



## Pointers for Balancing Risk on Conservation Easement Modification Eight Elements to Consider Pending a Tax Court Decision

The Land Trust Alliance has long held that a modification clause in conservation easements strengthen easements and improves enforceability. A modification clause, which may include amendment, consent, waiver and other discretionary approvals, enhances the “protected in perpetuity” standard and improves the chances of perpetual easement protection. This clause (or clauses) along with well-crafted guiding principles helps conservation organizations properly address unforeseen circumstances. The following Pointers reflect *Land Trust Standards and Practices* and can help land trusts and donors avoid IRS challenges while retaining the tools necessary for perpetuity.

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### IRS Audit Scrutiny

In recent years, the IRS increased its scrutiny of conservation easements and continues to do so on audit. While the IRS has attempted to deny deductions based on the presence of an amendment or modification clause, no court opinion to date has upheld that position, nor has the IRS issued any rulings prohibiting modifications or amendments. These Pointers provide interim guidance while the land trust community continues to wait for the Tax Court to formally opine on the issue. In a summary judgment opinion, one tax court judge ruled that an amendment clause is valid so long as it does not “endanger qualification under section 170(h).” Land trusts must report all modifications annually on Form 990<sup>1</sup>.

If your donors or their advisors fear an IRS audit, there are many actions they can take to reduce audit risk of the overall easement transaction. These include ensuring the appraisal is moderate and fully substantiated, having fully substantiated documentation of the entire easement transaction and, finally, including an amendment clause with the elements below that specifically uphold perpetuity and comply with Section 170(h).

If you do remove your standard amendment clause, then, at a minimum, document in writing, signed by all parties for the land trust’s permanent records, that the deviation from the practice of having an amendment clause does not indicate a presumption against any amendment.

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<sup>1</sup> IRS Form 990 instructions for Schedule D reporting of easement modifications state: “For purposes of this Schedule D reporting requirement, an easement is *modified* when its terms are amended or altered in any manner. For example, if the deed of easement is amended to increase the amount of land subject to the easement or to add, alter, or remove restrictions regarding the use of the property subject to the easement, the easement is modified.....Use of a synonym for any of these terms doesn't avoid the application of the reporting requirement. For example, calling an action a 'swap' or a 'boundary line adjustment' doesn't mean the action isn't also a modification, transfer, or extinguishment.” See the full instructions at <https://www.irs.gov/pub/irs-pdf/i990sd.pdf>.

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### Background

The following *Eight Elements of Conservation Easement Modification* provide a framework for analysis to assist drafters and land trust personnel in crafting an amendment clause that upholds perpetuity and survives scrutiny by the IRS. In the land trust's discretion, these elements can be included in one or many clauses.

- The Alliance recommends including a clause or clauses to allow modifications that are consistent with the overall purposes of the easement, subject to the requirements of applicable laws. Doing so clarifies up front for all parties the limited circumstances under which the parties may modify a conservation easement.
- [\*Land Trust Standards and Practices\* \(2017\)](#) requires land trusts holding easements to have a written policy on amendments that articulates the principles for and limitations on amendments, consistent with the concepts embodied in the Amendment Principles (Practice 11H1). To date, tax court decisions have only ruled against clauses that explicitly provided for removal of land from the easement.
- Drafters should review the Amendment Principles in the 2017 [\*Amending Conservation Easements: Evolving Practices and Legal Principles\*](#) (the Amendment Report) and ensure any amendment clause reflects the concepts embodied in these seven principles (the Amendment Principles):
  - (a) Clearly serve the public interest and be consistent with the land trust's mission
  - (b) Comply with all applicable federal, state and local laws
  - (c) Not jeopardize the land trust's tax-exempt status or status as a charitable organization under federal or state law
  - (d) Not result in private inurement or confer impermissible private benefit
  - (e) Be consistent with the conservation purpose(s) and intent of the easement
  - (f) Be consistent with the documented intent of the grantor and any direct funding source
  - (g) Have a net beneficial or neutral effect on the relevant conservation values protected by the easement

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### Drafting Pointers

#### **Eight Elements for Conservation Easement Modification**

Land trusts may wish to consider including the following elements, worded as developed by your attorney, staff and board and informed by your state law, policies and experiences. Use these *Elements* as a checklist to ensure that the concepts occur somewhere in your conservation easement. Following each element are italicized annotations providing the legal basis or the rationale for inclusion.

1. Perpetual duration of the easement and intent to protect conservation purposes in perpetuity.
  - *This element is about upholding conservation permanence, which the IRS wants to see emphasized. The word "perpetuity" appears twice in Tax Code Section 170(h). See also 9-2016 Summary Judgment order in Sells v. Commissioner, U.S. Tax Court Docket Nos.*

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6267-12, 6801-12, 6835-12, 6836-12, 6837-12, 6838-12, 19246-12 and 13553-13.

- The [IRS Conservation Easement Audit Techniques Guide](#) (revised January 24, 2018) also addresses the need to emphasize perpetuity: “The restriction on the use of the real property must be enforceable in perpetuity, meaning that it lasts forever and binds all future owners. An easement deed will fail the perpetuity requirements of § 170(h)(2)(C) and (h)(5)(A) if it allows any amendment or modification that could adversely affect the perpetual duration of the deed restriction.” While perpetuity applies to the entire document, the Tax Court has specifically stated that it wants to see perpetuity acknowledged in any modification clause.
2. Recognition that change happens over the course of time to which the land trust and the landowner may need to respond.
    - Thus, an acknowledgment of some kind that natural conditions, landscape changes, consistent uses, agricultural and silvicultural economic conditions, cultural conditions, technologies and many other factors may change, requiring the land trust to use its sole discretion to evaluate whether modification is necessary and is consistent with the purposes of the easement.
    - This explains the basis for the legitimacy and logic of amendments and discretionary waivers and approvals. Word the clause to allow the land trust discretion as uses evolve, if consistent with the conservation purposes and values. Agricultural and silvicultural easements may need to address changes in underlying practices that respond to market conditions, while still protecting in perpetuity all conservation purposes and values. An essential boilerplate clause to balance this point is the prohibition on use of economic hardship to defeat conservation restrictions.
  3. Full disclosure that nothing requires Grantor or Grantee to modify the easement deed.
    - This element is in response to IRS briefs in various cases, such as *Belk*, *Balsaam*, *Sells*, *Kumar* and *Pine Mountain*. This element addresses the IRS requirement that a land trust must retain all decision-making control and act exclusively in the public interest.
  4. Sole discretion for all determinations retained by the Grantee.
    - Avoid words such as “freely amend” or “not unreasonably withheld” and “Grantor and Grantee agree,” which cause concern for the IRS. Also avoid explicit Grantor rights to require any amendment or modification. Again, this is to avoid challenge by the IRS based on word choices that cause the Service concern about abuse.
  5. Incorporate the concepts embodied in *all* of the Amendment Principles.
    - These principles are consistent with the Treasury Regulations, Tax Code and case law.
    - Several of these basic principles overlap, but every concept embodied in a principle should be part of the easement language somewhere in the deed. Drafters can include the concepts in many ways and while it is not necessary to include all of the concepts in the modification clause, it may be logical and prudent to have them in one place.

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- *Drafters can include the concepts in the Amendment Principles in many ways and need not explicitly repeat the Principles. Drafters can avoid references to off-record documents by merely including the underlying concept. For example, a drafter can incorporate funders' intent in the easement's conservation purposes.*
6. Conforms to all of Grantee's policies in effect at the time of the amendment.
    - *The Amendment Report addresses land trust policies on modification.*
  7. Any extinguishment, with the exception of *de minimis* corrections, requires approval as dictated by state law. Easements for which the donor obtained a federal income tax deduction must comply with the U.S. Tax Code.
    - *IRC §170(h) and the Treasury Regulations §1.170A-14 apply, requiring that the donor must grant an easement in perpetuity, and the deed must protect the conservation purpose in perpetuity. This element is often included in a separate extinguishment clause.*
  8. Approval, waiver, discretion and consent provisions. The treatment of this essential tool for perpetual stewardship is the subject of some debate about whether to include it in a conservation easement. Some have concerns that the IRS will attack its use. Others balance the risks in favor of including a clause in order to set forth the limits of the use of these tools as many land trusts have done with amendments.
    - *The Amendment Report addresses approvals, waivers and consents. The standards for amendment and discretion are similar, but because land trusts exercise administrative discretion for temporary uses, structures or one-time events that are lesser in scope and scale than amendments, some of the standards are different. Similarly, sufficient overlap exists to reasonably encompass approvals, waivers and consents within the modification clause if a land trust so chooses.*
    - *This could also be a standalone clause, and many land trusts elect to treat this element in a separate section.*
    - *If you include this clause, you may wish to state explicitly, both in the easement and in the document granting the approval, waiver, consent or other discretionary act, that it is revocable in the land trust's sole discretion based on consistency with the conservation purposes or any other measurable standard as stated in your template.*
    - *Practice 11F2 of Land Trust Standards and Practices requires a land trust to establish written procedures to guide its decision-making if using discretionary approvals or if conservation easement deeds contain such clauses.*

### Other Elements to Consider with Counsel

Land trusts might consider including these additional elements in the conservation easement or in the amendment policy. Consider which elements are appropriate for your area, program, risks, funders and other stakeholders.

- The Grantor compensates the Grantee for actual and reasonable expenses (including

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staff costs) associated with processing the amendment. Require a stewardship contribution in accordance with the policies of the Grantee at the time the parties sign and record the amendment.

- No amendment is effective unless documented in writing, executed by the Grantee and the Grantor (and any third-party interest holders), notarized and recorded according to the real estate laws of your state.
- Consider whether holders of any mortgages or other liens should subordinate their interests to any substantive modification. Foreclosure of unsubordinated liens may extinguish that modification and potentially jeopardize easement enforcement. Understand your state law regarding the standard for extinguishment by prior right or prejudice; have land trust counsel carefully explain and evaluate your subordination requirement policy and also individual subordinations in light of the facts of each modification. If you are reducing building or division rights or otherwise further restricting Grantor rights or expanding Grantee rights, then consider the prudence of subordination to avoid disputes that are expensive and time consuming. As a practical matter, having the subordination may deter lenders and others with economic motivations from claiming that a modification has a junior priority to a lien being foreclosed.
- Advise the Grantor to obtain their own tax counsel, and confirm with the landowner that the Grantee is not responsible for any tax advice or consequences of any nature or type, and that the Grantee gives no assurances, no representations and no guarantees.
- Require an updated baseline *if* the on-the-ground conditions change because of the modification.
- Consider whether the amendment requires analysis and documentation from outside experts regarding conservation values, property attributes or valuation, and whether the Grantor should pay for this. The IRS often looks for this third-party independent evaluation and documentation.

### **General Suggestions**

- Draft defensively.
- Strive for a reasonable balance; you can't anticipate or define everything.
- Clearly express the intentions of all parties to the easement to guide courts on interpretation.
- Avoid jargon, abbreviations, colloquialisms, terms of art or technical terms.
- Beware of common law that may construe easement language against conservation.
- Understand the politics of your jurisdiction and its influence on the judiciary.
- Include a clause that directs judges to interpret the conservation easement fully in favor of conservation in all situations, not just ambiguities, and consistent with state conservation easement enabling act.
- Avoid conflict between clauses, and make explicit all assumptions.
- Explicitly address all conservation values and protected attributes.

### **Example Clause - For Illustration Purposes Only**

*The Land Trust Alliance is not engaged in rendering legal, accounting or other professional counsel or advice. This example merely illustrates the above elements of a possible modification clause. The IRS has not approved nor endorsed this clause, nor does it take into account all state*

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*law issues and local land trust considerations. For this reason, it is imperative that you work with your own legal advisors to craft a clause that makes sense for your organization. The Elements should assist you to construct your own tailored modification clause.*

### Example Clause

*Many ways exist to address IRS concerns, state law, Land Trust Standards and Practices, the Amendment Principles, risk balancing and the land trust's individual policy. The example below comes from three conservation attorneys spanning the country.*

#### 24. Amendment and Grantee's Discretionary Approval

24.1 Background. Grantor and Grantee have determined, in good faith, to articulate herein the limitations of any permissible modifications hereto. Grantor and Grantee recognize that natural conditions, landscapes, uses and technologies change over time, including (select appropriate: agricultural and silvicultural economic conditions, open space, scenic, other consistent with the particular easement) practices. Grantee and Grantor recognize that unforeseen or changed future circumstances may arise which makes it beneficial or necessary to take certain action in order to ensure the continued protection of the Conservation Values (Purposes) of the Protected Property and to guaranty the perpetual nature of this Conservation Easement. Additionally proposed activities may require the exercise of discretion by Grantee, as further described below. This Section therefore ensures that the Grantee protects the Conservation Values (Purposes) of the Protected Property in perpetuity.

24.2 Purpose. To this end, if approved by the Grantee in its sole discretion, Grantor and Grantee have the right to modify this Easement. Grantee may exercise its discretion in accordance with the provisions and limitations of this Section. Grantee has no obligation to agree to any modification of this Easement. No modification shall adversely affect the perpetual duration of this Easement or the perpetual protection of its Purposes.

24.3 Amendment Requirements. Grantee shall not consent to any amendment of this Easement unless Grantor submits a written request for amendment pursuant to Grantee's existing amendment policy and such amendment otherwise qualifies under Grantee's policy then in effect respecting conservation easement amendments. The effect of such amendment shall be at least neutral with respect to or enhances the Conservation Values, shall be consistent with the Conservation Values of this Easement, shall comply with I.R.C. Section 170(h) and any regulations promulgated pursuant to such section, and all applicable federal, state and local laws, shall be consistent with Grantee's public mission, shall not jeopardize the land trust's tax-exempt status or status as a charitable organization under federal or state law, and shall not result in private inurement or confer impermissible private benefit. Grantor and Grantee may amend this Easement to be more restrictive to comply with the provisions of I.R.C. Section 2031(c). Grantee may require subordination of any mortgage as a condition of permitting any substantive amendment to this Easement.

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24.4 General. Notwithstanding the foregoing, Grantee and Grantor shall have no power or right to agree to any activity, use or structure that would (i) result in the extinguishment in full of this Easement; (ii) adversely affect the perpetual nature of this Easement; (iii) adversely affect the qualification of this Easement or the status of Grantee under any applicable laws, including IRC Sections 170(h) and 501(c)(3) and the laws of the State of xxx; or (iv) result in either impermissible private benefit or inurement to any party. For purposes of this Section, the terms impermissible private benefit and inurement shall have the same meanings ascribed to them in IRC Section 501(c)(3) and associated Treasury Regulations. Any modification that results in a partial extinguishment with the exception of corrections and clarifications of boundary disputes, legal descriptions and internal use demarcations, and any other *de minimis* modification, shall follow any applicable state laws regarding approvals.

24.5 Discretionary Acts. Grantee may consent to activities, structures or uses, issue waivers or licenses or otherwise exercise discretion regarding which the Easement is silent or ambiguous, under the conditions and circumstances set forth below. Because of unforeseen or changed circumstances, if an activity, structure or use that is not expressly permitted under this Easement is deemed beneficial or necessary by Grantor, Grantor may request, and Grantee may in its sole discretion grant, permission for such activity, structure or use without resorting to the formalities of Grantee's amendment policy and process, subject to the following limitations. Such request for Grantee's consent shall be made in writing and shall describe the proposed activity or use in sufficient detail to allow Grantee to evaluate the consistency of the proposed activity with the preservation and protection of the Conservation Values. Grantee may grant its consent only if it determines, in its sole discretion, that (x) the performance of such activity is, in fact, beneficial or necessary; and (xi) such activity (A) shall not result in private inurement or confer impermissible private benefit, (B) results in an at least neutral result with respect to or enhances the Conservation Values of this Easement, and (C) does not violate the terms of this Easement. Grantor shall not engage in the proposed activity or use unless and until Grantor receives Grantee's approval in writing.

24.6 Costs. If Grantor is the party requesting an amendment of, or discretionary approval pursuant to, this Easement, Grantor shall be responsible for all reasonable and customary fees and costs related to Grantee's evaluation of said request and an amendment's execution, including reasonable attorney's fees and costs, staff, contractor, legal, expert, consultant fees and costs incurred by Grantee, and any costs associated with any updated Baseline Documentation Report prepared pursuant to the provisions of this Section.

24.7 Updated Baseline Documentation. In the event Grantor and Grantee agree to an amendment or discretionary approval pursuant to this Section that results in alterations to the land, then the Baseline Documentation Report shall be supplemented appropriately to reflect the modification scope, scale and intensity. The supplement shall be acknowledged by Grantor and Grantee as memorializing the condition of the Property as of the date of the amendment or discretionary approval.

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24.8 Recording. Grantor and the Grantee shall execute any amendment approved after following the procedures in this section, subject to review by xxxx if applicable in the subject state, as necessary, and shall be recorded in the xxxx Registry of Deeds.

24.9 Form. Any modification that Grantee determines in its sole discretion to be beneficial or necessary, shall be in the form of either (i) an amendment, in the case of a permanent modification of this Easement, including but not by way of limitation, a clerical or technical correction or modification of a reserved right; or (ii) a discretionary approval, waiver or consent in the case of a temporary activity or impact relating to the maintenance or management of the Protected Property which does not require a permanent modification of the Easement. All amendments and discretionary actions shall be subject to this Section. Nothing in this Section, however, shall require Grantor or Grantee to consult or negotiate regarding, or to agree to any amendment or discretionary approval, consent or waiver.

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**DISCLAIMER**

The Land Trust Alliance designed this material to provide accurate, authoritative information about the subject matter covered with the understanding that the Land Trust Alliance is not engaged in rendering legal, accounting, tax or other professional counsel. If a land trust or individual requires legal advice or other expert assistance, they should seek the services of competent professionals. The Land Trust Alliance is solely responsible for the content of this series.

**QUESTIONS?**

Please call or write to [Leslie Ratley-Beach](#), Conservation Defense Director 802-262-6051 or [Sylvia Bates](#), Director of Standards & Educational Services 603-708-1073.