Green, or Greed? A Fresh Perspective on the Valuation of Conservation Easements

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GREEN, OR GREED? A FRESH PERSPECTIVE ON THE VALUATION OF CONSERVATION EASEMENTS

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Abstract:
Charitable contributions of "conservation easements" have since 1980 allowed high-income taxpayers to shelter income from taxation through overvalued deductions. Overvaluation has increased dramatically in the past 20 years: a 2016 study of all easement decisions since 1980 reported that while overvaluation had averaged by a factor of two before 1994, it averaged by a factor of ten for decisions between 1994 and 2016. SOI data disclose that aggregate easement contributions deducted on Schedule A grew from $2.26 billion in 2015 to $6.5 billion in 2018 (the most recent year available). A recent report by supporters of conservation easements acknowledges that "neither the [IRS] nor the courts have sufficient resources to effectively police valuation abuse."

Most of the concern has been with "syndicated conservation easements" ("SCEs"), and most proposed remedies to easement overvaluation focus on SCEs. We show, however, that exactly the same traits that produce overvalued SCEs -- allowing charitable deductions based on "fair market" value, which sanctions deducting unrealized appreciation without taxing the corresponding gain, combined with the unavoidable need to value contributed easements through as manipulable a process as appraisal -- have facilitated abusive overvaluation of non-syndicated easements too. That combination can leave an easement contributor better off than if she had done anything else with the land, including selling it for its (true) fair market value. The only effective solution to easement overvaluation is to restrict the deductibility of easement contributions attributable to unrealized gain. To that end we propose limiting charitable contributions of easements granted with respect to recently acquired property initially to cost, much as Congress has previously done with other contributions of appreciated property that are vulnerable to abuse, while allowing that limitation to evolve with real estate values over time. We also propose an upfront excise on unrealized appreciation in contributed easements, to increase the salience to prospective contributors of the risks of overvaluation.

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I. INTRODUCTION

"No good deed goes unpunished" would be a fitting description of the criticisms levelled at the Internal Revenue Service for its pursuit through litigation of deductions claimed, pursuant to I.R.C. §§ 170(f)(3) and 170(h), for charitable contributions of conservation easements. It is a pursuit in which the Service has prevailed more often than not. It has successfully challenged such deductions on a variety of grounds, some of which might reasonably be characterized as technical, the latter provoking much of the criticism. But the deductions the Service has challenged have also routinely been overvalued, overvaluation that has been both persistent and growing. In the beginning at least, conservation easement contributions seem to have functioned in some measure as Congress intended, providing (with relatively modest overvaluation) an incentive to conservation by owners of land facing developmental pressures. Before 1994, according to one recent study, deductions were overstated on average by a factor of about two; for cases between 2000 and 2016, however, that had grown to more like a factor of ten. Recent decisions have continued to manifest that trend.

The escalating overvaluation has been effectuated principally by taxpayers claiming values, based on the asserted developmental potential of property, that are many multiples of the price at

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2 Stephen Small’s impression is that early contributions of conservation easements generally functioned to preserve land long held by individual taxpayers, a state of affairs that changed with the emergence of syndicated easements around the turn of the century. See generally Stephen J. Small, Proper -- And Improper -- Deductions for Conservation Easement Donations, Including Developer Donations, 105 TAX NOTES 217 (2004) [hereinafter Small, Improper Deductions]. Small was the principal drafter of the § 170(h) regulations, and has since continued to work extensively in the area.


4 As to individual cases, see, e.g., Belair Woods, LLC v. Comm'r, T.C. Memo. 2018-159, at *18 (2018) ("This valuation presupposed that the 141.15 acres had increased in value by 1,380% during the previous 2-1/2 years, amid the worst real estate crisis since the Great Depression."); see also infra Part III.B.3.c. According to the Statistics of Income, aggregate easement contributions reported on Schedule A grew from about $2.26 billion in 2015 to some $6.5 billion in 2018 (the latest year for which the data are available); at the same time contributions of land and real estate in the aggregate (not including easements) were about $3.13 billion in 2015 and $3.16 billion in 2018, though they did spike to about $3.9 billion in 2017 (possibly in anticipation of the decline in individual marginal rates in 2018). See documentation at https://www.irs.gov/statistics/soi-tax-stats-individual-noncash-charitable-contributions. For all four years 2015-2018 Easements were larger by average size of contribution ($606,500) than any other category of contribution; the next highest by average size was "Other Investments" ($324,435).
which the property recently changed hands. The claimed values implausibly suggest that real estate market prices have somehow, persistently, come nowhere close to reflecting the true developmental values of land. They are nevertheless used to justify inflated deductions for the loss of value claimed to result from restricting development of the land. Just as implausibly, the latter imply that the conservation benefits flowing from easements are many times what someone wanting to conserve the underlying land would have had to pay contemporaneously to purchase the land itself. Even putting that anomaly aside, and focusing just on the amounts claimed as deductions in recent cases, they have become indefensibly inflated. That inflation is not, as many proposed solutions to the problem assume, confined to essentially fraudulent "syndicated conservation easements" ("SCEs"), described in detail in a recent Bipartisan Investigative Report of the Senate Finance Committee. Both prior analyses and more recent decisions illustrate that the entire landscape of conservation easement contributions is littered with overvalued deductions. Any remedy premised on the assumption that SCEs are the extent of the problem is destined to leave a great deal of conservation easement abuse untouched. SCEs are just a particularly visible manifestation of a more fundamental problem.

The overvaluation of SCEs, and the valuation of conservation easements more generally, rest on a common foundation. For income tax purposes the amount allowed as a deduction on the contribution of property (other than money) to a charity is generally its "fair market value." That allowance, while a long-standing and familiar feature of the income tax, is at odds with virtually every other income tax provision governing property dispositions: it permits contributors to take deductions for unrealized appreciation without ever taxing the corresponding built-in gain. The singular generosity of this "appreciated property rule" is transformed into a serious vulnerability by the fact that "fair market value" for purposes of a charitable contribution is intrinsically

5 The discrepancy between the amounts claimed as deductions for easements and the value of the interests they conserve is an important aspect of this problem that has been emphasized in particular by Daniel Halperin. See Halperin, Better Way, supra note 1. That dimension raises questions of commensurability that are beyond the scope of this paper. See infra note 49.

6 S. COMM. ON FIN., 116TH CONG., SYNDICATED CONSERVATION-EASEMENT TRANSACTIONS: BIPARTISAN INVESTIGATIVE REPORT, AS SUBMITTED BY CHAIRMAN GRASSLEY AND RANKING MEMBER WYDEN (Comm. Print 2020) [hereinafter SENATE BIPARTISAN REPORT].

7 Treas. Reg. § 1.170A-1(c)(2); see infra Part III.A.

8 See, e.g., Daniel Halperin, A Charitable Contribution of Appreciated Property and the Realization of Built-In Gains, 56 TAX L. REV. 1 (2002) [hereinafter Halperin, Appreciated Property]; Roger Colinvaux, Charitable Contributions of Property: A Broken System Reimagined, 50 HARV. J. ON LEGIS. 263, 268 (2013) [hereinafter Colinvaux, Broken System]; Sims, Recollections, supra note 1, at 44-45. In almost all other circumstances the amount deductible on disposition is limited to that part of the property's value that is already tax-paid, that is, to its adjusted basis. See infra Part III.A. Halperin’s analysis leads him to advocate constructive realization on most charitable contributions of appreciated property. Halperin, Appreciated Property, supra, at 4. Colinvaux’s analysis leads him to advocate denying deductions for almost all contributions other than in cash. Colinvaux, Broken System, supra, at 323-29.
counterfactual. It is the price at which an arm's-length transfer by a hypothetical "willing seller" to an equally hypothetical "willing buyer" is *imagined* to take place. Actual charitable contributions of property, however, by their very nature are never truly at "arm's length": there is no real adversity of interests; the recipient-donee, in contrast with a real arm's-length purchaser for value, has no incentive to minimize the price that it is (not) required to pay. By the same token, the fair market value hypothesized by the Treasury Regulations must *always* be externally supplied. For some assets -- those that are fungible and regularly traded, most commonly corporate stock -- external prices are readily and reproducibly available. For assets that are not fungible and for which sales are fewer and farther between -- real estate and art are examples -- ascertaining fair market value can be considerably more beset by uncertainty. Introduce into that uncertainty the fact that neither donor nor recipient has any interest in minimizing the value assigned to the contribution -- a higher valuation makes the donor better off but does not leave the recipient (who isn't actually *paying* anything) any worse off -- and you have an incentive, and a recipe, for overvaluation.

The appreciated property rule has long been the Achilles heel of the charitable deduction in general, as Congress at times has expressly acknowledged. It has wrestled with the resulting valuation problems off and on for over forty years. Much of the tax system's machinery for combatting valuation abuse, introduced into the statute beginning in 1981, has responded, implicitly or explicitly, to aggressiveness in valuing charitable contributions. But even with the most challenging of conventional valuation problems there is usually some more or less salient set of prices from more (or less) comparable arm's-length sales to which one can eventually appeal. What is qualitatively different about conservation easements is that they essentially *never* change hands, much less at arm's length. Consequently, in valuing them, there are no comparable property interests to the market prices of which it is possible to appeal. Their "fair market values" must instead be determined by indirect methods that, more often than not, are suffused with speculation and imprecision. The resulting malleability of conservation easement valuation has intensified the temptation to exploit the more general incentive identified above to overvalue charitable contributions. With the passage of time that confluence of inducements has led to the overvaluation of contributed easements that, in both depth *and* extent, has become simply intolerable. SCEs are just the tip of that iceberg.

Even those prepared to acknowledge and address the overvaluation of conservation easements have either overlooked or ignored but in all events skirted this central dimension of the problem. Many of the analyses and "solutions" that have been proposed are peripheral, misguided, or both. Katherine Jordan and Douglas Longhofer, for example, argue that the Service should stop

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9 *See infra* Part III.A.2.
ensnar[ing] legitimate conservation transactions" in "supposed technical violations in easement deeds," and confine its enforcement efforts to challenging SCEs, syndicated through pass-through entities, as "shams." Of like mind about the shortcomings of the Service's efforts, though of a diametrically contrasting view about the appropriate response, is the Tax Court's Honorable Mark Holmes, who has opined that the IRS should stop harassing "reasonably valued" conservation easements with "contestable" technical challenges and just feed all the disputes "into a valuation grinder," thereby weeding out all those "presumably . . . reasonably valued" claimed conservation easement deductions that he "fear[s]" the government's efforts have needlessly jeopardized, from the "syndicated conservation-easement deals with wildly inflated deductions on land bought at much lower prices." Some among the conservation easement community are prepared to go so far as to deny that a valuation problem actually exists. For example, a recent, 129-page "unofficial" report, prepared by an ABA Section on Real Property, Trust & Estates Law "Task Force," devotes 100 or so pages (replete with 28 detailed examples) to proposed post-contribution liberalizations of the treatment of conservation easements, and a few pages to rehashing (or disparaging) proposals by others to curb overvaluation, while collectively offering no "judgment about the extent to which valuation of conservation easements represents a tax issue that merits priority attention." Nor can we fail to mention Mr. Robert Ramsay, Chair of the "Partnership for Conservation," who asserts that one of many "myths" about conservation easements is that the "development rights" to a parcel of realty "cannot exceed the value of the land." There has even been a suit, filed in April 2021 by


12 ABA Real Property, Trust & Estate Law Section, Conservation Easement Task Force Report: Recommendations Regarding Conservation Easements and Federal Tax Law, 53 REAL PROP. TR & EST. L.J. 245, 331-334 (2018) [hereinafter ABA-RPTE Report]. The report was not presented to either the ABA House of Delegates or its Board of Governors, and "is not the ABA's official position." Id. at 247. At least some task force members are acknowledged to have clients with conservation easement issues. The authors' collective disclaimer is notable for its careful wording:

Although some members of the Task Force have clients who would be affected by the federal income tax principles addressed by this Report, or have advised clients on the application of such rules, neither a Task Force member nor the firm or organization to which any member belongs has been engaged by a client to make a government submission with respect to, or otherwise to influence the development or outcome of, the specific subject matter of this Report.

Id.

13 Id. at 331.

three appraisers in the Northern District of Georgia, alleging that the IRS has engaged in a pattern of harassment, and seeking (among other things) to enjoin it from enforcing § 6695A, which imposes penalties on appraisers whose work leads to overvaluation penalties.\footnote{Benson v. IRS, No. 2021-cv-00074 (N.D. Ga, April 4, 2021). See infra notes 69 and 142.}

There are, to be sure, more moderate voices. Stephen Small, for example, is of the view that, in the two decades immediately following the 1980 adoption of § 170(h), "open space with important wildlife habitat or wildlife corridors . . . owned by the same owners, or the same family, for years . . . were typical of the properties protected by conservation easements."\footnote{See infra notes 69 and 142.} While Small believes that in those early years the statute was working "the way Congress intended," he is critical of the syndicated easement transactions that have emerged in the past fifteen to twenty years, and has himself proposed remedial legislation.\footnote{Small, Improper Deductions, supra note 2, at 218.  Small's specific suggestion was that if an investor whose holding period for their investment was less than 18 months claimed a deduction in excess of 250% of the investment, their deduction would be limited to basis.  Small, Modest Proposal, supra note 16, at 1086. The proposed 250% threshold, presumably fixed so that a 40% investor would no more than break even on the investment, appears to have been reflected in IRS Notice 2017-10, which treats syndicated easements that exceed that threshold as listed transactions. It has also been incorporated into recent legislative proposals. While a step in the right direction, we suggest below that we can and must do better than that. See infra Part IV.B.}

The work of Professor Nancy McLaughlin, who has written in this area as extensively as anyone,\footnote{See, e.g., Nancy A. McLaughlin, Conservation Easements and the Proceeds Regulation, 56 REAL PROP. TR. & EST. L.J. 111 (2021) [hereinafter McLaughlin, Conservation Proceeds]; Nancy A. McLaughlin, Tax-Deductible Conservation Easements and the Essential Perpetuity Requirements, 37 VA. TAX REV. 1 (2017); McLaughlin, Valuation Conundrum, supra note 3; see also Starkman, supra note 3.} suggests, on the other hand, a slightly different perspective. Her 2016 study, in particular, discloses overvaluation reaching back to the beginning, albeit far less aggressive before 1994 than it has since become. Much of what she documents has occurred outside the realm of syndicated easements. So although Professor McLaughlin has been unstinting in her efforts to facilitate the constructive use of conservation easements, she remains cognizant of the flaws in existing practice, and in particular of the wider prevalence of overvaluation. She, together with King Burnett and John Leshy, have proposed steps both to standardize and make more stringent the terms on which conservation easements are granted, and the ways in which they are administered and enforced following grant.\footnote{K. King Burnett, John D. Leshy, & Nancy A. McLaughlin, Building Better Conservation Easements for America the Beautiful, HARV. ENVTL. L. REV. ONLINE (Sept. 15, 2021) [hereinafter "BLM"]). The article draws on the experience of the Department of Agriculture in purchasing easements.}
evidence of a willingness even to admit to the prevalence of excessive valuation outside of syndicated easements; there is little acknowledgment of how many of the easements found in reported decisions differ only quantitatively -- just in degree, and in how elaborate their window dressing -- from the SCEs that more responsible easement advocates decry. Beyond that, the larger conservation easement community seems uninterested in -- almost studiously averse to -- confronting the pivotal role played by the appreciated property rule in fueling overvaluation of conservation easements, SCEs and non-syndicated easements alike. It, together with the pliability of the appraisal process on which valuation of conservation easements is compelled to rely,20 lies at the core of this problem. Unless and until responsible members of the conservation community, or at least those responsible for the formulation and administration of our income tax laws, acknowledge and address that reality, recent proposals intended to curb the large and growing overvaluation of conservation easement deductions almost surely will fail.

We survey in greater detail in Parts III and IV the sorts of solutions that have been proposed. At this preliminary juncture we take note of just two. One is Judge Holmes' suggestion that the entire problem might satisfactorily be addressed through case-by-case litigation of value. That has long been criticized in individual cases as "an inefficient, wasteful, and inherently imprecise method of resolving" valuation disputes.21 As a general approach it would be prohibitively expensive. The purveyors of conservation easements are well-financed, well-represented, and determined;22 the Internal Revenue Service's resources are limited. There is little reason to be confident, as the volume of litigation continues to grow, that the Service will continue to be able to keep up. Even advocates of liberality in allowing conservation easement deductions acknowledge that "neither the Service nor the courts have sufficient resources to effectively police valuation abuses."23

The other consists of recent legislative proposals to limit, to 2.5 times investment, deductions for conservation easements claimed with respect to property held by a pass-through entity during the first three years of the investors' collective holding periods for their interests. That proposal has been introduced in both houses of Congress.24 It is designed primarily to kill syndicated

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21 Losch v. Comm'r, 55 T.C.M. (CCH) 909, 921 (1988). A distinguished Tax Court Judge in one early case was "appalled at the time and energy both the parties and the Court have had to expend in the course of trial and decision in this case" on the matter of valuation. Symington v. Comm'r, 87 T.C. 892, 904 (1986) (Tannenwald, J.); see infra Part III.B.3.c. See generally Colinvaux, Broken System, supra note 8, at 283-85.

22 See Coal Prop. Holdings, LLC v. Comm'r, 153 T.C. 126, 140 n.4 (2019). The appellants in both Hewitt and Oakbrook Land Holdings, see infra note 110, were represented by a major New York firm. The defendants who have not settled in United States v. Zak, 426 F. Supp. 3d 1365 (N.D. Ga. 2019), see infra note 133, are comparably represented.

23 ABA-RPTE Report, supra note 12, at 331-32. We return to that possibility, infra, at Part III.C.

easements of the sort described in the Senate Bipartisan Report, by imposing a hard, readily
identifiable limitation that would render SCEs uneconomic.\textsuperscript{25} It is, moreover, supported by what
might be described as the mainstream conservation easement community. But the focus on SCEs
has served to obscure just how much broader the problem really is. Even taken on its own terms
legislation like S. 2256 is flawed: it would apply only to easements contributed by pass-through
entities; even there it would have no effect on easements contributed by entities whose investors are
sufficiently patient to wait out its three-year limitation. More importantly, it might well have the
unfortunate collateral consequence of \textit{blessing} easement valuations that exceed, but by \textit{less than} 2.5
times, the contributor's basis, even when such valuation itself is -- as it often will be -- aggressive.

The simple fact is that the deduction for a contributed conservation easement should never
exceed (much less substantially surpass) the fair market value of the property with respect to which
the easement is granted. To claim otherwise is to say that giving away the development rights to
land is giving away more than the land -- lock, stock, and barrel -- itself. What is more, fair market
value should \textit{not} be hard to determine when, as found in the facts of so many recent decisions, the
property involved had changed hands in a roughly contemporaneous arm's-length sale. In such
circumstances the limitation of S. 2256 to 2.5 times the recent sale price is plainly too generous.\textsuperscript{26}

Flawed though it is, a bill like S. 2256 does point the way to an effective response to
conservation easement overvaluation. Deductions for easements donated with respect to recently
acquired property should in general be limited to \textit{adjusted basis}, that is, to cost. That is the

\textsuperscript{25} In contrast with most investments characterized as "tax shelters," the "economics" of SCEs are driven entirely by
the tax benefit produced by the charitable deduction \textit{in the year of contribution}. Consequently, a positive return
requires the allowance of a deduction enlarged by comparison with the amount invested to more than \( I / t \), where \( I \) is the
investment and \( t \) is the taxpayer's marginal rate. At a (rounded) top marginal rate of 40%, positive economics for each
$1.00 of investment would thus require a deduction of more than $1.00/0.40 = $2.50, which would then produce tax
savings of $1.00. That, presumably, is the origin of the threshold in Notice 2017-10, the limitation in bills like S. 2256,
and the earlier proposal by Small. At any lower marginal rate a 2.5x deduction, even if (taking into account the
percentage limitations of 170(b)) entirely allowed in the first year, would produce a negative return in the first year with
nothing to make up the shortfall thereafter. The 2.5x-for-3-years limitation of S. 2256 thus trades on the extreme
impatience to which tax-motivated conservation easement shelters are thought to cater.

Traditional shelters (like most investments generally) have involved tax benefits generated over time, with the
property that when discounted to present value the returns (including tax benefits) in the aggregate exceed the original
investment; that is, the investment has a positive "net present value." \textit{See}, e.g., Theodore S. Sims, \textit{Debt, Accelerated
investments that involve the expensing of durable asset costs do not produce positive returns in the first year, but
generate positive economics through subsequent returns. \textit{Id}. at 281.

\textsuperscript{26} \textit{See infra} text and notes at notes 90-97; \textit{infra} Part IV.B. As noted there, the 2.5x limitation could itself be taken as
condoning overvaluation by comparison with cost.
foundation for what we propose. There is ample precedent for such a limitation: it would be consistent with the income tax rules governing the disposition of property more generally; more to the point, it is a limitation that Congress has seen fit to impose on other species of charitable contributions that are viewed as particularly susceptible to abuse. In contrast with S. 2256, our proposed limit on valuation would be applied irrespective of whether the easement is contributed by an individual or via a pass-through entity. As suggested above (and as we document in Parts II and III), non-syndicated easements are as prone as SCEs to overvaluation. Any serious effort to eliminate conservation easement abuse must take cognizance of that reality. What constitutes "recently acquired" is necessarily arbitrary, but the three-year period in existing proposals seems reasonable.27 After the expiration of three years, however, our proposed limit would not, as under existing proposals, just expire; it would remain in place but be allowed to increase.28 What in general we propose to show is that, given their almost unique potential for abuse of the appreciated property rule, and, as reflected in recent decisions, the willingness of private actors to exploit that potential to its limits, conservation easements bear a compelling similarity to other assets for which Congress has acted to limit charitable contributions to basis. A comparable limitation is called for here.

The final element of our proposal would take account of two striking aspects of conservation easements, features that distinguish them from most other tax-shelter investments. The first is just how simple they are to construct: stripped to their essentials they consist of little more than some undeveloped land, a suitably aggressive appraisal, and a story.29 The other is the immediacy of their projected returns: the tax benefit from contributing an easement accrues entirely in the year of contribution; in the case of an easement on newly-acquired property, that means in the taxable year the investment is made.30 That combination of simplicity and immediacy creates powerful temptations to invest. To counter that temptation, we propose imposing an upfront cost on

27 In this respect our proposal is similar to Small's, see Small, Modest Proposal, supra note 16, at 1086, except that our extended holding period is three years not eighteen months, and our limitation generally is to cost, whereas he proposed limiting it to cost only where the claimed deduction exceeded cost by a factor of 2.5. In effect, our proposal is tantamount to increasing to three years the long-term capital gain holding period, for purposes of determining the amount deductible taking into account I.R.C. § 170(e)(1)(A), solely with respect to contributions of conservation easements.

28 After three years we would adjust the allowable maximum value automatically at the rate of increase in housing prices in the general vicinity of the property burdened by the easement. We would also allow for higher valuations when justified and documented, not by speculative discounted cash flow valuations of property's "highest and best use," but only by reference to genuinely relevant comparable sales. See infra Part IV.C.2.

29 See infra Parts II and III.B.3.b.

30 See supra note 25. That immediacy is subject to and moderated by the percentage limitations on and carryover provisions related to charitable contributions of I.R.C. § 170(b). Those limitations have been substantially liberalized for contributions of conservation easements. See infra note 142.
contributing an easement, in the form of a 5% fee levied on that portion of the contribution attributable to unrealized appreciation. The fee could be structured so that it would only modestly reduce the incentive to contribute a fairly valued conservation easement; at the same time, it would be a deterrent to contributions found to have been substantially overvalued. By imposing that cost at the threshold, rather than penalizing overvaluation only after the fact, the fee we propose would have greater salience to prospective contributors, cautioning them to think carefully before investing in what they have reason to think might be an overvalued conservation easement.

Congress has long been aware of the general susceptibility of the appreciated property rule to abuse.\textsuperscript{31} It has acted to cabin that vulnerability primarily (but not entirely) with palliative administrative controls and valuation penalties levied only after the fact.\textsuperscript{32} But conservation easements are so uniquely prone to manipulation, and to exploiting the appreciated property rule beyond any reasonable limit, that those controls, even if supplemented by additional administrative requirements such as those recently proposed by Burnett, Leshy and McLaughlin, will not prove adequate to the task. Any serious effort to halt excessive valuation of conservation easements will require more fundamental reform.

In Part II we outline the foundation for that claim. In Part III we explore in more detail the background to and central nature of the problem, and its manifestation in some more recent decisions; we also address in greater detail what we see as shortcomings in the differing administrative approaches advocated by Jordan & Longhofer and Judge Holmes. Part IV takes up more generally the topic of reform. Parts IV.A-B address recently proposed solutions of a legislative nature, including bills like S. 2256. Part IV.C returns to the role of the appreciated property rule, and its implications for successful reform. We elaborate in Part IV.D on the proposals we offer in lieu of other solutions. We believe that, if adopted, they would lead to a more effective and comprehensive solution to the problem of overvalued conservation easements, while leaving intact the basic structure and incentives of the existing deduction, shorn of its vulnerability to widespread overvaluation.

II. A Fresh Perspective

To put the matter into perspective we start with two Tax Court decisions, widely separated in time, both involving charitable contributions of appreciated property, one having nothing else to do with conservation easements. The latter concerned the doyenne of a distinguished corner of the

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{31} See generally Colinvaux, Broken System, supra note 8.
\item \textsuperscript{32} See infra Part III, at 18-19. Congress also enacted I.R.C. § 170(e)(1)(A), limiting contributions of ordinary income property to basis, discussed infra in Part II, text and notes at notes 39, 44-47.
\end{itemize}
\end{footnotesize}
mid-twentieth century world of modern and contemporary art in New York City, the Baroness Hilla von Rebay, a close friend of and an advisor to Solomon R. Guggenheim. Her tax case, *Rebay v. Commissioner*, involved the contribution of eight "non-objectivist" paintings, all of her own creation, to three organizations described in I.R.C. § 170(c), for which she claimed charitable contribution deductions totaling $169,000.

The other case involves one William Duane Horton, of Chattanooga, Tennessee, a "talented entrepreneur" and real estate developer, who while out with his wife one day in 2007 "driving on a country road about fifteen minutes outside Chattanooga in search of the perfect place for a new home," came upon a 143 acre parcel of undeveloped land that while "significantly larger and considerably more overgrown than what they wanted, . . . they thought . . . could be the diamond in the rough for which they had been prospecting." Its value was something that (as found by the Tax Court) Horton "was uniquely able to see." He "quickly contacted various investors to plan how to buy and develop it." With them he organized Oakbrook Land Holdings, LLC ("OLH"), through which he purchased all 143 acres at the end of 2007 for $1.7 million. Horton's unique and evidently instantaneous grasp of the extraordinary value of the parcel's potential was so perspicacious that in little more than a year -- despite a contemporaneous 3% decline in local housing prices -- the development rights to just 106 (less than three-quarters) of those 143 acres were claimed to have mushroomed in value to $9.545 million, the amount that OLH sought to deduct when it contributed a conservation easement restricting their development at the end of 2008.

To be sure, neither of the claimed deductions was ultimately allowed. The only then available evidence of the value of Mrs. Rebay's non-objectivist paintings was a single $15,000 sale, apparently to an engineer who knew little about serious art but who had business dealings with Mrs. Rebay's lawyer, evidence the Tax Court found unpersuasive; it allowed a total of $2,300 of the $169,000 she had claimed.

Mr. Horton's claimed deduction was likewise disallowed; not, however, because it was "wildly inflated," but for failure to comply with one of those contestable

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33 22 T.C.M. (CCH) 181 (1963). During the years at issue, 1955-59, Mrs. Rebay had adjusted gross incomes, mostly from dividends, ranging from $135,000 to $159,000, sufficient for her to be taxed at the margin, if not at the prevailing top 91% marginal rate, at least at 88% or 89%.

34 *Oakbrook Land Holdings, LLC v. Comm'r*, T.C. Memo. 2020-54, at *3 (2020) (Holmes, J.). In a separate opinion from which Judge Holmes alone dissented, the full Tax Court upheld the validity of Treas. Reg. § 1.170A-14(g)(6)(ii), governing the disposition of proceeds following judicial extinguishment of an easement, which OLH and Horton had challenged. *Oakbrook Land Holdings, LLC v. Comm'r*, 154 T.C. 180 (2020). That decision was sustained on appeal in *Oakbrook Land Holdings, LLC v. Commissioner*, No. 20-2117 (6th Cir. Mar. 14, 2022). The history of challenges to the proceeds regulation is recounted infra, text and note at note 110.

35 See infra note 199.

technical deficiencies of which Jordan & Longhofer and Judge Holmes alike have so little good to say. Indeed, Judge Holmes was so persuaded that Horton's deduction -- of over 7.5 times the land's year-earlier allocable acquisition cost\(^{37}\) -- was claimed entirely in good faith that he set aside the government's assessment of negligence and overvaluation penalties.\(^{38}\)

The issues raised by Mrs. Rebay's contributions were quelled a few years later in the Tax Reform Act of 1969, when Congress legislated (in effect) to limit contributions of ordinary income property like Mrs. Rebay's paintings to her basis.\(^{39}\) The current income tax environment does differ in important ways from what prevailed during the mid-1950s, when Mrs. Rebay contributed her paintings. What is more, the comparison between Mrs. Rebay's paintings and Mr. Horton's conservation easement is not exact. Nevertheless, their characteristics are sufficiently similar that the comparison makes a powerful case for the proposition that, unless Congress acts with respect to contributions of conservation easements, as it did fifty years ago with respect to contributions of ordinary income property, to limit their deductions in some manner and in some measure to basis, it will fail to halt the ongoing proliferation of conservation easement valuation abuse.

Efforts to curb conservation easement abuse that are confined to syndicated easements will not be effective to deal with the problem. A glance at the facts and the Tax Court Memorandum opinion in Oakbrook Land Holdings will suffice to highlight that conclusion. The typical SCE against which the government has taken administrative action involves income tax deductions four to five times the participants' investments in the syndication.\(^{40}\) In contrast, Duane Horton's Oakbrook Land Holdings, whose contribution the court expressly noted was "not a syndicated conservation easement,"\(^{41}\) laid claim to a "charitable" deduction more than 7.5 times the cost of the (recently acquired) land over which the easement was granted.\(^{42}\) It (and cases like it)\(^{43}\) may differ in

\(^{37}\) The allocable cost of the 106 burdened acres was $1.7*106/143 = $1.26 million: $9.545/$1.26 = 7.575.

\(^{38}\) See infra note 145.

\(^{39}\) I.R.C. § 170(e)(1)(A) reduces the amount of any charitable contribution of property otherwise taken into account under this section . . . by . . . (A) the amount of gain which would not have been long-term capital gain . . . if the property contributed had been sold by the taxpayer at its fair market value (determined at the time of such contribution).

Since a sale at fair market value would produce gain of FMV - AB, a deduction initially of fair market value, reduced as provided in § 170(e)(1)(A), leaves a deduction of FMV - (FMV - AB) = AB. Before the Tax Reform Act of 1969, § 170(e)(1) had applied only to gain taxed as ordinary income by reason of the "recapture" provisions of I.R.C. §§ 617, 1245 and 1250. The 1969 Act extended it to all gain not taxed as long-term capital gain, which included Mrs. Rebay's paintings, which were non-capital assets in her hands. I.R.C. § 1221(3). It also reduced fair market value deductions in some circumstances for assets with unrealized long-term capital gain. See infra notes 45 and 47.

\(^{40}\) See, e.g., I.R.S. Notice 2017-10, 2017-4 I.R.B. 544; SENATE BIPARTISAN REPORT, supra note 6, at 12.

\(^{41}\) Oakbrook Land Holdings, LLC v. Comm'r, T.C. Memo. 2020-54, at *13 n.8 (2020).

\(^{42}\) See supra note 37.
origin from the more mass-marketed SCEs, but it was no less (indeed, it was a good deal more) aggressive. And it was made possible by exactly the same combination of elements -- the appreciated property rule and an inflated appraisal -- that have produced the deductions claimed by purveyors of SCEs.

The difficulty of valuing, and the susceptibility to overvaluation of, non-fungible appreciated assets in cases like *Hilla Rebay* was an important aspect of Congress’s decision fifty years ago to broaden the scope of § 170(e). But there was more to it than that. At then-prevailing marginal rates above 50%, the ability to deduct the fair market value of appreciated, ordinary income property -- even if fairly valued -- could leave a taxpayer better off by contributing than selling it. To avoid the limitation of § 170(e)(1)(A), conservation easements are invariably contributed with respect to long-term capital gain property. As marginal rates on long-term capital gains have always been well under 50%, the possibility of doing better by contributing than selling a fairly valued easement has always been out of reach. Since, moreover, marginal rates generally are now below 50%, that possibility no longer exists, even with respect to ordinary income property. Despite that development § 170(e)(1)(A) continues to limit such contributions to basis. What is more, Congress has acted to broaden the scope of § 170(e) by imposing comparable restrictions, even with respect to gain otherwise taxable as long-term capital gain, in other situations viewed as having the potential for abuse. As conservation easements have come to

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43 See infra Part III.B.3.

44 See H.R. REP. NO. 91-413, at 55 (1969). The IRS in 1986 addressed the problem of valuation for artworks by creating the Commissioner’s Art Advisory Panel, which provides advice and value recommendations regarding taxpayer appraisals of tangible personal property in income, estate and gift tax returns. When a work is appraised at $50,000 or more, the IRS examining agent or appeals officer must refer the case to the Art Appraisal Service, which may in turn refer it to the Panel. The Panel members are gallery owners and directors and museum curators. See The Art Advisory Panel of the Commissioner of Internal Revenue, Annual Summary Report for Fiscal Year 2020, Publication 5392 Dept. of Treasury Internal Revenue Service.

45 See STAFF OF THE JOINT COMMITTEE ON TAXATION, 91ST CONG., GENERAL EXPLANATION OF THE TAX REFORM ACT OF 1969 77-78 (1970) [hereinafter 1969 ACT BLUEBOOK] (“As a result, in some cases it was possible for a taxpayer to realize a greater after-tax profit by making a gift of appreciated property than by selling the property, paying the tax on the gain, and keeping the proceeds.”); S. REP. NO. 91-552, at 80-81 (1969).

The extreme case is of zero-basis ordinary income property. At a 55% marginal rate the sale of $100 of such property for $100 produces after-tax proceeds of $45; a $100 contribution, if allowed, produces after-tax proceeds of $55. Hilla Rebay’s paintings in her hands were non-capital assets, I.R.C. § 1221(3), with an adjusted basis of (or approaching) $0. At her (roughly) 90% marginal rate during the years at issue a sale for $100 would have produced an after-tax return of just $10; in contrast, each $100 contribution would have produced $90 after tax.

46 Some minor exceptions exist. E.g., I.R.C. §§ 170(c)(3)(B) (certain contributions of inventory), 170(e)(4)(A) (contributions of scientific property used for research).

47 In 1969 Congress had been less concerned about, but not entirely indifferent to, the reduced but not non-existent advantages of contributing preferentially taxed long-term capital gain. It curtailed some such contributions of tangible personal property, and contributions generally of capital gain property to private foundations, but in a manner that took account of that reduced advantage. See Halperin, *Appreciated Property*, supra note 8, at 1-2, 2 n.5. The limitation in
exhibit a special proficiency at exploiting the appreciated property rule, on that ground alone they merit being comparably curtailed.

The emergence of appraisal-based valuations that are increasingly far above actual fair market value makes the case for reform qualitatively more compelling. It introduces, again, the prospect of doing better in strictly financial terms by contributing a conservation easement than by doing anything else with the property subject to the easement. That, too, is evident from Oakbrook Land Holdings, where the $9.545 million deduction for the restriction covering 106 acres, if it had been allowed, would (at a marginal rate of 35%) have immediately returned to Mr. Horton and his investors over $3.3 million, nearly twice what they had just paid for the entire 143 acre tract of land. Using appraised valuations of development potential, taxpayers like Duane Horton have been attempting through conservation easement contributions to exploit in an extreme way the allowance of charitable deductions based on claimed "fair market" values, including values attributable to unrealized appreciation; they are doing so to essentially the same extent that, and to exactly the same effect as, contributions of ordinary income property exploited the appreciated property rule in a world of high marginal rates before the adoption of § 170(e)(1)(A). And that, in turn, points to the conclusion that the only effective way of curbing conservation easement valuation abuse will be to tether the allowable deductions in some fashion or another to basis.

We realize that, for much of the conservation community, this conclusion will be met with hostility. For the part of that community more conversant with conservation than taxation, conservation easements are simply a valuable tool for conserving our national heritage. Tax litigation aside, they see them as remarkably free of institutional restrictions, and view what is being conserved as presumptively worth the cost. But the values being protected -- their "conservation values" -- are difficult to quantify, much less to equate to the costs of conserving them.49 The case of tangible personal property was motivated by concerns for valuation. Id. at 29 & nn.91-94; see also Colinvaux, Broken System, supra note 8, at 273-74. When preferential taxation of long-term capital gain was restored in 1991 following its repeal by the Tax Reform Act of 1986, Congress left in place a complete reduction to basis of those contributions of long-term capital gain property previously singled out for partial reduction in 1969. I.R.C. § 170(e)(1)(B)(i)-(ii).

Since then Congress has expanded the categories of long-term capital gain property for which deductions are limited to basis, most significantly to most categories of intellectual property. I.R.C. §§ 170(e)(1)(B)(iii)-(iv), 170(m) (enacted in 2004).

48 In 2008 the top marginal rate was 39.6%.

49 Observers like Halperin, Better Way, supra note 1, at 311, question whether the benefits, either to the government or to the public, from conservation easements are worth the revenue lost to the deductions, a concern expressed by the Treasury in 1979. See Sims, Recollections, supra note 1, at 47-48. That very discrepancy has been acknowledged by advocates for conservation easements, in arguing that proposed regulations requiring donee organizations to receive a share of the proceeds when an easement was extinguished was ill-considered and should be withdrawn. The position of
costs, in contrast, are both quantifiable and real. And since those costs are not being incurred by the conservation community, they can afford to be unconcerned that the price being paid is inflated, or that the benefits of that inflation are accruing to those at the top of the income distribution and least in need of government assistance, aid that is not merely unjustifiable but is being illegitimately obtained.

Congress has blessed the use of this tool, but only on the premise that the easements are being fairly valued. When land worth preserving has been held for some time, and with the passage of time has appreciated in value and come under developmental pressure, allowing a deduction for restricting development by contributing an easement may seem reasonable, even if the deduction is allowed with respect to unrealized appreciation.\(^{50}\) We believe that in adopting § 170(h) that is basically what Congress had in mind.\(^{51}\)

There is no reason to think, however, that Congress intended to legitimate an unlimited, tax-implemented raid on the Treasury. But that is exactly what happens when a Duane Horton purchases vacant rural land and almost immediately -- defined for present purposes as just a year and a day later -- engages in what might most fairly and accurately be characterized as a "conservation easement flip." It can hardly have been accidental that Horton engaged as an appraiser an individual known to be capable of producing conveniently bloated appraisals, based on realty's "highest and best use." The appraiser was prepared to value the OLH easement at $19.5 million, if that was what Horton and his colleagues had in mind; after a requested reconsideration he trimmed it to a mere $9.545 million.\(^{52}\) But it defies credulity -- there is no nicer way of putting it -- to view that $9.545 million appraisal as realistically capturing the value of development rights that no one except for William Duane Horton was even remotely able to discern, with respect to a tract of land that he managed to purchase shortly thereafter for under $1.3 million.\(^{53}\)

the New York Landmarks Conservancy, as characterized by Judge Holmes, was that the proposed regulation improperly assumed that a conservation easement represented a positive economic value to donees because of the possibility that donees might one day receive proceeds from extinguishment. . . . It argued that any such assumption was "unrealistic" since "[t]he value of a conservation restriction to the donee organization is not a monetary value but a philanthropic value as a device for achieving the charitable objectives of the organization."

\(\text{Oakbrook Land Holdings, LLC v. Comm'r, 154 T.C. 180, 236-37 (2020)}\) (Holmes, J., dissenting). Even taken at face value that observation does not explain why, if the original conservation objectives cease to be achievable and the restriction is extinguished, the donee organization shouldn't receive back and reuse for conservation purposes whatever the Federal government had previously paid for the restriction.

\(^{50}\) See Small, Modest Proposal, supra note 16, at 1088.

\(^{51}\) As contrasted with facade easements, which raise very different considerations, with which we do not deal here.

\(^{52}\) Oakbrook Land Holdings, T.C. Memo. 2020-54, at *8 n.3. See infra note 95 for further discussion of that appraiser's role in valuing many of the easements at issue in the decisions discussed infra in Part III.B.3.

\(^{53}\) See supra note 37.
claim to a $9.545 million deduction amounted to little more than an attempt at tax-induced, appraisal-enabled theft. Any responsible tax lawyer understands full well that this is exactly what is going on, even if, for whatever reason, they are among those who are unable to arrive at a "judgment about the extent to which valuation of conservation easements represents a tax issue that merits priority attention."54 Plainly it does. OLH’s claimed deduction, and others like it, are qualitatively indistinguishable from mass-marketed SCEs. They are decidedly not what Congress had in mind when it enacted § 170(h).

In what follows we sketch briefly the exceptional nature of our system’s basic treatment of deductions for contributions of appreciated property. Equally briefly we sketch the ways in which the allowance of deductions for contributing conservation easements differs from most other charitable contributions. With respect to the former we emphasize the extent to which the fair market value rule of Treasury Regulations § 1.170A-1(c)(2), however familiar it may be, seriously departs from the way in which we treat virtually all other dispositions (voluntary or otherwise) of appreciated property.55 With respect to the latter we emphasize (1) the pernicious role of appraisals using speculative, discounted cash-flow ("DCF") analyses of developing property to its so-called "highest and best use," leading to often demonstrably excessive easement valuations, and (2) that excessive valuations are not by any means confined to "syndicated" conservation easements, but may be found in a substantial fraction of reported decisions involving non-syndicated easements.

It is not sensible -- and more importantly will prove futile -- to try to curb conservation easement abuse by partitioning the world into "bad" syndicated conservation easements and everything else, or by undertaking to litigate value in every case. What we should be trying to do instead is distinguish legitimate conservation easements, over land with real conservation value that has appreciated over time and that is truly under developmental pressure, from conservation easement flips. Because the latter are what all the SCEs, and a substantial fraction of the other litigated conservation easement decisions, have involved. And if one keeps an open mind about tinkering with the appreciated property rule there is, as we have already suggested, a simple way of accomplishing that. But the form of what has been proposed thus far will not do; at best it

54 It seems telling that a 9-person task force more than half of whom specialize in some aspect of tax or estate planning managed to craft a 130-page formal report on one of the currently most controversial tax issues while uttering the word "basis" just four times, two of which just quoted what is called for by Form 8283. ABA-RPTE Report, supra note 12, at 336. The third reference lists donor basis as a suggested reporting requirement for a proposed Form 990 Schedule B-1. Id. at 328. The last of these references expressed the thought that the deduction for an easement contribution might be limited to basis if it was -- i.e., after it had been found to be -- overvalued by more than 35%. Id. at 335. At least that last reference implicitly acknowledges that the authors are cognizant of the fact that some charitable contributions are indeed limited to basis.

55 Halperin, Appreciated Property, supra note 8; Colivaux, Broken System, supra note 8.
might kill SCEs, but it would do nothing to halt comparably aggressive individual easement contributions, and it might have the perverse effect of legitimizing a host of other claimed deductions that were less spectacularly but still indefensibly overvalued.\footnote{See the discussion of HRH Investments, infra at Part III.B.3.c.}

III. CHARITABLE CONTRIBUTIONS AND CONSERVATION EASEMENTS

A. Charitable Contributions of Property

1. The Appreciated Property Rule

Deductions for charitable contributions of appreciated property\footnote{Charitable contributions of property other than money are almost invariably of appreciated property. With property that has depreciated in value it is usually better to sell the property, claim any available loss deduction, and contribute the proceeds instead.} are treated in a manner that is exceptional among income tax-relevant transfers of property. The amount generally allowed as a deduction is the property's "fair market value" at the time of contribution, defined in Treasury Regulations § 1.170A-1(c)(2) as "the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."\footnote{E.g., I.R.C. § 1001, allowing basis of property to be subtracted in measuring gain or loss on disposition; §§ 165, 166, limiting loss deductions generally to adjusted basis; Treas. Reg. § 1.165-7. So if property that had appreciated is eventually disposed of at a loss, no deduction is allowed for the unrealized and previously untaxed appreciation. Consequently, the amount deducted may not as a rule exceed what is tax-paid, i.e., basis.}

That treatment is so familiar an aspect of our tax system that it is easy to lose sight of just how radically it departs from the way in which we generally treat dispositions of property: in almost all other cases the amount allowed as a deduction (or otherwise subtracted in determining the tax consequence) is limited to the taxpayer's adjusted basis.\footnote{See generally MARGOT L. CRANDALL-HOLLICK, CONG. RESEARCH SERV., R46178, THE CHARITABLE DEDUCTION FOR INDIVIDUALS: A BRIEF LEGISLATIVE HISTORY (2020). A useful history of its origins and development will be found in Colinvaux, Broken System, supra note 8, at 271-75. For substantive evaluations and criticism of the rule see, e.g., Halperin, Appreciated Property, supra note 8; Colinvaux, Broken System, supra note 8, at 318-24. In general the treatment allowed by Treas. Reg. § 1.170A-1(c)(2) is limited to gain on property that if sold would produce long-term capital gain, and even then not always. See § 170(e)(1)(B); supra note 47; infra text and notes at notes 185-188. Contributions of so-called "ordinary income" property are by I.R.C. § 170(e)(1)(A) effectively limited to basis: the contribution is reduced by the amount of gain that would not be taxed as long-term capital gain on sale. See Colinvaux, Broken System, supra note 8, at 266-67, 279; text at note 39.}

Where appreciated property is involved, the fair market value rule of Treasury Regulations § 1.170A-1(c)(2) effectively permits deductions

\footnote{See I.R.C. § 170(a)(1). As to the participants' assumed knowledge of the relevant facts, see infra note 97. See generally MARGOT L. CRANDALL-HOLLICK, CONG. RESEARCH SERV., R46178, THE CHARITABLE DEDUCTION FOR INDIVIDUALS: A BRIEF LEGISLATIVE HISTORY (2020). A useful history of its origins and development will be found in Colinvaux, Broken System, supra note 8, at 271-75. For substantive evaluations and criticism of the rule see, e.g., Halperin, Appreciated Property, supra note 8; Colinvaux, Broken System, supra note 8, at 318-24. In general the treatment allowed by Treas. Reg. § 1.170A-1(c)(2) is limited to gain on property that if sold would produce long-term capital gain, and even then not always. See § 170(e)(1)(B); supra note 47; infra text and notes at notes 185-188. Contributions of so-called "ordinary income" property are by I.R.C. § 170(e)(1)(A) effectively limited to basis: the contribution is reduced by the amount of gain that would not be taxed as long-term capital gain on sale. See Colinvaux, Broken System, supra note 8, at 266-67, 279; text at note 39.}

\footnote{E.g., I.R.C. § 1001, allowing basis of property to be subtracted in measuring gain or loss on disposition; §§ 165, 166, limiting loss deductions generally to adjusted basis; Treas. Reg. § 1.165-7. So if property that had appreciated is eventually disposed of at a loss, no deduction is allowed for the unrealized and previously untaxed appreciation. Consequently, the amount deducted may not as a rule exceed what is tax-paid, i.e., basis.}
for unrealized, untaxed appreciation without taxing the corresponding gain. In allowing a deduction for pre-tax gain, rather than limiting it to what is tax-paid, the appreciated property rule is nearly unique.

2. Valuation of Charitable Contributions

In ordinary circumstances adjusted basis is readily ascertainable. In contrast, at least in the absence of an arm's-length exchange, fair market value often is not. For assets subject to regular trading, market value is relatively easy to determine. But for less fungible property determining fair market value is often difficult. Given the resulting uncertainty, the appreciated property rule creates a natural temptation toward aggressive valuation of charitable contributions.\(^{60}\)

Valuation has been more generally vexing for the income tax. Over the past forty years it has elicited a series of penalty and reporting provisions intended to combat valuation abuse. Most of them are framed in terms of overvaluation generally. But they have largely been enacted in response to aggressiveness in valuing charitable contributions, reflecting the vulnerability introduced by the appreciated property rule. The first general penalty provision aimed specifically at overvaluation was § 6659, adopted with the Economic Recovery Tax Act of 1981. Congress took note of the magnitude of then pending valuation disputes, and the tendency of courts in such cases to "split the difference" between taxpayers and the Service, resulting in an incentive to overvaluation.\(^{61}\) In response, it adopted a bright-line penalty (with rates graduated from 10% to 30% based on the extent of the overstatement) on underpayments of tax attributable to overstatements of claimed valuations that exceeded the correct value by more than 150%.\(^{62}\)

While § 6659 was phrased generally, charitable contributions were clearly on Congress's mind when it adopted that provision.\(^{63}\) In the Deficit Reduction Act of 1984, Congress returned to the topic. It acknowledged the centrality of the appreciated property rule to valuation abuse of charitable contributions, repeating an example of the contribution of an appreciated painting from the 1981 Act's legislative history. It specifically

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\(^{60}\) Colinvaux, *Broken System*, supra note 8, at 310.

\(^{61}\) That incentive was abetted by the fact that the then prevailing interest rate on deficiencies was less than prevailing market rates.


\(^{63}\) The history to the 1981 Act illustrated the operation of new I.R.C. § 6659 with an example of a taxpayer contributing a painting and claiming a deduction of five times the painting's true value. See id. at 334. The history to the 1984 legislation addressing valuation of charitable contributions used the same example. See Staff of the Joint Comm. on Taxation, 98th Cong., General Explanation of Revenue Provisions of the Deficit Reduction Act of 1984 502 n.18 (1984) [hereinafter 1984 Act Bluebook].
recognized that the tax benefits provided to taxpayers who contribute appreciated capital-gain property to charities create opportunities for overvaluation because the donor is entitled to deduct the fair market value of the property, but does not realize capital gain equal to the appreciation. One way to reduce these opportunities to overvalue would be to eliminate the advantage that charitable gifts of appreciated property have over gifts of cash. The Congress understood, however, that many charitable organizations depend on this tax benefit for fund-raising and as a means of acquiring valuable property.  

Aware that the Service had successfully challenged some instances of overvaluation, Congress nevertheless acknowledged the impossibility of detecting all or even most of them through audit, and took note of the corrosive effect on compliance of the "widespread publicity given to the extent of gross overvaluations by some donors." Consequently, while continuing to allow deductions based on fair market value, Congress addressed the problem of overvaluation with the imposition of new substantiation and disclosure requirements, and by stiffening the then applicable penalties. It required donors to obtain (and in some cases submit) qualified appraisals for contributions in excess of statutorily prescribed thresholds. As a further check on overvaluation, it required reporting by charitable recipients that disposed of contributed property (other than publicly traded securities) with a claimed value of more than $5,000 within two (later extended to three) years following receipt. Finally, solely with respect to overvalued charitable contributions, Congress increased the penalty rate of recently adopted § 6659 to a flat 30%, and curtailed the IRS's freedom to waive the penalty.

Congress adopted these reforms in the hope that they would suffice to curtail valuation abuse of charitable contributions. The legislative history reflects that Treasury was skeptical, and that Congress itself was not oblivious to the possibility that the Treasury might be right:

64 1984 ACT BLUEBOOK at 503.
65 See id. at 504.
66 The new requirements denied a deduction for a claimed charitable gift of property valued at more than $500 unless the return included a description of the property; for a deduction of more than $5,000, it required the taxpayer to obtain a qualified appraisal, and to include a summary of the appraisal with the return (I.R.C. § 170(f)(11)), subject to an exception for gifts of publicly-traded securities (I.R.C. § 170(f)(11)(A)(ii)(I)). If the claimed deduction exceeds $500,000 the taxpayer must attach the appraisal itself (I.R.C. § 170(f)(11)(D)). The associated regulations (Treas. Reg. § 1.170A-13(c)) prescribe the information to be reported, which is required by statute to include both the acquisition date and the cost or other basis of the contributed property. Deficit Reduction Act (DEFRA) of 1984, Pub. L. No. 98-369, § 155(a)(1), 98 Stat. 494, 691 (1984); see generally Loube v. Comm'r, T.C. Memo. 2020-3 at *15 (2020). Congress also prescribed requirements for appraisals and appraisers, I.R.C. § 170(f)(11), elaborated on in Treas. Reg. § 1.170A-17.
67 See I.R.C. § 6050L(a)(1). The charity must (among other things) describe the property, report the date of and the amount received on disposition, and report the name, address and TIN of the donor. Cf. RERI Holdings I, LLC v. Comm'r, 149 T.C. 1 (2017) aff’d sub nom. Blau v. Comm’r, 924 F.3d 1261 (D.C. Cir. 2019).
The Congress understands that the Treasury Department remains concerned whether the substantiation and penalty provisions of the Act will prove sufficient to preclude taxpayers from overvaluing charitable donations of property in all circumstances. This concern relates principally to tax shelter promotions that exploit the deductibility of appreciation in capital gain assets.

. . . . The Congress expects the Treasury and Internal Revenue Service to monitor the effectiveness of the new provisions and to notify the tax-writing committees if there are any continuing valuation concerns that should be addressed by further legislation.68

Congressional expectations did not, however, reckon with the possibilities latent in the allowance of deductions for conservation easements, which it had adopted in permanent form just four years before. In retrospect, moreover, the materialization of those possibilities does not seem to have been deterred by the fact that, in 1989, Congress revised the overvaluation penalties both to simplify and to make them more uniform and more stringent.69

B. Conservation Easements

1. Valuation

The development of §§ 170(f)(3) and (h), from their origins in the legislative history to the Tax Reform Act of 1969 to their permanent adoption in the Tax Treatment Extension Act of 1980, has been chronicled elsewhere.70 They took their permanent form as the third of three exceptions -- the others being remainder interests in a personal residence or farm, and undivided fractional interests in property -- to the general prohibition against the allowance of deductions for contributions not in trust of so-called "partial interests" in property.71

Conservation restrictions differ in important respects from the other exceptions to the partial interest rule. A remainder interest in real property will eventually become possessory, thereby ensuring that at some point the donee will succeed to its entire fair market value. As to undivided interests in tangible personal property, of which what has most commonly been controversial is art, the statute requires that the donee succeed to possession of the entire interest in the contributed

68 1984 ACT BLUEBOOK at 504-05.

69 Revenue Reconciliation Act of 1989, Pub. L. No. 101-239, § 7721, 103 Stat. 2106, 2395-99 (1989). It repealed § 6659 and adopted what is now § 6662, which generally imposes an "Accuracy-Related Penalty on Underpayments" of tax. Sections 6662(a) and (e) impose a 20% penalty on underpayments of income tax attributable to a "substantial valuation misstatement," defined as one in excess of 150% of what is determined to be the "correct" amount; § 6662(h) increases the penalty to 40% in the case of a "gross valuation misstatement," one in excess of 200% of the correct amount. I.R.C. § 6695A, added in 2006, applies to an appraiser whose appraisal results in a substantial or gross valuation misstatement. McLaughlin, Valuation Conundrum, supra note 3, at 303-05.

70 The history leading to the permanent adoption in 1980 is recounted, among other places, in Sims, Recollections, supra note 1, at 44-45.

71 See id.
property in a finite period of time.\textsuperscript{72} In most such instances, then, the donee will eventually be in a position to benefit from and even to sell the underlying property itself. Conservation easements, in contrast, "take the form of a limitation, held by a charitable recipient, on the use that someone else (the fee owner) may make of the encumbered property."\textsuperscript{73} They are perpetual restrictions that never become possessory, and by their very nature do not change hands in arm's-length transactions. There is no market in which they might be valued,\textsuperscript{74} and so their value must be determined by appraisal.

The valuation of both contributed remainder interests in realty and contributed fractional interests in property also involve appraisal. But in either instance the required appraisal is generally of the fair market value, determined at the time of contribution under Treasury Regulations § 1.170A-1(c)(2), of the entire (in principle, alienable) property the interest in which is being contributed. As far as we are aware such appraisals are not systematically problematic.\textsuperscript{75}

With conservation easements, in contrast, what must be valued is not some underlying item of transferable property, but the otherwise non-transferable intangible interest being conferred on the charitable recipient. Valuing that interest, using so-called "before and after" valuation, requires not one but two appraisals,\textsuperscript{76} the first of the property before imposition of the conservation restriction, the second as burdened by the restriction. The need for multiple appraisals is infrequently required elsewhere in the law,\textsuperscript{77} and is a principal source of both the difficulty and the controversy in valuing conservation easements.

\textsuperscript{72} I.R.C. § 170(o) requires, among other things, that the donor contribute all remaining interests in the property by the earlier of ten years following the contribution or her death; the donee must have enjoyed substantial physical possession in the interim, or the deduction is subject to recapture; the statute also caps the amount of subsequent fractional gifts at the lesser of fair market value at the time of the initial contribution or the subsequent contributions.

\textsuperscript{73} See Sims, Recollections, supra note 1, at 47.

\textsuperscript{74} E.g., ABA-RPTE Report, supra note 12, at 331. Some government programs do purchase conservation restrictions, including in California (see Sims, Recollections, supra note 1, at 43 & note 9) and within the U.S. Department of Agriculture. BLM, supra note 19, at 8. Such programs seem to be relatively few, and it is not clear to what extent (if any) the purchased easements are subsequently traded. Contributed easements do not seem to be traded; the only transferee to whom they might be of value is the fee holder, who is by their perpetual nature prohibited from acquiring them, except in the event of judicial extinguishment. The provision of the regulations governing extinguishment is discussed infra at note 110.

\textsuperscript{75} One conspicuous exception is the valuation of art, a problem that has been addressed with the IRS's Art Advisory Panel. See supra note 44.

\textsuperscript{76} E.g., McLaughlin, Valuation Conundrum, supra note 3, at 232-37; Sims, Recollections, supra note 1, at 50-53; ABA-RPTE Report, supra note 12, at 331-34; Losch v. Comm'r, 55 T.C.M. (CCH) 909, 914 (1988); Starkman, supra note 3, at 1476.

\textsuperscript{77} Before and after valuation is prescribed by Treas. Reg. § 1.165-7 for determining the amount of a casualty loss, although in such instances the before value is typically of the property as it actually existed before the damage was sustained, not of some hypothesized, speculative future use. Outside of taxation it has been used in eminent domain proceedings. E.g., Olson v. United States, 292 U.S. 246 (1934), which involved the determination of just compensation.
When Congress was deliberating making § 170(f)(3)(B)(iii) permanent, the Treasury expressed concern about that aspect of the legislation in particular. Its concern was focused primarily on the determination of "after" valuations; it thought that "before" valuations would typically be the property's current fair market value, unburdened by the contemplated restriction, and was concerned that the after valuation would end up being inherently speculative.\(^{78}\) If what eventually materialized had been as the Treasury apprehended the resulting deductions for conservation easements would have been a matter of some concern but little more. In that event each individual deduction would in the worst case be capped at the property's pre-restriction, unburdened fair market value. But the Treasury's prognostication was misplaced, and it turns out optimistically so. As matters have developed the most problematic valuation controversies have involved before valuations, based on appraisals that range from aggressively speculative to fancifully imaginative estimates of the unburdened property's "highest and best use."

2. Highest and Best Use Valuation

Echoing language in the Senate Report on the 1980 legislation, the regulations expressly sanction consideration of the probable use of property to be burdened by a conservation restriction in valuing the restriction. They provide that

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.\(^{79}\)

As noted elsewhere the intended import of that language is less than entirely clear.\(^{80}\) While on its surface it appears to sanction pre-restriction valuation taking account of property's highest and best use, it simultaneously pushes back against expansive "highest and best use" valuation, noting that the prospects for development might be "remote," or that value might already be "restricted" by other land use regulations.\(^{81}\) Whatever the exact import of the Senate Finance Committee Report, or

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\(^{78}\) Sims, Recollections, supra note 1, at 51 n.44.


\(^{80}\) Sims, Recollections, supra note 1, at 52-53. As Sims notes, "the Committee Report language could be seen more as cautioning against, than as expressly condoning, speculative highest and best use valuations of conservation restrictions." Id.

\(^{81}\) See Sims, Recollections, supra note 1, at 52 n.54; see also Minor Tax Bills: Hearing Before the Subcomm. on
of the corresponding provision of the regulations, it has become increasingly clear, especially over the past fifteen years, that "highest and best use" before valuations are at the heart of the most serious valuation abuse. And, in contrast with the Treasury's expressed concern with speculative "after" valuations, there is no theoretical ceiling on the amount of a deduction that can be claimed where aggressive "before" valuations are concerned. If recent case law and commentary are a guide, it is now commonplace in conservation easement cases to find highest and best use valuation invoked where it is clearly out of place, producing overvaluation that is both systematic and egregious. That is most conspicuous in cases involving restrictions on property for which there is a recent arm's-length price, despite which the property's "highest and best use" is deployed to produce an appraised value claimed to justify a dramatically higher deduction.

It is true that different economic actors, bringing differing skills, aspirations, and tolerances for risk to the endeavor, can put the same piece of realty to different uses, leading to significantly

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See, for example, Mountanos v. Comm'r, 105 T.C.M. (CCH) 1818 (2013) (Part II.A, text preceding note 3), aff'd 651 F. Appx. 592 (9th Cir. 2016):

The highest and best use of property can be any realistic, objective potential use of the property. . . . . [It] is presumed to be the use to which the land is currently being put absent proof to the contrary. . . . . A proposed highest and best use different from the property's current use requires the taxpayer to demonstrate "closeness in time" and "reasonable probability" of the proposed use. (Citations omitted.)

See also Losch v. Comm'r, 55 T.C.M. (CCH) 909, 914-15 (1988). Mountanos involved an 880-acre ranch in California, used for recreation, subject to a contract pursuant to California's Williamson Act that conferred favorable property tax treatment in return for restricting development to agricultural use. In 2005 the taxpayer nevertheless granted an easement to a local land conservancy and claimed a charitable contribution with an appraised value of $4.7 million, premised on residential or vineyard development as the highest and best uses of the land. The court noted that "We consider existing zoning, historic preservation and other laws and restrictions at the time contributed as well as economic feasibility in evaluating whether a proposed use was reasonably probable and likely in the near future." Mountanos, T.C.Memo. 2013-138, at *8.

The court found insufficient evidence of access, water supplies, or demand to render vineyard use "reasonably probable"; given the Williamson Act restrictions it concluded that residential development was not a "probable use . . . in the near future." It ultimately found the highest and best "before" use of the ranch, recreation, to be identical to its use thereafter; treated the "correct" value of the contributed easement to be $0; and sustained imposition of gross overvaluation penalties based on all but $100,000 of the $4.7 million deduction claimed. Id. at *19.

That same ranch was listed for sale, ten years later, in May 2015, for $1.15 million; the listing broker (John Lazaro) was one of the taxpayer's valuation experts in the Tax Court proceeding. It sold on September 18, 2018, for the asking price. ESTATELY, https://www.estately.com/listings/info/7181-scotts-valley-road--2 (last visited February 6, 2022). Even taking account of the 9% decline (see infra note 199) in Lake County housing values from 2005 to 2018, and on that account hypothesizing a $1.15/0.91 ≈ $1.25 million market value in 2005, the eventual sales price suggests that the $4.7 million valuation claimed in 2005 was elevated by a factor of about 4.

82 E.g., McLaughlin, Valuation Conundrum, supra note 3, at 267-80, 307-22.
83 E.g., id.; Starkman, supra note 3, at 65-70.
84 See supra text at notes 52-54; infra text at notes 89-97.
different outcomes with different valuations. But the notion that such differing possibilities (together with the differing expenditures of effort and resources to effectuate them, subject to differing risks) somehow systematically fail to be reflected in a roughly contemporaneous arm's-length transfer price determined in a reasonably functioning market is inconsistent with our beliefs about the operation of markets.

The standard conceptualization of "fair market value," in the income tax and elsewhere, reflects the fundamental belief that the parties to an exchange are reasonably well informed and at liberty to proceed or not; neither the "willing buyer" nor the "willing seller" of the regulatory definition is assumed to be "under any compulsion to buy or sell," and both are assumed to have "reasonable knowledge of relevant facts." As one court put it, in the context of valuing a facade easement, it is

a basic tenet of the fair market value paradigm . . . that, with respect to both the hypothetical buyer and the hypothetical seller, "each is a rational economic actor, that is, each seeks to maximize his advantage in the context of the market that exists at the date of valuation."

One-half of that equation is that in agreeing to an exchange the seller is seeking to obtain a price that reflects the maximum value that she reasonably believes might ultimately be extracted from her property. She might not get the most that she ideally would like; her estimate of the maximum value may differ from (be less than) that of the purchaser; the assessments of the prospective seller and buyer might be influenced by differences in their respective tolerances for risk. But in positing that both buyer and seller are reasonably informed, and under no compulsion to proceed --

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85 See, e.g., Oakbrook Land Holdings, LLC v. Comm'r, 119 T.C.M. (CCH) 1352 (2020) (where the court opined that taxpayer’s experience in development made him “uniquely able to see” the potential of the land at issue). The Supreme Court long ago observed in affirming a condemnation award that

[p]roperty is not to be deemed worthless because the owner allows it to go to waste, or . . . because he is unable to put it to any use. Others may be able to use it, and make it subserve the necessities or conveniences of life. Its capability of being made thus available gives it a market value which can be readily estimated.

Miss. & Run River Boom Co. v. Patterson, 98 U.S. 403, 408 (1878); see also Olson v. United States, 292 U.S. 246 (1934).

86 See Ellis, supra note 14; Ramsay, supra note 14; Small et al., supra note 14. Market "efficiency" is most commonly associated with securities markets, especially those with active, competitive trading by well-informed actors. See, e.g., JONATHAN BERK & PETER DEMARZO, CORPORATE FINANCE 308 (5th ed. 2020) (“The idea that competition among investors works to eliminate all positive-[Net Present Value] trading opportunities is referred to as the efficient markets hypothesis. It implies that securities will be fairly priced, based on their future cash flows, given all information that is available to investors.”).

so that up until the point of agreement the seller remains free to search for a higher bidder -- it is fair to infer that the price on which the parties settle fairly represents the true worth of the land, valued at its highest, reasonably foreseeable, practicably achievable use.\textsuperscript{88} It reflects, in other words, valuation at that moment premised on the property's highest and best use. That premise is certainly consistent with the language of Treasury Regulations § 1.170A-14(h)(3)(ii).

Despite this, the deductions at issue in an increasing number of recent opinions reflect claimed "before" valuations based on highest and best use that are many multiples of the property's cost, even as reflected in a relatively recent arm's-length transaction. Given the temporal proximity of those transactions to the corresponding contributions, such claims carry the remarkable implication that the value of development rights captured by highest and best use valuation can somehow exceed the value of the unburdened land.\textsuperscript{89}

As outlandish as that seems it has been provided with intellectual cover by observers who otherwise profess to be sympathetic to eliminating conservation easement abuse. As noted in the introduction, Jordan & Longhofer have criticized the IRS's litigation strategy as misguided by focusing on technical shortcomings in easement documents, typically involving the requirement that a conservation easement provide protection "in perpetuity," thereby invalidating "legitimate" contributions, while shying away from addressing the difficult problem of valuation.\textsuperscript{90} They urge the Service to focus instead on attacking syndicated conservation easements by challenging as "shams" the vehicles taxed as partnerships through which the tax benefits are syndicated.\textsuperscript{91} In so doing they acknowledge that the easement valuations typically claimed by SCEs do not meet the standards articulated in court decisions\textsuperscript{92} and the § 170 regulations for what constitutes "reasonably probable" prospects for developing property to its highest and best use.\textsuperscript{93}

At the same time, Jordan & Longhofer are explicit in ascribing such overvaluations to an "appraisal quirk," namely that the "potential profit associated with" developing property to its highest and best use may in some instances "far exceed the value of the underlying land," with the consequence "that the easement value can exceed the value of the" land. It is to the perversion of this "quirk" using "sham" organizations -- not the quirk itself, which they appear to view as otherwise legitimate -- that they ascribe the valuation abuses found in SCEs. They illustrate that

\textsuperscript{88} See, e.g., Mountanos v. Comm'r, T.C. Memo. 2013-138, at *6-7 (2013), aff'd 651 F. App'x. 592 (9th Cir. 2016); Losch v. Comm'r, 55 T.C.M. (CCH) 909 (1988); see also infra text and note at notes 111-113.

\textsuperscript{89} Ramsay, supra note 14.

\textsuperscript{90} See Jordan & Longhofer, supra note 10, at 1260.

\textsuperscript{91} See id. at 1261.

\textsuperscript{92} E.g., Stanley Works v. Comm'r, 87 T.C. 389 (1986); Whitehouse Hotel Ltd. P'ship, 139 T.C. 304.

\textsuperscript{93} Jordan & Longhofer, supra note 10, at 1261-63.
claim with an example that deserves to be quoted at length. It is based on the Bothwell Ranch, a fourteen-acre parcel containing one of the last orange groves remaining in the San Fernando Valley, listed for sale at $13.9 million, even though it was

already zoned to permit residential development, could be divided into 26 half-acre lots; nearby homes advertised as "competitive resales" sold for an average price of $2.8 million. If the advertised comparable homes represented reasonably probable redevelopment of the orange grove, the potential value of Bothwell Ranch could easily exceed $70 million if it were converted into a residential development.

. . . [I]f the owners of the ranch . . . placed a conservation easement on the grove, the HBU of luxury residential development should guarantee them a deduction equal to the sales price of those homes less any associated development costs. 94

There are important shortcomings, both with Jordan & Longhofer's example and with the more general inference they extract from it. The problem with the example itself is its tacit assumption that those "associated development costs" would represent some trivial fraction of the sales price of the homes, leading them to equate the development value foregone, and hence the value of a contributed easement, with the sum of the (presumed) prices of the completed homes, ignoring the time, effort, and expense of turning fourteen acres of orange grove into twenty-six completed houses ready for sale. Equating those two values captures exactly the sort of indifference to the rudiments of DCF analysis that has helped fuel the recent proliferation of inflated highest and best use valuations. 95 On any number of plausible assumptions about those variables (to say nothing of the risks involved), that $70 million highest and best use valuation could easily turn into something with a present value less than one-fifth that amount, less, not more, than the price for which Bothwell Ranch was apparently being offered for sale. 96

94 See id. at 1262 n.26 (emphasis added). Their claim elicited a brief but scathing reply by Ellis, supra note 14, with which we agree, although the matter is not, as Ellis's title might suggest, confined to SCEs.

95 A handful of appraisers appear to be regularly involved in valuing conservation easements, including David Roberts (now deceased), who played a role in many of the decisions surveyed in Part III.B.3, and Claud Clark, III, against whom (among others) the Justice Department brought suit "to prevent him from issuing future appraisals involving syndicated conservation easements." SENATE BIPARTISAN REPORT, supra note 6, at 53; see United States v. Zak, 426 F.Supp.3d 1365 (N.D. Ga 2019). In a proceeding by the Alabama Real Estate Appraisers Board to revoke Clark's license, which he voluntarily surrendered, an expert retained by the Board testified in detail to the sorts of considerations that Clark routinely ignored in producing inflated discounted cash flow-based appraisals, and that Jordan & Longhofer may well have overlooked -- or at least swept under the rug with the trivializing phrase "less any associated development costs" -- in postulating that the development value of Bothwell Ranch might be close to $70 million, evidently about 26 times the average nearby "competitive resale" price of $2.8 million. See SENATE BIPARTISAN REPORT, supra note 6, at 54-56; cf. McLaughlin, Valuation Conundrum, supra note 3, at 238-39.

96 See Jordan & Longhofer, supra note 10, at 1262 n.26. To begin with, even at $13.9 million, the land cost alone for each house would be on the order of $600,000, and that's before adding in costs of development in terms of design, permitting, and provisioning utilities and roads; the cost of labor and materials in construction; the costs of marketing and sale; and time. One way of getting a back-of-the-envelope hand on the aggregate of those costs (other than time) is to assume some net profit-margin to the developer on each house, and to supplement it with assumptions about time to
Numerical details aside, the more important point is just how preposterous it is to assume that the development rights to a parcel of realty could ever legitimately be worth more than the unburdened land. Whenever a piece of property exhibited that characteristic -- the sum of its parts being worth more than the whole -- someone would surely step in and purchase the fee in the land so as to profit by selling the (ex hypothesi more valuable) development rights. Just imagining that state of affairs leads to a recognition that any such discrepancy in value would quickly be bid away, with the underlying land being revalued to not less than the value of the development rights.  

Complete the first of the 26 houses and to complete the sale of the last one. Using what strike us as optimistic assumptions -- that it took two years from acquisition to have the first house ready for sale, that all 26 could be sold by the end of the ensuing two years, that the developer's net profit margin was 25%, and using a discount rate of 10% -- the present value of the profits from developing the houses would be about $13,050,000. Just increasing the number of years to complete and sell all the houses from two to three, or to four, reduces the present value to about $12,450,000 and $11,900,000, respectively. Preserving the assumption of all houses completed and sold by four years after land acquisition but increasing the discount rate to 15% produces a present value of $11,400,000. By comparison with our assumptions, the court in Trout Ranch, in arriving at highest and best use valuations for a subdivision in Gunnison County, Colorado, assumed a profit margin of 15% of gross revenues. Trout Ranch, LLC v. Comm'r, T.C. Memo. 2010-283, at *3 (2010). Since these estimates are linear functions of profit margin, using 15% would reduce each of them by 40%, all to less than $8 million. Calculations are the authors', and are available on request. They assume that net revenues are realized at the end of each year of sales. Increasing the revenue frequency from annually to monthly increases the baseline $13,050,000 estimate to just over $13,580,000. 

Courts confronted with implausible appraised assessments of developmental values have not been indifferent to that reality, especially when there has been a roughly contemporaneous arm’s-length sale. See, in particular, the bench opinion in the Tax Court proceeding in PBBM-Rose Hill, Ltd. v. Comm’r, No. 26096-14, https://dawson.ustaxcourt.gov/case-detail/26096-14 (T.C. Sept. 9, 2016). See also, e.g., Hughes v. Comm’r, T.C. Memo. 2009-94, at *24 (2009) (“After all, the best evidence of fair market value is a recent sale of the property at issue”); Mountanos v. Comm’r, T.C. Memo. 2013-138, at *6-8 (2013), aff’d 651 F. App’x. 592 (9th Cir. 2016).

An alternative, "asymmetric information" story has recently been put forward in support of the claim, at least in the context of facade easements. Jacob Dean & Megan Glosser, Just a Facade? Analyzing Historic Preservation Easement Issues, 174 TAX NOTES FEDERAL 1083 (2022). Dean & Glosser's case for the plausibility of disparities between a recent purchase price and fair market value rests on two moves. The first is a strained gloss on Olson v. United States, 292 U.S. 246 (1934), which they take as standing for the general proposition that "cost" bears no necessary relationship to "fair market value." They observe (at 1085, footnote omitted, emphasis added) that the Court in Olson importantly, decoupled the FMV of the property from the owner's purchase price. The Court stated that the FMV "may be more or less than the owner's investment. He may have acquired the property for less than its worth, or he may have paid a speculative and exorbitant price. Its value may have changed substantially while held by him." To this (at 1088) they later add that “[i]t is generally easier . . . to understand . . . a disparity between purchase price and FMV when a substantial period of time elapses . . . . But that is not required, as the Supreme Court noted in Olson and the previous examples illustrate."

The problem is that Olson (see supra note 77) involved condemnation of shoreland bordering Lake of the Clouds that appeared to have been of long-standing tenure, and nothing in the opinion countenances a generalized "decoupling" of cost from market value, even where there has been a recent arm's-length exchange. Indeed, in a passage that could easily describe conservation easements, in that there were no market transactions in the "flowage easements" at issue in Olson, the Court invokes value as the outcome of "fair negotiations between an owner willing to sell and a purchaser desiring to buy," adding that "there should be taken into account all considerations that fairly might be brought forward and reasonably be given substantial weight in such bargaining." 292 U.S. at 257. The implicit
A number of courts have nevertheless been recently confronted with charitable contributions based on inflated DCF-based valuations that were at odds with prices observed in contemporaneous arm's-length sales. Most of them have sensibly pushed back. One of the first to do so with real clarity, however, did not involve a conservation easement, but an even more brazen episode involving a contributed remainder interest in developed property subject to a long-term lease. The taxpayer in *RERI Holdings,*98 an LLC owned by (among others) the owner of the Miami Dolphins, Stephen Ross, had purchased a remainder interest in a 288,000 square foot building that was rented to a web hosting facility under a long-term lease and had recently been sold for $42 million. The remainder interest, deferred for some twenty years, was acquired for about $3 million by Ross's LLC, RERI Holdings. About eighteen months later, RERI contributed the remainder to the University of Michigan, of which Ross was a major benefactor, and claimed a $33 million charitable deduction based on an aggressive DCF valuation of the residual rentals following expiration of the lease. As required by the terms of the contribution, U of M held the remainder for a little over two years99 and then resold it for under $2 million.100

The description above is a barebones abstraction, but it is faithful to the financial outlines of the case. The entire proceeding produced two lengthy preliminary opinions denying motions for assumption, as in Treas. Reg. § 1.170A-1(c)(2), is of symmetric information. Dean & Glosser's next move involves the example to which they principally refer, Example 7 of Treas. Reg. § 1.170A-14(h)(4): that example assumes a highest and best use value of an otherwise developable 200-acre estate (containing an historic house) that is $175,000 more than its value as foreclosed from development by an easement. Dean & Glosser observe (at 1086) that "any mention of purchase price or [the owner's] basis" is "[c]onspicuously absent from this example." But what is just as conspicuously missing is any reference to when the owner acquired the estate; the example does not speak one way or another to the possible relevance of a recent arm's-length sale.

The real estate firm by which Dean & Glosser are employed, which appears to specialize in historic rehabilitation, recently filed suit to invalidate Notice 2017-10, which includes a ratio of deductions to investment greater than 2.5-1 among its criteria for classifying an easement contribution as a listed transaction. See *GBX Associates LLC v. United States,* No. 1:2022cv00401 (N.D. Ohio filed Mar. 11, 2022).


99 The holding period presumably was imposed to avoid the under two-year reporting obligation then required by I.R.C. § 6050L, which was extended to three years by the Pension Protection Act of 2006.

100 As if that weren't enough, Mr. Ross's first act had an equally notable encore: in denying RERI's initial motion for summary judgment, the court laconically noted (T.C. Memo. 2014-99, at*8) that on December 3, 2005, after the expiration of the required two-year holding period, the University sold the SMI for $1,940,000 to HRK Real Estate Holdings, LLC (HRK), a Delaware LLC indirectly owned by petitioner and an associate. HRK had pre-sold the SMI to a third-party individual for $3 million on or about December 20, 2005. On December 26, 2005, that third party donated the SMI to another charitable organization and claimed a charitable contribution deduction of $29,930,000 in connection therewith, . . . .
partial summary judgment, followed by a four-day trial, much of it devoted to valuation, and culminated in a forty-five-page opinion on the merits. After sifting through the sea of technical detail in which this was all submerged, the Tax Court disallowed the deduction in its entirety and sustained the imposition of gross overvaluation penalties. At the end of all this the Court found the value of the remainder to be worth about $3.463 million when contributed, about 17% more than RERI had paid for it eighteen months before.\(^\text{101}\) Both the disallowance of the deduction and the imposition of penalties were sustained on appeal.

The case was resolved on grounds that are of immediate relevance to decisions involving conservation easements. Having purchased the remainder for about $3 million and claiming a deduction of $33 million, RERI elected not to report its basis in the contributed interest, as required by Treasury Regulations § 1.170A-13(c)(4)(i) and reflected on Form 8283. That omission caused the deduction to be disallowed. Since that same deficiency has shown up in a number of recent conservation easement cases, and speaks directly to both the sort of valuation argument advanced by Jordan & Longhofer and the valuations claimed in such cases, the D.C. Circuit's opinion in \textit{Blau}, upholding the Tax Court's decision, merits quoting at length:

RERI first argues that the taxpayer's basis in a donated property is not necessary to evaluate the taxpayer's charitable contribution because the deductible amount is the fair market value (FMV) of the property, and the basis is not an input in calculating the fair market value. But RERI fails to recognize that the purpose of the substantiation requirements is not merely to collect the information necessary to compute the value of donated property. The requirements have the broader purposes of assisting the IRS in detecting and deterring inflated valuations. \textit{Because the cost or other basis in property typically corresponds with its FMV at the time the taxpayer acquired it, an unusually large difference between the claimed deduction and the basis alerts the IRS to a potential over-valuation, particularly if the acquisition date, which must also be reported, is not much earlier than the date of the donation.} . . . Though the Congress left it to the discretion of the Secretary of the Treasury to impose additional reporting requirements, the Congress specifically identified the basis and the date of acquisition as the bare minimum that a taxpayer must provide. We should be very reluctant to set to naught what the Congress deemed essential.\(^\text{102}\)

\(^{101}\) Much of the opinion was devoted to an analysis of extensive testimony by four experts bearing on valuation, all of it involving discounted cash flow analyses of the same general sort used to support easement valuations based on the underlying property's pre-contribution highest and best use. \textit{E.g.}, 149 T.C. at 7-13. The value found by the court on the date of contribution, discounted at an annual rate of 12%, was equivalent in present value to what RERI had paid for the interest 18 months earlier.

The **RERI** litigation underscores the importance in general of the DEFRA-mandated disclosure by donors of both acquisition date and cost of contributed property, as well as the potential fatality of failing to disclose that information. More importantly, the Court of Appeals language in *Blau*, and the Tax Court's factual findings on valuation in *RERI*, both lean heavily against the claim that the market value of subsidiary interests in realty can somehow exceed (much less substantially) the price at which the realty itself recently changed hands, which is precisely what highest and best use valuation has repeatedly been deployed to maintain.  

It is a conclusion that applies with equal force to syndicated and non-syndicated easements alike.

### 3. Conservation Easement Decisions

The growing body of conservation easement decisions has been canvassed both extensively and intensively by others.  

The reported decisions reflect the prevalence of aggressive valuation that extends beyond the mass-marketed SCEs, detailed in the Senate Bipartisan Report, that have occupied so much recent attention. Professor McLaughlin's 2016 study, buttressed by *Oakbrook Land Holdings*, suffices to establish that. But there have been more reported decisions than just *OLH* since 2016. We sample them briefly here, primarily to highlight the shortcomings of solutions that have been proposed to date. One implication is that litigating value case by case will not in any remotely efficient way weed out the "wildly inflated" deductions that are widely associated with SCEs from the (presumptively) legitimate everything else; everything else has its own share of overvalued conservation easements, and attempting to deal with the problem by litigating value in each of them will be unreasonably resource intensive.  

Another is that even the world of SCEs is more complex than the conservation easement flips depicted in the Senate Bipartisan Report. Addressing overvaluation with a strategy that focuses narrowly on those consisting of just a piece of real estate and an appraisal lodged inside a pass-through entity, or that limits deductions to some arbitrarily fixed multiple of the investments in such an entity, will leave a great number of overvalued easements untouched.

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103 Although *RERI* did not involve an easement, the taxpayer's appraiser sought to justify the claimed $33 million valuation with the same sort of discounted cash flow analysis used to produce inflated, highest and best use valuations of conservation easements, and in Jordan & Longhofer's effort to justify valuing Bothwell Ranch using the $70 million aggregate sales prices of the hypothetical 26-house development. See *supra* text and notes at notes 93-94. Compare *RERI Holdings I*, 149 T.C. 1, with Jordan & Longhofer, *supra* note 10.

104 See, e.g., *BLM*, *supra* note 19; McLaughlin, *Conservation Proceeds*, *supra* note 18; McLaughlin, *Tax-Deductible Conservation Easements and the Essential Perpetuity Requirements*, *supra* note 18; McLaughlin, *Valuation Conundrum*, *supra* note 3; Starkman, *supra* note 3.

105 McLaughlin, *Valuation Conundrum*, *supra* note 3.

a. Non-Syndicated Easements

To Oakbrook Land Holdings, in the gallery of non-syndicated easements involving serious overvaluation, we would add *PBBM-Rose Hill, Ltd. v. Commissioner*. It differs from OLH in involving an easement contributed by a long-standing landowner, but is similar in that it also involved a nearly contemporaneous arm's-length sale of the land. PBBM had since 1996 operated a golf course about ten miles inland from Hilton Head, South Carolina, on 241 acres purchased for $2.44 million and conveyed by a deed that restricted its use to recreation or as open space for thirty years. Unable to operate at a profit, PBBM entered voluntary bankruptcy in 2006, and petitioned the court to lift the use restriction. It was opposed by (among others) a local property owners association; but the POA agreed to waive its opposition, while PBBM agreed in return to permit the POA to invoke the restriction to challenge any later development, and gave the POA an option to purchase the land itself. The POA exercised its option in August 2007. Shortly thereafter the bankruptcy court approved a sale for $2.3 million, and in early December entered judgment invalidating the use restriction as to the other adverse parties. In early January 2008 PBBM concluded the sale. Not, however, before having contributed an easement over all but seven of the 241 acres, just relieved of the pre-existing restriction, for which it claimed a "charitable" deduction of over $15 million in 2007.

The government argued that the deduction should be disallowed in its entirety, because the easement (1) did not serve a conservation purpose, and (2) failed to protect "in perpetuity" whatever conservation purpose it might serve; it also argued (3) that, in light of the pre-existing use restriction, the reduction in value from the contributed restriction was only $100,000. The Tax Court ruled for the government on all three. The Court of Appeals reversed as to the first. On the second, however, in one of the first Court of Appeals decisions to construe the proportionate share requirement in the "extinguishment" provision of Treasury Regulations § 1.170A-14(g)(6)(ii), it

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107 *PBBM-Rose Hill, Ltd. v. Comm'r*, 900 F.3d 193 (5th Cir. 2018). See also *Mountanos v. Comm'r*, 105 T.C.M. (CCH) 1818 (2013), aff'd 651 F. App'x 592 (9th Cir. 2016), discussed by Professor McLaughlin in *Valuation Conundrum*, supra note 3, at 271-72, and subsequently affirmed by the 9th Circuit. As described in note 81, supra, that decision disallowed the deduction for an easement, contributed by the long-standing owner of a ranch, claimed to be worth four times the value implied by the price for which the land eventually sold a dozen years later.

108 In *PBBM-Rose Hill* the sale was negotiated before contribution of the easement but did not close until shortly after contribution and the start of the following year. See supra Part III.B.2 and infra Part IV.B, which discuss the shortcomings of Jordan and Longhofer's proposal and of recent legislative proposals, respectively.

ruled in favor of the government.\textsuperscript{110} It also upheld the Tax Court on the valuation of the easement and sustained the imposition of penalties for gross overvaluation.

The easement in \textit{PBBM-Rose Hill} was contributed by a taxpayer that had held the land for years. And though the taxpayer was a partnership, it had carried on an active (though unsuccessful) business on the land, and could not reasonably have been disregarded as a "sham." There is also no suggestion that the easement was marketed to outside investors; if that happened it would only have occurred after the fact.\textsuperscript{111} The Tax Court found PBBM's sale to the POA for $2.3 million, even

\begin{quote}
\textsuperscript{110} Treas. Reg. § 1.170A-14(g)(6)(i) allows for the judicial extinguishment of a conservation easement in the unanticipated event that its conservation purposes can no longer be fulfilled, if by the terms of the easement the "donee's proceeds" from the sale of the land freed of the easement must be used by the donee in furtherance of the original conservation purposes. Treas. Reg. § 1.170A-14(g)(6)(ii) provides:

\begin{quote}
Proceeds. . . . 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.
\end{quote}

There has been extensive litigation over whether that language prescribes the donee's share as (1) an \textit{amount}, or (2) a \textit{fractional share} of the value of the property, in either event fixed at the time of contribution. There has also been litigation over whether the donee's share satisfies the regulation if it may be reduced by the value of subsequent donor improvements, claims (including mortgages liens) against the property, or costs of sale.

After extended consideration the court in \textit{PBBM-Rose Hill} concluded that, despite ambiguity introduced by the regulation's use of the term "proportionate value," it should be interpreted to require that the donee receive a fractional share of the proceeds of a subsequent sale. It then agreed that, since the easement in that case permitted the donee's share to be reduced by both expenses of sale and the value of subsequent donor added improvements, it did not satisfy the regulation. It did so, moreover, despite the existence of an earlier private letter ruling that permitted a deduction where the document conveying the easement contained similar language. 900 F.3d at 207-08; I.R.S. Priv. Ltr. Rul. 200836014 (Sept. 5, 2008). For earlier cases on other ways in which an easement may run afoul of the proceeds regulation, such as reduction by 3rd-party debt, and using value allowed as a deduction rather than as originally claimed, see, e.g., \textit{Kaufman v. Shulman}, 687 F. 3d 21 (1st Cir. 2012); \textit{Carroll v. Comm'r}, 146 T.C. 196 (2016).

The appellants in \textit{PBBM-Rose Hill} petitioned for rehearing, arguing that the opinion "frustrate[d] the legitimate reliance interests of 'countless taxpayers, land trusts, and conservation agencies.'" \textit{See Coal Prop. Holdings, LLC v. Comm'r}, 153 T.C. 126, 140 n.4 (2019) (noting that land trust organizations had filed amicus briefs in a number of cases, and evidently manifested an intense interest in securing a more liberal interpretation of the proceeds clause). The intensity of their interest seems notable, given that one would not have expected that clause to come into play with great frequency. Under Treas. Reg. § 1.170A-14(g)(6)(i) it is triggered only by a "subsequent unexpected change" in prevailing conditions that "make impossible or impractical the continued use of the property for conservation purposes." The taxpayers' petition for rehearing en banc was denied without dissent.

In \textit{Hewitt v. Commissioner}, 21 F.4th 1336 (2021), the Eleventh Circuit upheld a challenge to the proceeds regulation on the ground that, in not responding specifically to a handful of comments on that aspect of the regulations proposed in 1983 and finalized in 1986, it had not satisfied the requirements of the Administrative Procedure Act. Its opinion echoed much of the reasoning of Judge Holmes' dissent in \textit{Oakbrook Land Holdings, LLC v. Commissioner}, 154 T.C. 180, 230-59 (2020). On appeal of \textit{Oakbrook Land Holdings} itself, the 6th Circuit addressed directly and disagreed with the 11th Circuit's opinion in \textit{Hewitt}, and sustained the proceeds regulation. See \textit{supra} note 34.

\textsuperscript{111} Given the concentration of conservation easement activity in the states of Georgia, Tennessee, and South Carolina (see \textit{infra} note 118), it is possible that \textit{PBBM-Rose Hill} had that possibility in mind, though it is also possible that the owners had sufficient income to make use of the easements themselves, as has occurred in some reported cases.
though it closed after contribution of the easement, to be persuasive evidence of its true fair market value. PBBM introduced evidence in an effort to show that development of the land was feasible; the court was unpersuaded, observing in a bench opinion that "if PBBM had thought the property was worth $15,680,000 because of its development potential, it would not have sold the property to the subsidiary of the POA for only $2,300,000."112 It concluded, in short, that development was unlikely, and that the price paid by the POA reflected the actual highest and best use of the land. Given that sale, PBBM-Rose Hill thus involved a deduction for a non-syndicated easement overvalued by over $15 million, or nearly seven times the value of the underlying land.113

Decisions like PBBM-Rose Hill and Oakbrook Land Holdings are not isolated; much early litigation over conservation easements involved individualized, not syndicated, contributions.114 But a number of more recent opinions have been occasioned by easement contributions involving syndication, and it is to them that we now turn. We emphasize, however, that none of them consist of the transparently fraudulent, mass-marketed SCEs that have recently led to criminal indictments and guilty pleas, nor even of the sort involving entities carrying on no real business activity other than contributing an easement, and which might for that reason be challenged as a sham.

b. SCEs, in Brief

To highlight that reality, we begin by sketching the sort of retail SCE that at bottom is no more than the window-dressed sale of deductions based on an inflated appraisal, as detailed in the Senate Bipartisan Report. In its most compact form it involves the transfer of undeveloped land, ideally held by the transferor for more than one year, to an entity (usually an LLC) taxed as a partnership, in return for interests in the partnership. Those interests are then marketed to outside investors, followed by the contribution of an easement, with the easement valued to produce deductions equal to some multiple of (typically four to five times) the amounts paid by the investors for

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See infra text and note at note 140.

112 PBBM-Rose Hill, No. 26096-14, at 21-22. Although neither the Tax Court nor the Fifth Circuit seems to have remarked on the issue, it is odd to find a debtor in a bankruptcy proceeding willing to sell for $2.3 million property it claims was worth over $15 million.

113 Given the complete disallowance for non-compliance with the proceeds regulation, it is not meaningful to say by what factor the claimed deduction was overvalued. In light of the $2.3 million sales price to the POA, the government's valuation expert had put the value of the easement at $100,000; the Tax Court imposed no penalty on the tax attributable to the first disallowed $100,000, and an overvaluation penalty with respect to the tax attributable to the excess, presumably $15,060,000. 900 F.3d at 213-15.

114 See, e.g., Mountanos v. Comm'r, 105 T.C.M. (CCH) 1818 (2013), aff'd 651 F. App’x. 592 (9th Cir. 2016); Trout Ranch, LLC v. Comm'r, 100 T.C.M. (CCH) 581 (2010); Hughes v. Comm’r, 97 T.C.M. (CCH) 1488 (2009); see also McLaughlin, Valuation Conundrum, supra note 3, at 307-22 (appendices compiling previous façade easement and conservation easement cases); Starkman, supra note 3, at 1485-88 (table summarizing conservation easement cases from 2013 through 2018).
their interests. Sale of the interests and contribution of the easement are completed more or less simultaneously at the end of the taxable year. Since the partnership acquired the land in a non-recognition transaction, the transferor's basis and holding period are preserved in its hands. Consequently, the easement contribution is characterized as of property held for more than one year, even though the investors acquired their interests in the LLC shortly before the contribution.\textsuperscript{115} In the most transparent versions, the entity carries on no activities other than holding the land and contributing the easement. The window dressing consists of organizational documents that contemplate multiple possibilities for the entity's future "activities," including "development" and "hold for investment" options, as well as a "green option" -- contributing a conservation easement -- to be adopted by a vote of the partners/investors. The green option is invariably chosen.\textsuperscript{116} The marketing materials assembled by the Senate Finance Committee include correspondence that reflects efforts to calibrate prospective investors' year-end purchases to their ability to make use of deductions that year.\textsuperscript{117} These barebones SCEs are about as close as one can get to the outright sale of tax deductions, masquerading as conservation.

c. Reported Decisions Involving Syndicated Easements

Most of the cases litigated to a decision -- including many with interests sold to outside investors -- present a more complicated picture. In some the promoters do not appear initially to have set out to acquire land with conservation easements in mind; in others it is not even obvious at first glance that the conservation easement is to be syndicated. They do, however, have elements in common, including geography\textsuperscript{118} and the recurring appearance of a relatively small revolving cast of characters, including promoters, appraisers, syndicators, and recipient organizations.\textsuperscript{119} The

\textsuperscript{116} SENATE BIPARTISAN REPORT, supra note 6, at 14, 60 ff.
\textsuperscript{117} Id. at 41-43.
\textsuperscript{118} While a number of early easement cases seem to have originated in the west, a healthy fraction of recent opinions involve land concentrated in Georgia, South Carolina, or eastern Tennessee, which (along with parts of Florida and western North Carolina) evidently contain a sizeable reservoir of rural land and have been an especially fertile breeding ground for overvalued conservation easements. One is tempted to think of the region as a sort of "Southeast Triangle," in which Federal income tax liabilities mysteriously disappear. But it can happen anywhere that one can find vacant land for sale at accessible prices and a cooperative appraiser.
\textsuperscript{119} The individuals most often found producing inflated appraisals included (until his death) David R. Roberts. Among other things, Mr. Roberts offered to value the OLH easement at over 15 times the year-earlier purchase price for the underlying land (Oakbrook Land Holdings, LLC v. Comm'r, T.C. Memo. 2020-54, at *8 n.3 (2020)), and produced (among others) most of the appraisals in the HRH cases, described infra (see, e.g., Village at Effingham, LLC v. Comm'r, T.C. Memo. 2020-102, at *4-5 n.3 (2020)). They also include Claud Clark, whose activities are recounted supra at note 95. Common recipients include the Southeast Regional Land Conservancy, the Foothills Land Conservancy, and the Georgia Land Trust. Regular recent promoters include HRH Investments (see infra note 123); Nancy Zak (see infra text and note at note 133); and Peachtree Investment Solutions (see infra text and note at notes 136-140). See generally SENATE BIPARTISAN REPORT, supra note 6.
following brief survey is selective, not extensive. It is intended primarily to develop factual aspects of some reported decisions that will be of use in identifying shortcomings in solutions to this problem that have previously been proposed.

**Technical Deficiencies in Substantiation (RERI Holdings Redux).** In the category of a land acquisition that started out with other things in mind we would put the saga of HRH Investments ("HRH"). In mid-2007 HRH acquired from a paper producer for about $4.9 million two tracts of land totaling about 1,900 acres in Effingham County, Georgia. 

As recited by the court in one case, the tracts HRH purchased in 2007 abutted several properties that HRH's owners had previously developed. They intended to use the parent tract to expand on those adjacent developments, dividing it into smaller lots for sale to homebuilders. These development plans were abandoned as the 2008-2009 financial crisis engulfed the Nation, with particular severity on the housing market in the Southeastern states.

That story is not implausible. The facts in a number of recent decisions reflect developers not so much setting out from the start to burden land with conservation easements as turning down that path in the wake of the 2008 real estate collapse. In any event, by 2008 HRH had turned to conservation easements in an effort to recoup its investment.

A more complete picture of what transpired involves some nine Tax Court decisions rendered over two years in eight separate proceedings. Through an affiliated entity, HRH formed at least eight separate LLCs, each taxed as a partnership, and contributed portions of the parent tracts to each, in each case in exchange for an ownership interest. Between 2009 and 2011, more than one (and as much as three) years later, each LLC contributed to the Georgia Land Trust ("GLT") a

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120 *Oakhill Woods, LLC v. Comm'r*, 119 T.C.M. (CCH) 1144 (2020). The opinions in several related cases only mention a single tract, consisting of 1,490 acres priced (in round numbers) at $3,880,000 (about $2,600/acre). *Oakhill Woods* identifies a second tract purchased the same day, consisting of 405 acres priced at $1,010,000 (about $2,500/acre). Together, HRH purchased 1,900 acres for about $4,900,000.


122 Effingham County lies just northwest of and adjacent to Savannah, and is included in the Savannah MSA, the third largest (after Atlanta and Augusta) in Georgia. From 2000-2007 the County's population had grown by 35%; in 2007 it might well have looked attractive for development.

123 See *Englewood Place, LLC v. Comm'r*, T.C. Memo. 2020-105, at *3 n.2 (2020). They included, besides *Oakhill Woods, Belair Woods I*, and *Englewood Place, supra*, *Cottonwood Place, LLC v. Comm'r*, 120 T.C.M. (CCH) 91 (2020) (August 4); *Maple Landing, LLC v. Comm'r*, 120 T.C.M. (CCH) 23 (2020) (July 9); *Red Oak Estates, LLC v. Comm'r*, T.C.M. (RIA) 2020-116 (2020) (August 4); *Riverside Place, LLC v. Comm'r*, 120 T.C.M. (CCH) 19 (2020) (July 9); and *Village at Effingham, LLC v. Comm'r*, 120 T.C.M. (CCH) 15 (2020) (July 9). See also *Belair Woods, LLC v. Comm'r*, 120 T.C.M. (CCH) 73 (2020) (July 22). The reported opinions, details of which are summarized in the Appendix, add up to only 1550 acres and average 194 acres. Since 1900 acres total were acquired by HRH, more HRH-related LLCs are probably still out there. See also infra text at notes 126, 135, and 177.
conservation easement covering all but four to ten acres of the land transferred to it by HRH.\textsuperscript{124} While the transferee LLCs received parcels of differing size, on average they were about 200 acres, with a donated easement covering about 190, each having an average allocated share of HRH's original 2007 purchase price of about $500,000. The claimed deductions on account of the contributed easements, all evidently appraised for that purpose by David R. Roberts,\textsuperscript{125} averaged a bit over $5.3 million. In total they added up to about $42.3 million, attributable to land purchased between one and three years earlier for under $4 million.\textsuperscript{126}

The first of the HRH contributions to produce a reported opinion, based on a 2009 return, was \textit{Belair Woods I}. On December 18, 2008, HRH contributed 145 acres to Belair; just over a year later, on December 30, 2009, Belair granted to GLT a conservation easement over 141 acres, reserving the unencumbered four as two "home sites" for possible future residential development. Belair claimed a charitable contribution deduction of $4,778,000, a valuation, the Tax Court noted, that "presupposed that the 141.15 acres had increased in value by 1,380\% during the worst real estate crisis since the Great Depression."\textsuperscript{127}

The case arose on an IRS motion for partial summary judgment that the contribution be entirely disallowed for Belair's failure properly to substantiate it. Belair's documentation on Form 8283 (mis)described its interest in the underlying land as having been "acquired on August 1, 2007, by 'purchase/exchange.'" Like RERI Holdings, Belair did not report its adjusted basis in the land. In contrast with RERI, however, it provided an explanatory attachment, reciting that

\begin{quote}
  the taxpayer's basis in the property is not included in * * * the attached Form 8283 because of the fact that the basis of the property is not taken into consideration in
\end{quote}

\textsuperscript{124} The easements typically recited that they were being granted to preserve "significant natural, scenic, aesthetic, watershed, agricultural, forest, open space and plant habitat"; prohibited any "residential, commercial, and industrial use of the conserved land," including "any improvements, . . . mining, . . . [and] dumping garbage." They did, however, typically exclude two sites, aggregating fewer than 10 acres, "designated for residential development, . . . [t]he boundaries of [which were] set forth in the Easement." They also reserved rights to engage in "forest management, . . . agricultural, . . . [and] recreational activities," as well as the right to construct driveways and install utility services to the reserved homesites. \textit{E.g., Belair Woods I, T.C. Memo. 2018-159, at *4-5.}

\textsuperscript{125} See \textit{supra} note 118. The Senate Committee on Finance highlights Roberts's involvement with several conservation easement appraisals. See generally \textit{SENATE BIPARTISAN REPORT, supra} note 6. The opinions in two HRH cases, \textit{Cottonwood Place and Red Oak Estates}, were not explicit about Roberts's involvement.

\textsuperscript{126} At an average cost of $4,900,000/1,900 = $2,580/acre, the 1,520 acres covered by the contributed easements represented 1,520/1,900 = 80\% of HRH's acreage, having a ratably allocated $3,920,000 share of HRH's land cost.

\textsuperscript{127} \textit{Belair Woods I, T.C. Memo. 2018-159, at *18; see also, e.g., Englewood Place, T.C. Memo. 2020-105, at *4-5 n.3.} The markup from HRH's allocated cost to the LLC's claimed deduction occurred in two stages, initially when HRH sold interests in the LLCs to outside investors, and then further when the claimed deduction for each LLC's contribution was marked up over its investors' aggregate costs. \textit{See infra} text and notes at notes 133-135 and 173-177.
computing the amount of the deduction. . . . and the property further qualified as "capital gain property."\textsuperscript{128}

Guided by the full Tax Court's holding in \textit{RERI Holdings I}, the court ruled that Belair had neither strictly nor substantially complied with the reporting requirements of Form 8283 and the associated regulations. In language that echoed the Tax Court's opinion in \textit{RERI Holdings I},\textsuperscript{129} and prefigured that of the D.C. Circuit's affirmance in \textit{Blau}, the court observed that strict compliance with the mandated disclosure of cost or adjusted basis was needed to facilitate the Commissioner's efficient identification of overvalued property. The cost of property typically corresponds to its FMV at the time the taxpayer acquired it. . . . ("Actual sales are generally the best evidence of fair market value[]."). When a taxpayer claims a charitable contribution deduction for recently purchased property, a wide gap between cost basis and claimed value raises a red flag suggesting that the return merits examination. Unless the taxpayer complies with the regulatory requirement that he disclose his cost basis and the date and manner of acquiring the property, the Commissioner will be deprived of an essential tool that Congress intended him to have.\textsuperscript{130}

The court declined, however, to grant summary judgment, ruling that Belair's claim that it had relied on professional advice, and so had "reasonable cause" under § 170(f)(11)(A)(ii)(II) for not meeting the substantiation requirements, raised issues of fact to be resolved.\textsuperscript{131}

The next decision, handed down in early 2020, was \textit{Oakhill Woods}. In a cross-motion for summary judgment filed shortly after the 2018 opinion in \textit{Belair I}, Oakhill argued that, in requiring disclosure of adjusted basis, both the regulations and Form 8283 were invalid. That, too, was unsuccessful, with the court again disallowing the deduction, but again leaving open the possibility of establishing reasonable cause for the failure of substantiation. A sequence of decisions following \textit{Oakhill Woods} sustained in relatively quick succession the complete disallowance of the deductions in all seven remaining HRH cases (including \textit{Belair Woods}) in which the taxpayers generally abandoned the reasonable cause defense. Aside from the basis omission, the government succeeded with a parallel but independent ground for disallowance: the courts ruled that the "proceeds" clause in the easement conveyances provided for the donee's share to be reduced both by subsequent donor

\textsuperscript{128} \textit{Belair Woods I}, T.C. Memo. 2018-159, at *7-8.

\textsuperscript{129} \textit{RERI Holdings I, LLC v. Comm'r}, 149 T.C. 1, 14 (2017) ("Congress intended the new substantiation requirements to alert the Commissioner to potential overvaluations of contributed property and thus deter taxpayers from claiming excessive deductions."). \textit{aff'd sub nom. Blau v. Comm'r}, 924 F.3d 1261 (D.C. Cir 2019).

\textsuperscript{130} \textit{Belair Woods I}, T.C. Memo. 2018-159, at *17 (citations omitted).

\textsuperscript{131} \textit{Id.} at *24.
improvements and claims against the property, in violation of Treasury Regulations § 1.170A-14(g)(6)(ii), as construed in *PBBM-Rose Hill* and intervening Tax Court decisions.\(^{132}\)

Left unexplained in all nine Tax Court opinions is how the interests in these LLCs were utilized, to whom they were ultimately sold, and whether they were in fact syndicated. Serendipitously, the answer to those questions shows up in the opinion on a motion to dismiss in a separate proceeding by the government against (among others) one Nancy Zak, for (among other things) promoting abusive SCE shelters in violation of I.R.C. § 6700.\(^{133}\) While it was alleged that since 2009 Ms. Zak had participated in promoting upwards of forty such shelters, only three were described with specificity in either the complaint or the opinion on the motion. And while the details of the allegations did not identify the non-defendant participants in the schemes that were described, one -- denoted in both the complaint and the opinion as "Partnership Z" -- was described with sufficient numerical particularity so that with confidence we can identify it with one of the HRH-promoted LLCs, that in *Cottonwood Place v. Commissioner*.\(^{134}\) And from that we can tell, at least according to the government's allegations, that shortly before its easement was contributed on December 31, 2009, the ownership interests in the Cottonwood LLC were sold to fifteen investors via a private offering.\(^{135}\) So it is reasonable to infer that the other HRH-sponsored LLCs were similarly marketed, and that they in fact were syndicated conservation easements.

\(^{132}\) See supra text and note at note 110; see also *Coal Prop. Holdings, LLC v. Comm'r*, 153 T.C. 126 (2019). Reflecting identical documentation of the easements there is a marked similarly to the opinions, most written by Judge Lauber. The final two, *Red Oak Estates* and *Cottonwood Place*, were decided solely on the failure to satisfy the proceeds regulation.


\(^{134}\) Compare id. at 1371 (describing "partnership Z") with *Cottonwood Place, LLC v. Comm'r*, T.C. Memo. 2010-115 at *3-4 (2020). Partnership Z's easement covered "approximately" 135 out of 140 acres it held; it claimed a deduction of $4,592,000; those are identical to *Cottonwood Place*, except that the latter contribution was described more specifically as of 135.56 out of 140.56 acres. The government's complaint alleges a total of 13 such LLCs, of which we have reported decisions in only 8. See Complaint at 22-23, *United States v. Zak*, 426 F. Supp. 3d 1365 (N.D. Ga. 2019) (No. 1:18-cv-05774-AT); supra note 123.

\(^{135}\) Complaint at 24-27, *United States v. Zak*, 426 F. Supp. 3d 1365 (N.D. Ga. 2019) (No. 1:18-cv-05774-AT). 99 units were sold on December 29, 2009, to 15 investors for a total of $853,380, plus an "operating reserve capital contribution" of $99,900, a total of $953,370. The easement was contributed on December 31. So the investors' contributions exceeded -- i.e., HRH marked them up -- by a factor of over 2.7 the $348,300 allocable cost to HRH of the land contributed to *Cottonwood Place* (a calculation that ignores the costs of organizing the LLC, obtaining the appraisal, documenting the easement, and marketing the interests to prospective investors). This appears to have been among the earliest of the HRH LLCs, and Zak herself is alleged to have invested (¶ 72). Also of note is that the deficiencies in the appraisal alleged in ¶ 76 of the complaint are strikingly similar to the outside expert's assessment of the shortcomings in Claud Clark's appraisals made in the Alabama proceeding to revoke his appraiser's license, as recounted in the *SENATE BIPARTISAN REPORT*, supra note 6, at 54-56; see also supra note 95.
We are not here to defend either HRH investments or Nancy Zak. The Cottonwood appraisal (as well as all the other HRH appraisals) was culpably inflated: it was about thirteen times an allocable share of what the parent tracts had cost HRH two and one-half years earlier, and over five times what the Cottonwood investors paid for their interests. What we do question -- and all we really question -- is whether, as described in the Tax Court opinions and in the government's complaint in *United States v. Zak*, the partnerships/LLCs in question could successfully be challenged as shams. There was more to Cottonwood Place than just a parcel of undeveloped land, owned by an LLC whose partners could simply choose among developing, holding, and contributing an easement; each of them also owned land that was unburdened by the restrictions, and could at some point (at least in principle) either be sold (with or without the burdened land) or residentially developed. The only thing they were unambiguously guilty of was gross overvaluation of the easements; without the tax benefits from that inflated appraisal they were a bad deal, at least at the prices the investors had agreed to pay, but that aside there was nothing obviously objectionable about them. The Service was on entirely solid -- and successful -- ground in challenging them in the fashion that it did. Indeed, putting aside the reliance on professional advice defense (evidently abandoned following *Oakhill Woods*), after *RERI Holdings* they were low-hanging fruit; the IRS obtained decisions disallowing the deductions through summary judgment. It is difficult to imagine that the IRS would have been well advised, or secured victories more readily, either by challenging the LLCs as "shams," or proceeding directly to challenge the valuations.

*Professionally Syndicated Easements.* A second set of recent decisions all involve the donation of an easement with respect to land contributed to an LLC that was then acquired by one of a series of investment funds, each put together by an Atlanta firm -- Peachtree Investment Solutions -- that specialized in organizing and syndicating interests in those funds. Each such case involved the transfer of just under a 99% interest in the LLC, at what was effectively an arm's-length price; thereafter an easement valued at a substantial multiple of that price was contributed to a regional land conservancy. All were successfully challenged by the government, several on multiple grounds, but in each case the deduction was actually disallowed for its failure to satisfy the regulations' proceeds requirement, as construed in *PBBM-Rose Hill*. The lead case was *Coal Property Holdings*,¹³⁶ in which the government advanced multiple grounds for disallowance, including defects in documentation, valuation (the government claimed $0), and the failure of the proceeds provision (which again allowed the donee's proceeds to be reduced by subsequent donor improvements and claims against the land) to satisfy the regulations’ perpetuity requirement. The Tax Court ruled for the government on the latter ground. As the easements in almost all the other cases were implemented

with transfer documents like those in *Coal Property Holdings*, adverse rulings in those cases followed as a matter of course.\textsuperscript{137}

All these contributions were clearly intended to be syndicated: some 99\% of each LLC was acquired by one of Peachtree's "investment funds"; most involved appraisals by Mr. Roberts; and the participants (including the syndicator) have recently been named in a class action brought on behalf of investors in several of the funds.\textsuperscript{138} We assume that, as syndicated easements, they are among the transactions that Jordan & Longhofer deem worthy of being challenged, and view as more properly and productively to be challenged as shams.

We delve into them for two reasons. One is that, as matters turned out, in at least two instances the fund that acquired the LLC was not marketed to a collection of public investors but sold to just one investor.\textsuperscript{139} By itself that might not foreclose a ruling that, as actually structured, the LLCs to which the land was transferred were not legitimately partnerships. In one of those cases, however, a little under 4\% of the land, consisting of two contiguous parcels with lake frontage totaling ninety acres and suitable for future development, was not restricted by the easement; as with the LLCs organized by HRH, the possibility of future development of the unburdened land would at least have presented an obstacle to their being disregarded as shams.\textsuperscript{140} That detail aside, where a single major investor (or even a small group of investors) was involved, the LLC could with rudimentary foresight be endowed with sufficient other activity to plan around decisions in which the IRS succeeded in characterizing some of the more barebones SCE partnerships as shams. So, just as with the HRH-sponsored LLCs, it is far from obvious that the IRS would have enjoyed better (or at least easier) success if it had pursued some sort of "sham entity" approach to challenging these contributions than by adopting the litigation strategy that it did. And, not to put too fine a point on it, whether or not the LLCs involved could have successfully been challenged as shams, they did in fact entail abusively elevated valuations, they deserved to be disallowed, and the Service's challenge, on however technical the grounds, was a challenge that deserved to be mounted and to succeed.

\textsuperscript{137} In one case, *Railroad Holdings, LLC v. Comm'r*, 119 T.C.M. (CCH) 1136 (2020), the easement failed to satisfy the proceeds regulation because it allocated to the donee a fixed share, rather than a fixed percentage of the proceeds, as *PBBM-Rose Hill* and *Coal Property Holdings* had construed the regulation to require. *See also TOT Prop. Holdings, LLC v. Comm'r*, No. 5600-17, 2019 WL 11880554 (T.C. Nov. 22, 2019), aff'd 1 F.4th 1354 (11th Cir. 2021); *Plateau Holdings, LLC v. Comm'r*, 119 T.C.M. (CCH) 1619 (2020).

\textsuperscript{138} *Peskin v. Peachtree Inv. Sol.*, No. 1:21-CV-00002 (N.D. Ga.).

\textsuperscript{139} *See Coal Prop. Holdings*, 153 T.C. at 127; *Plateau Holdings*, T.C. Memo. 2020-93, at *2. Each case involved the acquisition by the investor of an approximately 99\% interest in the LLC.

\textsuperscript{140} The unburdened 90-acre tract was donated for use as a youth camp the following year. *See Plateau Holdings*, T.C. Memo. 2020-93, at *8 n.5.
One final point deserves mention. In any number of recent cases the deductions have been challenged and disallowed on technical grounds. Given the regular assessment of overvaluation penalties, however, their complete resolution has required valuing the easement, and that, in turn -- at least in the absence of settlement -- has required a trial. In some instances the trial was brief; in *Plateau Holdings*, the other Peachtree case involving a single outside investor, it took only a day. Others have required longer: the trial in *RERI Holdings*, much of it about valuation, consumed four days; *PBBM-Rose Hill* took six. Given the intrinsically complex nature of before and after valuation, it is a costly way of resolving these disputes, one that has elicited more than its fair share of judicial dissatisfaction.\(^\text{141}\) As private actors adjust future contributions to the requirements dictated by recent decisions, we can reasonably anticipate more, not less, litigation over valuation, certainly in the absence of more fundamental reform.

C. To Sum Up

Valuing conservation easements has proved to be even more daunting than anticipated. It requires multiple appraisals, not merely of a partial interest in transferable real property, but of a contributed, non-marketable, intangible partial interest itself. That, in turn, has facilitated capitalizing on the pre-existing vulnerability of the appreciated property rule in an unprecedented way; with hypothetical, "highest and best use" DCF calculations routinely used to produce inflated "before" valuations, there is no real upper limit on the magnitude of the deductions that might be claimed. The practice has been rationalized by the specious assertion that restrictions on the development of land may by an alchemy-like process somehow be transmuted into something worth more than the land itself. The coalescence of these features has left the deduction for contributions of conservation easements singularly vulnerable to exploitation, and among all charitable contributions of appreciated property uniquely susceptible to abuse.

Despite this they have, thus far at least, escaped serious corrective attention. Congress instead has been persuaded to treat them *more* generously than other gifts of appreciated property. In 2006 it temporarily liberalized for conservation easements the limitations that otherwise apply to contributions of long-term capital gain, allowing them to the extent of 50% (and in some cases 100%) rather than 30% of contributors' adjusted gross incomes.\(^\text{142}\) Those liberalizations were made

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\(^{141}\) See supra note 21.  
permanent in 2016, despite admonitions in the interim that the push to obtain them might be driven more by the susceptibility of § 170(h) to extraordinary valuation abuse than by exceptional donor generosity. They have, if anything, augmented the temptations to overvalue conservation easements.

In that environment, despite its critics and especially given the 2006 liberalizations, the IRS appears to have gone about challenging deductions for conservation easements in a measured, strategically effective way. That is all the more so given the increasingly aggressive valuation during the past fifteen years, corroborated by more recent cases like those surveyed in Part III.B.3. As a result, the criticisms of its conduct recounted in Part I, and the alternatives offered by critics like Jordan & Longhofer and Judge Holmes, seem poorly conceived. The discussion thus far has already dealt in some detail with the former; it should suffice to add that their proposal to combat SCEs by attacking their syndicating vehicles as shams, while conceivably effective against the most transparently fraudulent SCEs recounted in the Senate Bipartisan Report, would face an uphill battle with most of the more recent cases we have surveyed. And given its premise that the problem is confined to SCEs, it expressly does nothing to combat overvaluation of individual easement contributions. It would thus be ineffective at dealing with anything but the most flagrantly abusive SCEs.

Judge Holmes is equally critical of the IRS, but at the other end of the spectrum in terms of a solution. He ruled against the taxpayer in his memorandum opinion in *Oakbrook Land Holdings* (although he did set aside the government's imposition of penalties). The taxpayer's challenge to the validity of the proceeds regulation under which its easement was invalidated was rejected by the IRS.

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143 See, e.g., McLaughlin, *Valuation Conundrum*, supra note 3, at 229; Sims, *Recollections*, supra note 1, at 48 nn. 37-38. Even before those liberalizations were first adopted in 2006, a 2005 survey of possible compliance options by the Joint Committee on Taxation had suggested the need to curtail aggressive valuation. See STAFF OF THE JOINT COMM. ON TAXATION, 109TH CONG., OPTIONS TO IMPROVE TAX COMPLIANCE AND REFORM TAX EXPENDITURES, 282-85 (2005) [hereinafter JCT 2005 COMPLIANCE OPTIONS].

144 SCEs are so self-evidently abusive that, once identified, the government has in some instances succeeded in securing either injunctive relief or guilty pleas in criminal proceedings. See Press Release, Dep't of Justice, Atlanta Tax Professionals Plead Guilty to Promoting Syndicated Conservation Easement Tax Scheme Involving More Than $1.2 Billion in Fraudulent Charitable Deductions (Dec. 21, 2020) (announcing guilty pleas of easement-related criminal fraud by two Atlanta tax professionals); supra note 133. Such remedies do not, however, address the more general problem of overvalued easements.

145 Owing to the fact that one respect in which the grant violated the proceeds regulation (see supra note 110) had been the subject of an earlier favorable private ruling letter, Judge Holmes concluded that in relying on the PLR Horton had acted with "reasonable cause and in good faith" and so absolved him of the negligence penalty the IRS had assessed. *Oakbrook Land Holdings, LLC v. Comm'r*, T.C. Memo. 2020-54, at *39-44 (2020). In doing so he seems to have overlooked the fact that the easement also allocated to the donee organization a fixed amount equal to the value for which a deduction was originally claimed, rather than a fixed fraction of the sale proceeds, a defect in the grant that independently violated the proceeds regulation, and for which the PLR offered no comfort. See supra note 110.
full Tax Court, twelve judges joining the majority and three concurring in the result on varying grounds. Judge Holmes’ was the lone dissent. At the conclusion of a lengthy opinion, he, too, was critical of the technical objections the government has been interposing in challenging conservation easement deductions. To him,

[c]onservation-easement cases might have been more reasonably resolved case-by-case in contests of valuation. The syndicated conservation-easement deals with wildly inflated deductions on land bought at much lower prices would seem perfectly fine fodder for feeding into a valuation grinder. Valuation law is reasonably well known, and valuation cases are exceptionally capable of settlement.

With all due respect we think that gets the matter almost exactly wrong. To say, in effect, that enforcement directed at efforts to exploit § 170(h) should ideally consist of case-by-case litigation of value would consign the government to remaining bogged down in a swamp of litigation; it would continue to reward aggressive valuation, all but ensuring settlements on unjustifiably taxpayer-friendly terms. It runs counter to the 1981 congressional insight that led to the regime of overvaluation penalties in the first place, penalties that have obviously proved insufficient to overcome the high-powered incentives to contributing overvalued conservation easements. It is myopic to believe, as the quotation suggests, that "syndicated conservation-easement deals with wildly inflated deductions" will somehow automatically be weeded out by valuation from everything else. Even the ABA-RPTE section report, while expressing no opinion about whether

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146 Oakbrook Land Holdings, LLC v. Comm’r, 154 T.C. 180 (2020), aff’d, No. 20-2117 (6th Cir. Mar. 14, 2022); see McLaughlin, Conservation Proceeds, supra note 18.

147 While not actually claiming that the challenged easements were free of overvaluation, he insinuates as much when he complains that the Tax Court had come to a point where we are disallowing a great many conservation-easement deductions altogether, not for exaggeration of their value or lack of conservation purpose, but because of very contestable readings of what it means for an easement to be perpetual. . . . Today we uphold a regulation that will invalidate who knows how many other conservation-easement deductions.

Oakbrook Land Holdings, 154 T.C. at 258-59 (Holmes, J., dissenting).

148 Id. at 258 (Holmes, J., dissenting).

149 See supra text and notes at notes 61-64. It calls to mind Commissioner v. Duberstein, 363 U.S. 278 (1960), which cast the lower federal courts adrift in a sea of litigation, exhorting them to resolve essentially every income tax dispute about the ambit of the gift exclusion by ascertaining, “based ultimately on the application of the fact-finding tribunal's experience with the mainsprings of human conduct to the totality of the facts of each case,” id. at 289, whether a particular transfer had been prompted by “detached and disinterested generosity.” Id. at 285.

150 McLaughlin, Valuation Conundrum, supra note 3, at 302-05.

151 It is ironic to find that assessment articulated by the trial judge in a case the facts of which -- a nearly $10 million deduction claimed for contributing an easement on land purchased barely a year earlier for under $1.3 million -- almost paradigmatically falsify that belief. If Roberts’ $9.545 million valuation -- to say nothing of his originally proposed $19.5 million, with which even Mr. Horton and his colleagues “didn’t feel comfortable” -- does not qualify as "wildly inflated" it is hard to know exactly what does. When Judge Holmes goes on to muse about the "who knows how many other conservation-easement deductions" that the Tax Court's decision will be "disallowing . . . altogether" are free.
easement valuation should be of priority concern for the IRS, acknowledges that "neither the Service nor the courts have sufficient resources to effectively police valuation abuses."\textsuperscript{152}

In short, neither suggestion offers a viable solution to the problem of conservation easement valuation abuse. One narrowly tailored to the most transparently objectionable SCEs would leave much overvaluation untouched. Relinquishing technical challenges and litigating only valuation, on the other hand, would be impracticable, and would require resources the IRS does not have. Despite all the criticism, the government's efforts to date have not amounted to some unprovoked war on legitimate easement contributions; nor has the evidence been marshalled that the Tax Court's decisions have deterred carefully documented, reasonably valued easement contributions. The cases the government has challenged, even on technical grounds, have almost invariably involved more than trivial overvaluation.

IV. SOLUTIONS

At this juncture it is more productive to ask "Could the government do better?" at combatting conservation easement abuse. We preface our answer by recalling that in 1984, when Congress decided not to curtail directly the appreciated property rule, the committee reports acknowledged that its substantiation and penalty alternatives might not "prove sufficient to preclude taxpayers from overvaluing charitable donations of property in all circumstances," and admonished the IRS and Treasury "to notify the tax-writing committees if there are any continuing valuation concerns that should be addressed by further legislation."\textsuperscript{153} If anything has ever raised concerns that warranted such action, conservation easements are it. We start by describing and identifying shortcomings in other solutions that have been proposed to date, and then turn to what we think must be done to address the problem effectively.

A. Proposed Administrative Solutions

One approach consists of proposals to tighten the administration of § 170(h) and to enhance transparency with respect to conservation easement contributions. They consist principally of a menu of recommendations in 2016 by the Obama administration,\textsuperscript{154} criticisms of and alternatives to

\textsuperscript{152} ABA-RPTE Report, supra note 12, at 331-32.
\textsuperscript{153} 1984 ACT BLUEBOOK at 504-05, supra note 63; see supra text and notes at notes 64-68.
\textsuperscript{154} See DEP'T OF THE TREASURY, GENERAL EXPLANATION OF THE ADMINISTRATION'S FISCAL YEAR 2017 REVENUE PROPOSALS 213-17 (2016) [hereinafter 2017 REVENUE PROPOSALS]. Ten years earlier a series of compliance recommendations surveyed by the Joint Committee on Taxation had included a series of administrative reforms, including a proposal to reduce deductions claimed with respect to conservation (but not facade) easements by a factor...
which were developed by Professor McLaughlin in 2016 and further considered in the 2018 ABA-RPTE Task Force Report.

The Obama administration proposed, among other things, stiffening the requirements governing both the contribution and receipt of conservation easements. It would have tightened the criteria for an organization to be eligible to receive deductible easement contributions. It would also have required donors to describe in detail the conservation purposes of and the public benefits from each contribution, and would have required recipient organizations to attest to the accuracy of the stated purposes and benefits, and to the fair market value reported to the IRS. It also proposed requiring public disclosure by recipients (in redacted form) of much of the same information currently required to be reported by donors on Form 8283.

In her 2016 article on valuation, Professor McLaughlin likewise proposed administrative reforms, including extending to six years the statute of limitations on auditing conservation easements, and requiring donor reporting in enhanced and somewhat more standardized detail on Form 8283. She also proposed increased penalties for overvaluation, in particular those imposed on appraisers.

At the same time she was dismissive of the Obama administration's proposal to require detailed easement disclosure by recipient organizations, and recipient involvement in attesting to conservation purposes, public benefits, and the value of easement contributions, asserting that such

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155 McLaughlin, Valuation Conundrum, supra note 3, at 292-306; see also BLM, supra note 19, at 7-11.
156 ABA-RPTE Report, supra note 12, at 331-43.
157 It proposed narrowing the statutory definition of "conservation purposes," included a pilot project of officially allocated conservation easement tax credits, and would have categorically denied deductions for open space easements on golf courses. 2017 REVENUE PROPOSALS at 215-16.
158 The current regulations, Treas. Reg. § 1.170A-16, prescribing what must be disclosed by donors of property in Part II.B of Form 8283, include the appraised value of the contribution, the date and manner of acquisition, and the donor's adjusted basis. Part II of Schedule D to Form 990 requires some disclosure by recipients of information pertaining to easements received, but the requirements are not detailed and apply only in the aggregate.

The Obama administration, in contrast, proposed "public disclosure by donee organizations . . . sufficient for transparency and accountability including: detailed descriptions of the subject property and the restrictions imposed on the property, the conservation purposes served by the easement, and any rights retained by the donor or related persons; the fair market value of both the easement and the full fee interest in the property at the time of the contribution; and a description of any easement modifications or actions taken to enforce the easement that were taken during the taxable year." 2017 REVENUE PROPOSALS at 215-216. The disclosures contemplated by that passage, which by its terms applied only to donees, is more stringent than what is currently required by Form 8283; although not made explicit the more stringent requirements presumably would have been imposed in parallel on donors.

159 McLaughlin, Valuation Conundrum, supra note 3, at 295-299; see also BLM, supra note 16, at 9-12.
160 McLaughlin, Valuation Conundrum, supra note 3, at 302-305; see infra text and notes at notes 212-213.
reforms "are unlikely to significantly reduce overvaluation."\textsuperscript{161} McLaughlin's skepticism is neither completely spelled out nor convincing. Her case for not requiring recipient organizations to attest to valuation seems to be that they would have "an incentive to assert high values," knowing if they do so "that property owners are more likely to donate."\textsuperscript{162} That assessment seems questionable if, as the administration also proposed, a donee found complicit in overvaluation would jeopardize its exemption.\textsuperscript{163} But even granting that responsibility for valuation would be better left to donors (and, as McLaughlin proposes, appraisers), she gives no real reason for relieving recipient organizations of responsibility for attesting to the conservation purposes of and public benefits from contributed easements. If a recipient is incapable of that, it is hard to justify their qualifications to receive and to administer such interests in the first place. Beyond that she is critical even of Treasury's proposal to require public disclosure of easement details by donee organizations, noting only that "easement valuation is a complex process with which most people" are unfamiliar. She offers the conjecture that "such disclosures seem unlikely to curb valuation abuse except perhaps at the outer margin, where the prospect of public shaming might chill some of the most outrageous valuations." But valuation was only one of several things that the administration proposed to be disclosed, the balance of which McLaughlin does not appear to address.

Even if chilling a few "outrageous valuations" were all that they directly accomplished, the proposed disclosures would reduce the government's need to rely exclusively on examining personal or partnership returns to detect extreme valuations, of which on the evidence of recent decisions there have been more than an isolated few. In that respect it seems like a step in the right direction -- certainly if donees are required to report but not attest to donor valuations -- especially when it can be achieved at the trivial cost of requiring donees to share with the IRS and the public information that donors must in any event disclose to them whenever a contribution is made. It seems to us that McLaughlin's criticism misses the real point of, and almost surely understates the benefits of, detailed donee disclosure: even if by itself it deterred \textit{nothing}, it would provide more concentrated sources of information about conservation easement contributions, to the government and the public alike. By so doing it would more generally facilitate IRS detection of potentially overvalued contributions.\textsuperscript{164} One hardly needs a game-theoretic model to think that the resulting increase in the

\textsuperscript{161} \textit{Id.} at 292.

\textsuperscript{162} \textit{Id.} She adds that if forced to obtain their own appraisals, given the alignment of their incentives, donors and donees might gang up on the government in valuation disputes. \textit{Id.} at 292-93.

\textsuperscript{163} 2017 \textsc{Revenue Proposals} at 215.

\textsuperscript{164} {Disclosure of contribution details to/by donee and confidentiality of the return information. Check Eco-Vest/Clark 6103 litigation in \textit{Zak}.}
probability of detection will increase the expected cost of aggressive valuation. There is much to be said for exactly the sort of disclosure that the Obama administration proposed.\textsuperscript{165}

\textbf{B. Capping Valuation}

Proposals to tighten the allowance, reporting of, and disclosure about conservation easements deserve serious consideration. They do not, however, add any real teeth to efforts to combat valuation abuse. Legislation along the lines of S. 2256 would do better.\textsuperscript{166} If adopted, such bills would prohibit \textit{any} deduction on account of a conservation easement contributed through a pass-through entity by an investor/partner if, during any of the first three years following the last date on which the partnership acquired any portion of the contributed property, or (if later) on which any partner acquired an interest in the partnership, the amount of the deduction would exceed 2.5 times the adjusted basis of such partner's interest in the partnership allocable to the property with respect to which the contribution is made.\textsuperscript{167} It converts into a bright-line limitation the standard articulated in Notice 2017-10 for classifying syndicated easements as listed transactions.\textsuperscript{168} Its premises seem to be that (1) the problem of valuation abuse is largely confined to easement contributions the benefits of which are distributed to investors in pass-through entities, (2) limiting those investors to first-year deductions just sufficient (at best) to produce tax savings equal to their investments, and (3) a statutorily mandated three-year wait to secure larger deductions from syndi-

\textsuperscript{165} Sims, \textit{Recollections}, supra note 1, at 57-58, would go farther and identify easement donors. On possible administrative reforms the ABA-RPTE Task Force has little to add. In the 12 of its 124 pages devoted to valuation, it generally aligns itself with several of Professor McLaughlin's recommended reforms (she was among its authors). That aside it throws cold water on most of the Treasury's 2016 proposals. It's a fair inference that, to the report's authors as a whole, fixing valuation is little more than an afterthought. \textit{See ABA-RPTE Report, supra note 12; supra text and note at note 54.} Most of it is devoted to making a case for added "flexibility" in the administration of conservation easements. Despite the fact that the provision to which the Treasury agreed 40 years ago required that to be deductible a conservation restriction must both be "granted" and its "conservation purposes . . . protected in perpetuity," the report proposes the wholesale introduction of expanded discretionary and consensual powers to amend and even extinguish conservation easements for which deductions have previously been allowed. Only in connection with their recommended expansion of the ability to alter conservation easements after the fact does the Task Force propose anything in the way of meaningful restrictions and serious sanctions (such as loss of exemption), and only then to prevent abuse of the new opportunities for abuse that their proposals would inevitably introduce. They propose serious sanctions (such as loss of exemption) only in the context of relaxing restrictions on amendment and extinguishment. Internal evidence suggests that its hedged language on valuation and other issues reflects differences among the authors on matters both of allowance and taxation. \textit{See, e.g., ABA-RPTE Report, supra note 12, at 331-32, 359 n.207} ("The Task Force has not had an opportunity to reach consensus on a resolution to the dilemma occasioned by the decision in \textit{PBBM-Rose Hill}").


\textsuperscript{167} S. 2256, 117th Cong., § 2(a). The proposed legislation would also prescribe additional rules regarding tiered partnerships, family partnerships, penalties, and the statute of limitations. \textit{Id. at} § 2(a)-(c).

\textsuperscript{168} The standard prescribed in that Notice and carried forward into legislation like S. 2256 seems to have been inspired by Small, \textit{Modest Proposal}, supra note 16. \textit{See supra} note 17.
cated easements with more aggressive valuations will collectively suffice to deter investment in SCEs. It would, in effect, limit the tax benefits of contributing an easement to a 40% marginal rate investor to the amount invested, thereby killing the economics of contributions to which it applied.\textsuperscript{169} In so doing it would largely put a stop to the sort of syndicate-December 29/contribute-December 31 SCEs described in the Senate Bipartisan Report and Notice 2017-10, as well as syndicated easements of the sort that have been promoted by HRH Investments and Peachtree Investment Solutions.

At the same time its premises do not seem sufficiently well thought out. For one thing, overvaluation is not confined to contributions made by pass-through entities, but has been (and continues to be) widespread among individual easement contributions. It may be that conservation easement flips are typically marketed to outside investors, as happened with the HRH cases discussed in Part III. Even so, it is possible that, as a successful real estate developer, someone like Duane Horton might have acquired the property in \textit{Oakbrook Land Holdings} individually (or jointly with a few close associates), at least if he was willing to shoulder the risks.\textsuperscript{170} If so, S. 2256, by itself, would not have affected his (claimed) $9.545 million deduction.

For another, Notice 2017-10 itself used the 2.5/1 ratio of deductions to investment to single out conservation easements for scrutiny. By converting that standard into a prohibition, S. 2256 could be taken as \textit{condoning} claimed deductions \textit{not} in excess of 2.5 times adjusted basis, even for property held through a pass-through entity and that had recently changed hands at arm's-length. So while that limitation might halt syndicated investments whose "economics" were driven \textit{solely} by the first-year easement contribution,\textsuperscript{171} it might have just the opposite impact on investors not focused solely on conservation easement-derived year-one returns, but otherwise still interested in the most feasibly aggressive valuation of their contribution. For them a provision like S. 2256 could be interpreted as a safe harbor.\textsuperscript{172}

The bill would also be vulnerable to exploitation by investors prepared to be patient. Take, for example, a rounded version of Partnership Z in \textit{United States v. Zak}, almost surely based on Cot-

\textsuperscript{169} \textit{See supra} note 25. At any lower marginal rate the tax benefits -- during the first year and in the aggregate -- would be insufficient even to recoup the investment. If, on the other hand, marginal rates were to go up the calculus of S. 2256 would change.

\textsuperscript{170} Part III.B.3.c, \textit{supra}, identifies two Peachtree Investment Solutions deals involving a single investor.

\textsuperscript{171} \textit{See supra} text and note at note 24.

\textsuperscript{172} The allocated cost of the 106 acres burdened by the easement in \textit{Oakbrook Land Holdings} was about $1.26 million (\textit{see supra} note 37), yielding an S. 2256 limit of $3.15 million. If Horton's investors were less aggressive, and prepared to settle for "just" that valuation, at 35% the tax benefits would have been just over $1.1 million, reducing OLH's investment in all 143 acres net of tax savings to under $600,000, from which point they could have proceeded in some fashion to develop the 37 unburdened acres. Even with the easement valued at 2.5 times what they had recently paid for the unburdened underlying land, S. 2256 could be taken as saying "That's ok."
Tonwood Place v. Commissioner: the investors purchased their interests for a total of $950,000, and contributed an easement for which they claimed a value of $4,600,000, nearly five times their aggregate investments. It would clearly run afoul of S. 2256. Suppose, however, that the investors, although acquiring the land and investing in the LLC near the end of some Year 0, were prepared to wait until the end of Year 3 before contributing the easement, so that the limitation of S. 2256 did not apply. At a 35% marginal rate, a $4,600,000 Year 3 deduction would produce tax savings of $1,610,000 and would, in the absence of a successful valuation challenge by the government, still produce for the investors a compound average annual return of nearly 19%.174

S. 2256's implicit faith in the deterrent effect of impatience does not seem well founded, except in the context of the instant-gratification world of atypically high-powered tax shelters consisting of conservation easement flips; in that world aggressive valuation has produced tax-driven investments claimed to produce essentially unprecedented instantaneous payoffs, realized entirely in the first year, both within and outside the set of SCEs.175 Those preoccupied with killing off the most flagrant SCEs seem to have lost sight of just how unusual (at least if they are allowed to succeed) such essentially guaranteed all-but-instantaneous payoffs are. In contrast, in quaint artifacts like traditional real estate tax shelters of the past, investors did have to exhibit some patience, just as the world more generally requires of ordinary investors. So there is no guarantee that, if prospective investors had to adjust to the three-year wait imposed by a bill like S. 2256, they would be unwilling to do so. The LLCs created by HRH Investments contributed their easements between two and four years following HRH's purchase of the parent tract of land; with modest adjustments to timing, and investors sufficiently patient to invest at the beginning, S. 2256 would not have automatically foreclosed the deduction actually claimed in Cottonwood Place. There was, moreover, room for HRH to have sweetened the deal, if needed to reward the requisite patience.177


174 The cash flows at time 0 and in years 1-3 would be ($950,000), $0, $0, $1,610,000, producing an internal rate of return of 19.22%. If they were able to finance the purchase of their interests, say by borrowing 80% (a total of $760,000) at 15%, and even assuming that because of, say, § 163(d), the interest was not deductible, the compound annual return on their $190,000 net outlay would rise to over 28%. The cash flows would be ($190,000), ($114,000), ($114,000), $736,000. We suspect that these simple illustrations just scratch the surface of how S. 2256 might be exploited. (Calculations are available from the authors.)

175 See supra text and note at note 25.


177 Cottonwood Place was the transferee of 140 acres from HRH, of which 135 were subject to the easement. HRH's average cost/acre was $4,900,000/1900 = $2580; the cost ratably allocated to the land, carried over to Cottonwood Place and subject to the easement, was about $348,300. See supra text and notes at notes 135 and 136. For their interests the outside investors paid about $950,000, so in rough terms HRH marked up the land by a factor of about 2.7. See supra note 136. HRH could have enriched the investors' return by reducing its markup and their purchase price.
That is not something we condone, much less are convinced would survive a valuation challenge; we are simply pointing out that, even with a three-year waiting period, and assuming elimination of the rectifiable technical flaws that led to disallowance in the actual HRH cases, the government might still end up bogged down in time-consuming litigation over valuation. Planning around S. 2256 would have been even less complicated for small groups like the investors in Oakbrook Land Holdings, who in lieu of settling for a more modest easement valuation could simply have elected to exercise the requisite patience, developing the thirty-seven acres not subject to the easement in the interim, and claiming a larger deduction once S. 2256's holding period restriction had lapsed.

It is unlikely that what we have just sketched exhausts the ongoing possibilities for exploiting aggressive valuation of conservation easements, including those made through pass-through entities, if first-year deductions were limited to 2.5 times investment. Our point, then, is that legislation like S. 2256, in its current form, would not necessarily deter even some of the more aggressively valued deals found in the reported decisions, especially not for investors prepared to be patient. It would certainly not deter any easement contributed through a pass-through entity and valued at less than 2.5 times the investors' adjusted bases. Contributions within that envelope might not qualify as "wildly" inflated, but they are inflated, especially when the benchmark comparison is the price in a recent arm's-length sale. And it would do nothing to curb overvaluation of easements contributed outside a pass-through entity. S. 2256 thus would not provide a comprehensive, or even an adequate, solution.

C. The Centrality of the Appreciated Property Rule

In fashioning a limitation related to basis, however, S. 2256 does edge closer to a real solution. The core of the problem is the allowance of deductions for contributions of unrealized appreciation, or at least the extension of that rule to contributions of conservation easements. Despite that reality, tinkering with the appreciated property rule has been so studiously avoided as a possible solution that it might reasonably be regarded as the third rail of the problem. That concerted obliviousness is surely fueled by apprehension about the consequences; but it probably rests also on an ingrained, reflexive belief that allowing fair market value deductions for contributions of appreciated long-term capital gain property is sacrosanct, an inviolable, immutable feature of the natural order of things. As Kingsbury Browne, both the spiritual and practical father of the contributed conservation easement enterprise, long ago (rhetorically) asked of a Treasury official, "Isn't

Reducing their aggregate investment from, say, $950,000 to $600,000 -- still producing for HRH a gross profit on syndicating the interests of $250,000 -- would have produced 3-year cash flows of ($600,000), $0, $0, $1,610,000, increasing their compound return to nearly 40%.

178 The authors of the ABA-RPTE Report, many of them tax lawyers or estate planners, evidently went out of their way to keep their distance from that rail. See supra note 54.
your real problem with the appreciated property rule? If, so, why don't you go after that?" If doing so seemed untenable at the time, and the answer wasn't then even clear, it should by now be apparent to any reasonably impartial observer of what has unfolded since: in the wake of their 1980 statutory blessing and the 2006 liberalizations, conservation easements have emerged as uniquely capable of exploiting and transgressing any reasonable boundaries on the operation of that rule.

The natural starting point in coming up with a solution to the problem is whatever was actually paid for the unburdened land, the owner's adjusted basis. At very least with respect to land that recently changed hands in a taxable arm's length transaction, that should be the ceiling, on both the "before" value of the land and of any deduction for contributing a conservation easement. As recounted above, what has been lost sight of, and so has with few exceptions been missing from the discussion of conservation easement reform, is just how extraordinary a departure from our otherwise generally applicable income tax norms allowing deductions for unrealized appreciation is. In virtually all other instances we limit the amount deductible on the disposition of property to basis. And although as an historical matter the system has tolerated fair market value deductions for contributions of appreciated property, Kingsbury Browne's rhetorical question over forty years ago simply glossed over what should by now be obvious -- and what the tax-writing congressional committees had grasped by just a few years later, more than thirty-five years ago -- and that is just how fragile and vulnerable that tolerance is.

Conservation easements are just an extreme symptom of that more general problem. They push the intrinsic vulnerability of the appreciated property rule beyond acceptable limits. They have proved capable of generating outcomes that differ not just quantitatively, but qualitatively, from other contributions of appreciated property. But they are not the first episode to dramatize that fragility. As recounted in Part II, that consisted of contributions of ordinary income property at a time when marginal rates exceeded 50%. Then, even with fastidiously fair valuation, a taxpayer could do better by contributing property and deducting its fair market value than by selling it instead. That possibility, too, was compounded by aggressive valuation, facilitated, most commonly with non-fungible tangible assets like art, by the need to rely on appraisals. Faced with that

179 Sims, Recollections, supra note 1, at 44 n.16.
180 See supra text and notes at notes 142 and 143.
181 Or its fair market value when it passed from a decedent.
182 E.g., Blau v. Comm'r, 924 F.3d 1261 (D.C. Cir. 2019); see also cases cited supra at note 97.
183 There are few exceptions to the function of adjusted basis in keeping track of the extent to which property is tax-paid, the most glaring of which is the step-up in basis at death, prescribed by I.R.C. § 1014. There are isolated, more limited exceptions, such as the basis step-up for stock received in exchange for property transferred to a small business corporation of I.R.C. § 1202(i).
184 See supra text and note at note 64-68.
combination of vulnerabilities -- the possibility of achieving the best strictly financial outcome by contributing rather than selling the property,\textsuperscript{185} exacerbated by the use of inherently malleable appraised valuation in doing so\textsuperscript{186} -- Congress responded with § 170(e)(1)(A), which effectively limits contributions of ordinary income property to basis.\textsuperscript{187} By doing so it put them on essentially the same income tax footing as other dispositions of property. And it has continued to do so despite the fact that, just a decade later, Congress reduced the top marginal rate to 50\%, at or below which it has remained ever since. Even more to the point, Congress has selectively extended the basis limitation of I.R.C. § 170(e)(1) to categories of contributions of long-term capital gain property thought to be vulnerable to abuse.\textsuperscript{188} But it has still left the latter largely undisturbed, despite its recognition in 1984 that doing so posed serious risks to the system.

Conservation easements have now emerged to highlight for a second time, in a slightly different but in some ways even more spectacular fashion, the vulnerability of the appreciated property rule. The $9.545 million deduction claimed in \textit{Oakbrook Land Holdings}, recounted in Part II,\textsuperscript{189} is a sufficient illustration. Tax savings of $3.3 million from that deduction would be $1.6 million more than OLH had paid for the entire tract of land. If allowed, the deduction would produce for Horton an outcome that, from a strictly financial -- not charitable -- perspective, was better than anything else he might conceivably have done with the land. In contrast with Mrs. Rebay’s paintings, moreover, Horton and his colleagues have retained not only the 106 acres burdened by the easement but the remaining thirty-seven unburdened acres as well. If the deduction had been allowed, they would have acquired those interests at zero cost, and with a $1.6 million (tax-free) cash subsidy from the government to boot.

\textsuperscript{185} The Senate Finance Committee Report on what became the Tax Reform Act of 1969 observed that the charitable deduction was not intended to provide greater- or even nearly as great - tax benefit in the case of property than would be realized if the property were sold and the proceeds retained by the taxpayer. In cases where the tax savings is so large, it is not clear how much charitable motivation remains. It appears that the Government, in fact, is almost the sole contributor to the charity.

\textsuperscript{186} The Report of the House of Representatives, which was concerned about contributions of art and would have reduced to adjusted basis all contributions of tangible personal property, noted that such works "are very difficult to value and it appears likely that in some cases they may have been overvalued for purposes of determining the charitable contribution deduction." H.R. REP. NO. 91-413, at 55 (1969). \textit{See generally} Colinvaux, \textit{Broken System}, \textit{supra} note 8, at 272-74.

\textsuperscript{187} \textit{See supra} text and note at note 39.

\textsuperscript{188} I.R.C. § 170(e)(1)(B); \textit{see supra} text and notes at notes 45-47; \textit{see also} Colinvaux, \textit{Broken System}, \textit{supra} note 8, at 279; Halperin, \textit{Better Way}, \textit{supra} note 1, at 38-39.

\textsuperscript{189} \textit{See supra} text and note at note 48.
In the current environment, little more is needed to produce such results than a parcel of (preferably undeveloped) land and an appraisal based on a suitably inflated highest and best use "before" valuation of the land. The facts reflected in the opinions -- from decisions like PBBM-Rose Hill (and before it Mountanos190) through the HRH cases and the likes of Coal Property Holdings and on to Oakbrook Land Holdings itself -- however individuated and more or less elaborate their separate back stories, have those two things in common; in the final analysis, stripped of their window dressings, they all boil down to that. In that setting the emergence of the pure SCEs chronicled in the Senate Bipartisan Report, somewhat ironically, can be viewed as a salutary development. SCEs are not some unexpected perversion, distinguishable in principle from non-syndicated easements, of an otherwise defensible rule; they are simply the reductio ad absurdum of allowing fair market value deductions for contributions of conservation easements attributable to unrealized appreciation in the first place. They lay bare just how vulnerable that allowance is. The willingness of the mainstream conservation easement community to rally around efforts to curb SCEs testifies implicitly to just how rank an embarrassment they are. Abetted by the fiction that development rights can be more valuable than the underlying land, their emergence well and truly let the cat out of the bag: as long as the allowance of fair market value deductions is not tempered by taxing the corresponding gain, there is little intrinsic, palpable downside to exploiting that vulnerability by aggressive valuation, and in principle no real limit on the deductions that taxpayers might be tempted to claim. That temptation is intensified where, as by now is well understood, the incentives facing all participants to an easement contribution -- donor, donee, appraiser, and syndicator alike -- are aligned in the direction of inflated valuation.191

There is no reason to think that this is what Congress intended when it left the appreciated property rule undisturbed in 1984. It acknowledged that the rule created "opportunities for overvaluation because the donor . . . does not realize capital gain equal to the appreciation." It recognized that "these opportunities" could be quelled by eliminating "the advantage that charitable gifts of appreciated property have over gifts of cash." It refrained, however, from taking that step, on the premise "that many charitable organizations depend on this tax benefit for fund-raising and as a means of acquiring valuable property."192 That rationale extends only in sharply attenuated form, if it legitimately applies at all, to contributions of conservation easements. Recipient organizations do regard their mission as including the receipt (and possibly the administration) of conservation easements. But the easements themselves are not sources of support, and the recipients do not rely

190 See supra text and notes at notes 81 and 107.
191 McLaughlin, Valuation Conundrum, supra note 3, at 303-05; ABA-RPTE Report, supra note 12, at 334-35.
192 1984 ACT BLUEBOOK, supra note 63, at 503.
on them for that; if anything, they are a financial burden, as reflected in the practice of some organizations of requiring a monetary contribution to accompany each easement donation, to help defray the organization's operating costs.\textsuperscript{193} Whatever philanthropic or conservation value they may have to recipient organizations, the latter clearly do not rely on them for financial support. In that respect the case for retaining the appreciated property rule for contributions of conservation easements in particular is weaker than Congress hypothesized generally in 1984. Taking into account the rule's demonstrated capacity for mischief where such contributions are concerned, running the gamut from "wild" overvaluation to outright criminal tax fraud, the case for repealing the appreciated property rule with respect to conservation easement contributions seems strong. There is precedent for such selective repeal: in other situations involving contributions of capital gain property thought to be vulnerable to abuse, Congress has done exactly that.\textsuperscript{194}

D. Proposed Reforms

Short of outright repeal with respect to conservation easements, however, the appreciated property rule should at least be curtailed where such contributions are concerned. Motivated by the preceding analysis, we propose four remedial provisions: one would apply to conservation easements contributed by short-term owners; two would then affect contributions by longer-term holders; a fourth would apply to appreciated easement contributions in general.

1. Short-Term: Limit Easement Contributions to Property Cost

For property recently (or contemporaneously) acquired in a taxable transaction, the property's "fair market value," and the upper limit on a "before" valuation used to value a conservation easement, should conclusively be presumed to be the price for which the property was acquired.\textsuperscript{195} This is the obvious, natural, readily administered starting point in valuing a conservation easement. It would put an immediate halt to the most transparently aggressive valuation of conservation easements contributed with respect to newly acquired property. We would apply the limitation to all easement contributions; it would not be confined to SCEs, or to easements granted by pass-through entities.

Given the susceptibility of easement valuations to manipulation, the initial limitation to cost should as a prophylactic matter remain in effect for some non-trivial period of time following acquisition. The exact period is unavoidably arbitrary. Borrowing from existing legislative

\textsuperscript{193} See, e.g., Kaufman v. Comm'r, 784 F.3d 56, 59 (1st Cir. 2015); see also ABA-RPTE Report, supra note 12, at 324-25 (noting that some easement recipients treated the easement as a liability).

\textsuperscript{194} See supra notes 45-47; supra text and notes at notes 183-184.

\textsuperscript{195} In the event of property acquired from a decedent the limit would be the basis determined under § 1014. In all of what follows we maintain that assumption without further mention.
proposals we suggest three years. In effect our proposal could then be viewed as modifying the approach of bills like S. 2256, so that the deduction was limited to basis, rather than 2.5 times basis. Alternatively viewed, it would effectively extend the short-term/long-term capital gain dividing line from a holding period of one year to three for purposes of determining the amount allowable as a deduction for contributing a conservation easement under I.R.C. § 170(e)(1).

For contributions made in an individual capacity, rather than through some sort of pass-through entity, the application of this rule will be straightforward. For contributions made through any sort of pass-through entity (which in the interest of expositional simplicity we shall refer to as a partnership) the matter could become considerably more complex, especially if interests in the partnership are sold in taxable transactions following contribution to the partnership of the property with respect to which the easement is to be granted. To judge from the reported decisions, the property is typically acquired by the partnership in a non-recognition transaction that endows it with the transferor's basis and holding period; the interests in the partnership are then sold to outside investors, at a typically substantial markup, in taxable sales.¹⁹⁶ In that setting there are two possible choices in applying our proposal for (a) cost and (b) holding period. We propose using the outside investors/partners' costs and holding periods.¹⁹⁷ That is by far the simplest choice. And although in theory it would allow the use of a higher value for cost, and produce a more generous limitation, than using the partnership's inherited basis, our proposed limitation would be at least as effective as S. 2256 at curbing SCEs. We would therefore expect them to become economically unviable and disappear, rendering our choice of the more generous limitation moot.

2. Longer-Term: Limit Easement Contributions to Property Cost, Adjusted for Evolution of Neighboring Housing Prices

The limitation proposed in bills like S. 2256 disappears after three years. For reasons previously spelled out¹⁹⁸ we do not think that is appropriate. One alternative would be to limit the deduction to basis indefinitely. In lieu of that, however, we would allow the initial limitation to adjust over time. Specifically, we would allow our proposed initial limitation on before valuations to be adjusted automatically to reflect the evolution of housing prices. To a large extent those adjustments could be made using home-price indices specialized to the geographic locale in which the property was actually located. The Federal Reserve, for example, maintains a site devoted to

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¹⁹⁶ See supra text and notes at notes 127, 135 and 177.

¹⁹⁷ As under S. 2256, the three-year holding period restriction would begin to run from the later of (i) the last date on which the partnership acquired any portion of the contributed property and (ii) the last date on which any partner acquired an interest in the partnership. See S. 2256, 117th Cong., § 2(a) (1st Sess. 2021); supra text and notes at notes 166-167.

¹⁹⁸ See supra text and notes at notes 172-175.
home price indices, including at least one (and typically several) for each state, as well as at least one index for upwards of 400 more narrowly defined locales, typically municipal or metropolitan areas. At worst, then, the automatic adjustments we propose would be made using statewide data; more typically they would be made using data for prices in a geographic area much closer to the property in question.

With that adjustment, the maximum amount allowable as a deduction for a contributed easement would keep pace with the general growth in real estate prices over time.

3. Longer-Term: Limit Easement Contributions to Property Fair Market Value, Determined Using Comparable Sales or Other Reliable Data

A limitation to cost, even with an adjustment based on the general change of housing prices, will not always capture property's current fair market value accurately. So we would also allow a different value to be established, but only by clear and convincing evidence. Adequate evidence would include, for example, sales data for comparable property that was genuinely salient, in the sense that the sales were proximate in both geography and time. They might also include other factors specific to the property involved, such as the assembly of a larger parcel in a manner that enhanced the values of the constituent individual parcels. At the same time, to minimize the prospect of courts remaining bogged down in protracted litigation over value, we would curtail or prohibit the sort of speculative, DCF-based assessments of "highest and best use" developmental values that have plagued the valuation process and produced much of the controversy to date. Given the extent to which such methods have been deployed to justify outlandish valuations, we think it fair to err on the side of parsimony in allowing appraisers to justify valuations that depart widely from original cost, adjusted for changes in housing prices over time.

4. All Easement Contributions: Impose a 5% Excise on Unrealized Appreciation Claimed as a Deduction

While explicit limits on valuation seem both necessary and appropriate, they do not directly address the fact that abusively valued conservation easements have flourished in part because of their simplicity, at least compared to other tax-oriented transactions. To repeat: little more is

199 The St. Louis Federal Reserve Bank maintains a House Price Indexes [sic] website with upwards of 650 indices, many of which track housing prices back to the last quarter of the twentieth century. They include at least one index for nearly 400 states, Metropolitan Statistical Areas, or other regions, and over 180 versions of the Case-Shiller Repeat Sales Index. See House Price Indexes, FEDERAL RESERVE BANK OF ST. LOUIS, https://fred.stlouisfed.org/categories/32261 (last visited Feb. 26, 2022). The site allows the user to customize the date range for housing prices tracked by any of the indices. They were the basis for the housing price comparisons provided in notes 35 and 81, supra.

required than a plot of land and an appraisal. The low entry cost, combined with the prospect of instantaneous returns, has surely contributed to the explosive growth of conservation easements generally, not just syndicated easements, over the past twenty years.

For that reason it would be desirable to alter at the threshold the calculus facing prospective donors of conservation easements. One simple way of accomplishing that would be the imposition of an excise or fee, based on the amount of unrealized appreciation (after an appropriate allocation of the basis in the underlying land\textsuperscript{201}) included in the amount claimed as a deduction on contributing the easement. The excise would be levied on the donor in the year of contribution.\textsuperscript{202} To deter playing the audit lottery with aggressive valuation, we would base the excise on the value \textit{claimed} as a deduction at the time of contribution, \textit{without} any downward adjustment if the deduction were subsequently to be reduced on audit, after litigation, or even by amendments to the tax return on which the deduction was initially claimed.\textsuperscript{203} For a conservation easement that has been carefully valued, the excise would alter the economics and make the deduction less valuable, but it would still leave in place a substantial incentive to making the contribution. More importantly, it would always leave the donor of a carefully valued easement better off than if they had refrained from making the contribution in the first place. In the case of aggressive valuation that is vulnerable to challenge, on the other hand, a substantial reduction in the value ultimately allowed might well leave the donor worse off. Consequently, what we propose would leave in place a generous incentive to contributing conservation easements that are carefully valued, while simultaneously creating a deterrent to overvaluing them with more traction than the existing overvaluation penalties, which are only levied ex post.\textsuperscript{204}


\textsuperscript{202} We would include some mechanism by which the excise might be satisfied over time, if and to the extent that the tax benefit from the deduction was spread over time by virtue of the percentage limitations of § 170(b). Any such mechanism would be subject to some minimum fraction of the excise to be paid in the year of contribution.

\textsuperscript{203} As we have noted, some donee organizations impose an up-front fee in connection with easement contributions. \textit{E.g.}, \textit{Kaufman v. Comm’r}, 784 F.3d 56, 59 (1st Cir. 2015) (fee equal to ten percent of the contribution). This approach also has statutory precedent. I.R.C. § 170(f)(13)(A) already requires a $500 filing fee for each contribution of a façade easement producing a deduction in excess of $10,000. And the proceeds regulation of Treas. Reg. § 1.170A-14(g)(ii), is a precedent for fixing the amount at the time of contribution, irrespective of any subsequent adjustment. The regulation requires that the ”proportionate value of the donee's property rights shall remain constant,” based on the amount \textit{claimed} as a deduction, rather than the amount eventually allowed. \textit{See, e.g.}, \textit{Carroll v. Comm’r}, 146 T.C. 196 (2016) (easement provision giving donee a share on extinguishment based on the deduction allowed, rather than the fair market value of the easement at the time of contribution, did not satisfy the proceeds regulation).

Our objective here is to foreclose defensive amendments to reduce the excise made after a taxpayer has become aware that a deduction might be challenged. To that end, it might be appropriate to prohibit any defensive amendment beyond the date of (\textit{not} the date received) any notification to the taxpayer of any inquiry by the Service into a return on which a conservation easement deduction has been claimed.

\textsuperscript{204} Compare McLaughlin, \textit{Valuation Conundrum}, supra note 3, at 303-305.
While the choice of rate is again somewhat arbitrary, we propose an excise of 5% of the unrealized appreciation implicit in the contribution. Assuming (as we have) a donor taxed at a 35% marginal rate, the operation of the excise can be illustrated in the following way. For the contribution of an easement valued at $1 million, with an allocated share of the basis in the underlying property of $200,000, a 5% excise on $800,000 of unrealized appreciation would produce a fee of $40,000. At 35%, on the other hand, the contribution would produce a tax benefit of $350,000. The excise would simply reduce the net benefit of the deduction from $350,000 to $310,000. The impact of the fee would increase with the fraction of the contribution consisting of appreciation, reaching its maximum at a zero basis, in which event, in our example, the fee would be $50,000, and the after-contribution after-fee net benefit would be $300,000.

If structured as we propose, with the excise based on the amount claimed rather than the amount finally allowed as a deduction, the final value (after audit) of the tax benefit from the deduction net of the excise would decline as the overvaluation grew. But the overall economics would become negative only in the event of claimed deductions that were massively overvalued compared what was found to be the "correct" value of the contributed easement. If in our illustration $1 million was the easement's true fair market value, the amount claimed as a deduction would have to exceed $7.2 million -- overvaluing the contribution by a factor of more than seven -- for the after-audit tax benefit net of the excise to be negative. In general, the higher the ratio of the top marginal rate to the excise rate the more extreme the overvaluation will have to be to produce negative overall economics.

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205 In contrast, the tax payable if the appreciation had been taxed as long-term gain would be $160,000.

206 To take an extreme example, even if the amount of the contribution attributable to appreciation were entirely disallowed and the deduction limited to the $200,000 basis, the $40,000 excise (based on the $1,000,000 originally claimed) could never exceed the $70,000 tax benefit from deducting the $200,000 basis. As long as the basis was at least $114,286, the contribution would have positive economics even if the unrealized appreciation were to be entirely disallowed. In that event the tax benefit from the deduction would still be $114,286*0.35 = $40,000, just equal to the excise imposed.

207 In our example a $7.2 million deduction claimed for an easement with an allocable basis of $200,000 would produce an excise of 0.05*$7 million = $350,000. If after audit the allowed deduction were reduced to the easement's $1 million true fair market value, the tax benefit at 35% would just equal $350,000.

208 A rule-of-thumb simplification is that the contribution would have to be overvalued by a factor equal to the ratio of the taxpayer's marginal rate to the excise rate for the economics to be negative. It is more complex because the excise rate applies to the unrealized appreciation, while the marginal benefit of the deduction is based on the entire contribution. Taking the latter into account, it can be shown that the combination of excise and eventually allowed deduction will have positive economics unless the overvaluation (O) satisfies

\[ O > F\left(\frac{t}{z}\right) - (F-B), \]

where \( F \) and \( B \) are true fair market value and basis, respectively, and \( t \) and \( z \) are the tax and excise rates. In our example \( t/z = 0.35/0.05 = 7 \), so the expression above produces \( O = 7 \) million - $800,000 = $6.2 million, and a total claimed deduction (including both fair market value and overvaluation) of $7.2 million. If basis were 0, that would boil down
A provision similar to the excise we propose was previously advocated by one of us. What we propose here is more narrowly tailored to the problem, in that the excise would be based on the unrealized appreciation implicit in the contribution, rather than the contribution itself. In functional terms, either proposal is similar to a percentage reduction in the deduction allowed for conservation easement contributions, of the sort included in a 2005 survey of tax compliance and reform proposals by the Joint Committee on Taxation. What was said then about the comparative merits of an explicit excise remains apposite now:

[T]he difference would be more than mere optics. By subjecting the prospective donor to an excise tax based on the claimed valuation, without any prospect of a reduction in the excise in the event that the claimed valuation was reduced, it would associate a real cost with the position the donor takes in his return, not just with the ultimate outcome. That . . . would induce most prospective donors at the very least to ask, before signing, "Do I really want to claim this valuation? Because once I do there is no turning back."

Others have questioned the effectiveness of after-the-fact penalties at deterring easement overvaluation. On the evidence of recent decisions, that ineffectiveness persists. Given the low entry cost associated with, and the immediacy of the returns promised by, contributions of conservation easements, something more salient seems called for: a warning sign at the threshold, one with a tangible cost that varied with the claimed valuation of the contribution, could by itself play an important role in quelling conservation easement abuse. It would do so, moreover, by just modestly attenuating, while at the same time preserving, the incentives to contributing conservation easements, certainly for contributions that were reasonably valued. At the same time, it would create the prospect of unfortunate consequences for easements like those found in recent cases that have exhibited overvaluation by many multiples of the contributed easement's legitimately defensible value.

to $O = $6 million, a total claimed deduction of $7 million, and overvaluation by a factor of 7.

In practice the economics would be slightly more complex still if the basis allocated to the contributed easement increased with the claimed deduction, but the variation would favor the taxpayer by reducing the amount of the initial excise as the allocated basis increased, reducing the amount of unrealized appreciation subject to the excise.

Sims, Recollections, supra note 1, at 61-62.

JCT 2005 COMPLIANCE OPTIONS, supra note 143, at 282-85. The JCT outlined a two-thirds reduction in the amount claimed as a conservation easement deduction, roughly equivalent to a 23% excise to a 35% bracket taxpayer. See supra note 154.

Sims Recollections, supra note 1, at 62 (footnotes omitted).

McLaughlin, Valuation Conundrum, supra note 3, at 302-03.

See supra note 25.
V. Conclusion

In 1980, when Congress made permanent the exception to the partial interest prohibition on charitable deductions for contributions of conservation easements, it was aware that determining their fair market value would require a multi-step appraisal process that was more challenging than valuing other exceptions to the partial interest limitation. Separate but roughly contemporaneous developments reflected a growing congressional awareness of the vulnerability of charitable contributions generally to overvaluation, due to the appreciated property rule. That awareness led to the enactment of explicit overvaluation penalties in 1981, and then to the adoption in 1984 of more stringent requirements governing documentation of charitable contributions.

In retrospect it was probably inevitable that the inherent malleability of the appraisal process would eventually coalesce with the appreciated property rule to generate irresistible temptations to massive overvaluation. That is exactly what has materialized in the past twenty years: speculative appraisals, premised on fanciful assessments of property's highest and best use, have led to conservation easements "with wildly inflated deductions on land bought at much lower prices."²¹⁴ The most egregious cases, of which there have been unfortunately many, involve claimed deductions based on appraised values that are many multiples of the price at which the underlying, unburdened land had recently changed hands. Such claims are intertwined with the intrinsically implausible claim that the rights to develop land to its highest and best use can somehow be more valuable than outright ownership of the land. Those developments have not, as is so widely assumed, been confined to the mass-marketed syndicated easements described in detail in the Senate Bipartisan Report. As shown in work by McLaughlin, Starkman and others, corroborated by the cases surveyed in Part III, overvaluation has been endemic to conservation easements from the start. So while most recent attention has focused on SCEs, the problem is far more widespread.

Even though the regime of overvaluation penalties is now more stringent than when first adopted, it (together with other administrative requirements) has obviously not thus far deterred overvaluation. The government's enforcement efforts have been responsibly pursued; but given the dimensions of the problem and the limitations on its resources it is probably too much to expect it to keep up. The alternatives proposed by some critics -- ranging from challenging SCEs as shams to litigating the value of every conservation easement -- would amount to just so much chipping away at the margins of the problem; it would not improve on what the government has accomplished to date. The latter would leave the government bogged down in an "inefficient, wasteful, and inherently imprecise"²¹⁵ process for which "neither the Service nor the courts have sufficient resour-

²¹⁵ Losch v. Comm'r, 55 T.C.M. (CCH) 909, 921 (1988); see also Symington v. Comm'r, 87 T.C. 892, 904 (1986)
ces";\textsuperscript{216} and as Congress grasped when it first addressed the problem in 1981, it would tend to induce settlement on unduly taxpayer friendly terms. The former would leave much overvaluation completely untouched. Even proposed legislation that would limit SCE investors to deducting some multiple of their investments would leave non-syndicated easements untouched; it might simultaneously function to legitimize overvaluation within the proposed statutory limit. Strengthening reporting and other administrative provisions to improve transparency about what is going on would enhance the Service's ability to identity instances of overvaluation, but it would still not get at the root of the problem.

At bottom, the engine that drives what has become relentless overvaluation of conservation easements is the appreciated property rule. But conservation easements are not just some mine-run species of contributed interest, more or less indistinguishable from other contributed interests, and hence no more vulnerable to abuse. The appraisal process by which they must be valued, together with the absence of data on market prices of comparable restrictions, effectively means that the sky is the limit where the starting point in valuing them -- the "before" valuation -- is concerned. Given that starting point, it has become possible in principle (and has repeatedly been attempted in practice) to produce easement contributions with claimed before valuations so far in excess of the market value of the underlying land as to leave the contributors better off than they would be by doing anything else with -- including just selling -- the land.

In such circumstances there is both historical precedent and a compelling need for a legislative solution that will curb those possibilities. Drawing on other episodes that have involved comparable abuses, we have proposed a limited set of modifications to the application of the appreciated property rule to conservation easements. They would anchor the valuation of those interests to a characteristic of property that is both realistic, observable, and defensible. In so doing they would preserve the originally intended incentives of the deduction, stripped only of unwarranted overvaluation. Calculating the "before" value of property for purposes of determining a contribution would begin with adjusted basis, tied to the last market transaction in the property; that value would periodically and automatically be adjusted for changes in market value. More speculative valuations, based on DCF analyses of imagined (and imaginary) "highest and best uses," would no longer be allowed. As an added deterrent, we propose an upfront excise on the amount of unrealized appreciation in a claimed donation, modest in amount but sufficiently visible to give prospective donors pause before signing a return that claims a deduction for an overvalued conservation easement. The changes we propose would collectively preserve the originally

\textsuperscript{216} \textit{ABA-RPTE Report, supra} note 12, at 331.
intended incentives to contribute conservation easements, while forestalling ongoing perversion of those incentives to reap unintended, indefensibly overstated, and excessive tax benefits.
### APPENDIX -- Contributions by HRH Investments Sponsored LLCs

#### HRH Summary (Reported Decisions)

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/Acre = 2580

All to Georgia Land Trust
All but last two reported as appraised by David Roberts

#### Case

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