit time frame for compliance so it may occur at any time.
- ▶ The deed contained sufficient safeguards to protect the conservation purpose in perpetuity.
- ▶ Treas. Reg. section 1.170A-14(g)(3) allows for the taxpayer to obtain the deduction if the future event is “if on the date of the gift it appears that the possibility that such ... event will occur is so remote as to be negligible.”

COURT'S RESPONSE

- ▶ The Court noted the regulations clearly stated: “The provision states ‘no deduction *will be* permitted under this section for an interest in property which is subject to a mortgage *unless* the mortgagee subordinates its rights in the property.’ 26 C.F.R. § 1.170A-14(g)(2) (emphasis added).” The court concluded that the Mitchell’s donation did not strictly comply with the regulations.
- ▶ The court concluded that “the Commissioner is entitled to demand strict compliance with the mortgage subordination provision, irrespective of the likelihood of foreclosure in any particular case.”

BELK, JR. v. COMM.,
774 F.3d 221(4TH Cir. 2014)

- ▶ Olde Sycamore executed a conservation easement (“the Easement”) covering roughly 184 acres of the land on which the golf course now sits.
- ▶ Olde Sycamore reserved the right to “substitute an area of land owned by [it] which is contiguous to the Conservation Area for an equal or lesser area of land comprising a portion of the Conservation Area.”

TAX COURT DECISION: FAILS PERPETUITY

- ▶ The Tax Court concluded that the Belks were not entitled to claim a deduction for the donation of the easement because Olde Sycamore had not donated “a qualified real property interest.”
- ▶ The Tax Court reasoned that “because the conservation easement agreement permits [the Belks] to change what property is subject to the conservation easement, the use restriction was not granted in perpetuity.”

QUALIFIED REAL PROPERTY INTEREST

- ▶ The term “qualified real property interest” means a restriction (**granted in perpetuity**) on the use which may be made of the real property. IRC 170(h)(2)(C).

BELK'S ARGUMENTS

- ▶ Belk maintains that the Code requires only a restriction in perpetuity on some real property, rather than the real property governed by the original easement.
- ▶ Belk argued the Savings Clause would override the easement right to substitute property.

COURT'S RESPONSE TO RIGHT TO SUBSTITUTE DOES NOT AFFECT PERPETUITY

- ▶ The plain language of the Code provides that a “qualified property interest” includes “a restriction (granted in perpetuity) on the use which may be made of **the** real property.”
- ▶ The placement of the article “**the**” before “real property” makes clear that a perpetual use restriction must attach to a defined parcel of real property rather than simply some or any (or interchangeable parcels of) real property.

COURT CONCLUDES

- ▶ The Easement at issue here fails to meet this requirement because the real property contributed to the Trust is not subject to a use restriction in perpetuity.
- ▶ “Thus, while the restriction may be perpetual, the restriction on ‘the real property’ is not. For this reason, the Easement does not constitute a ‘qualified’ conservation contribution.”

ANCILLARY POINTS MADE BY THE COURT

- ▶ Permitting the Belks to change the boundaries of the Easement renders the appraisal meaningless; it is no longer an accurate reflection of the value of the donation, for parts of the donation may be clawed back.
- ▶ The requirement in the Treasury Regulations that a donor of a conservation easement make available to the donee “documentation sufficient to establish the condition of the property” would also be skirted if the borders of an easement could shift. Treas. Reg. § 1.170A-14(g)(5)(i).

SAVINGS CLAUSE INEFFECTIVE

- ▶ Belk argued the Savings Clause would override the substitution provision in the easement.
- ▶ Belk argued that the Savings Clause meant to ensure the overriding intention of the parties that the easement qualify as a charitable deduction.
- ▶ Court: The taxpayer was engaging in the “sort of trifling with the judicial process [that] cannot be sustained.”

STATE LAW IRRELEVANT

- ▶ Belk argued that North Carolina law permits conservation easements to be amended.
- ▶ Belk argued that the Tax Court's logic would render all conservation easements in North Carolina ineligible under § 170(h).
- ▶ Court states: Irrelevant. “But whether state property and contract law permits a substitution in an easement is irrelevant to the question of whether federal tax law permits a charitable deduction for the donation of such an easement.”

EFFECT ON EXISTING EASEMENTS IN CALIFORNIA

- ▶ CALIFORNIA REQUIRES CONSERVATION EASEMENTS TO BE IN PERPETUITY.
 - Civil Code Section 815.2: **“A conservation easement shall be perpetual in duration.”**
 - What is the enforceability of a California conservation easement that permits substitution of property in light of Belk?
 - Can the same be the case for accepting a conservation easement subordinate to debt as in Mitchell?

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