Glass v. Commissioner

471 F.3d 698 (6th Cir., 2006), affirming 124 T.C. No. 16 (U.S.T.C., 2005).

State: Michigan
Procedural Status: Case concluded.
Date: 2006

Summary of Facts and Issues:

In 1992 and 1993, respectively, Charles and Susan Glass donated two conservation easements to the Little Traverse Conservancy (LTC). The conservation easements protected 410 feet out of the taxpayers' 460 feet shore frontage on Lake Michigan, and comprised just over one acre in total. The shore frontage consisted of beach and a steep bluff. This type of bluff and beach were known to be habitat for bald eagles, piping plovers, and two endangered plant species. The easements restricted most development along the beach and bluff, but did allow certain reserved rights to establish a boathouse, storage shed, day shelter, and a scenic viewing platform, as well as cutting vegetation for safety and view purposes, and for walking paths. The Glasses claimed deductions for the charitable contributions, based on independent appraisals. The IRS initially challenged the valuation of the easements, and the case worked its way through administrative channels for several years. Eventually, the IRS also contended that the easements did not qualify under the conservation purposes test of I.R.C. section 170(h) because they failed to protected habitat or open space. A trial was held in August 2004, at which the court bifurcated the valuation issue and the 170(h) qualification issue, and determined to rule first on the qualification issue. After the trial, the parties settled the valuation issue.

Holdings:

1) The Tax Court held that the conservation easements were granted for conservation purposes within the meaning of I.R.C. § 170(h)(4). In particular, the easement's purpose and effect was to protect bald eagle and endangered plant habitat, therefore qualifying as a "conservation purpose" under section 170(h)(4)(A)(ii), the "protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem." According to the court, the Glasses presented credible evidence that the easement would protect and preserve the
bald eagles' habitat and communities of threatened plant species on the land. Because the easements qualified under the habitat prong of the conservation purposes test, the court did not address the open space prong.

2) The Tax Court further held that the easements were granted "exclusively for conservation purposes" within the meaning of section 170(h)(5), noting that the easement was perpetual and legally enforceable, and also recognizing the Holder's commitment and financial resources to enforce the easement.

****December 2006 Update: In a December 21, 2006 opinion, the Sixth Circuit resoundingly affirmed the Tax Court's decision in all respects. In particular, the Circuit Court held that the easements protected significant habitat because threatened and endangered species were documented on the encumbered property and because, even without such documentation, there was ample evidence that such species could potentially inhabit the encumbered property.

The Circuit Court also held that the easement's reserved rights were not inconsistent with the easement's habitat protection purposes. Third, the Circuit Court upheld the Tax Court's analysis of § 170(h)(5).

Analysis and Notes:

The Tax Court opinion was very thorough, included a review of the legislative history of § 170(h), and held for the donors on every account. The court's conclusion that the easements met the §170(h)(4) conservation purposes tests seemed well-founded, given the strong evidence of the existence of endangered animals and plants on the protected property. The analysis of §170(h)(5) was also an important part of the case, for it suggests certain basic criteria for a conservation easement holder to observe in order to demonstrate that it will hold the easement "exclusively for conservation purposes." These criteria include: (a) the holder has the organizational commitment to land conservation; (b) the holder has adequate financial resources to enforce the easement; (c) the holder's enforcement of the easement is directly related to its purposes for tax-exemption; and (d) the easement contains language requiring that any subsequent holder be an entity fully committed to enforcing the easement.

****August 2006 Update: The case is currently on appeal before the Sixth Circuit, with several major issues under review, including what constitutes "significant wildlife habitat" and whether the landowner's reserved rights under the easement are consistent with the easement's purpose of protecting wildlife habitat.

December 2006 Update:

Full Disclosure Note: Although the Glasses were *pro se* throughout this litigation, the author of this document, Robert H. Levin, represented them for the purposes of drafting their appellate brief. In addition, the Land Trust Alliance and Little Traverse Conservancy filed a joint *amicus curiae* brief to espouse certain interpretations of I.R.C § 170(h).

The Sixth Circuit's opinion represents a huge win for the land conservation community, as several aggressive arguments set forth by the IRS were rejected out of hand.

On appeal, one of the Government's thematic arguments was that the easements should be held to a higher standard (both for significant habitat purposes and inconsistent reserved rights purposes) because of their relatively small size. The Sixth Circuit soundly rejected this approach, citing as persuasive authority IRS Private Letter Ruling 8546112 (recognizing the deductibility of an open space easement on ¾ of an acre) and noting that the quality of the habitat and the actual effect of the reserved rights, not the size of the protected property, is what matters.

Another aggressive, perhaps even radical, argument presented by the Government was that potential development on nearby properties (not owned by the Glasses) would undermine the habitat protection purposes of the conservation easements and therefore the easements should not qualify for a deduction. Again, the Sixth Circuit dismissed this reasoning, recognizing that easement donors have no legal right to control what development may or may not occur on these nearby properties.

One issue on appeal was whether the taxpayers had to show actual evidence that endangered or threatened species inhabit the property, or instead whether it was enough

to demonstrate that such species could *potentially* live, feed, or roost on the property. The Sixth Circuit, citing IRS Private Letter Ruling 200403044 as persuasive authority, held that a showing of potential habitat is sufficient in certain instances. Presumably, declaring a property potential habitat must be based on valid scientific data or reasoning and not simply pulled out of thin air. And despite this favorable ruling, easement donors and holders would be wise to carefully document which particular species or ecological communities are protected by their easements, both in the easements themselves and in the baseline data.

The Circuit Court distinguished this case from Turner v. Commissioner, 126 T.C. No. 16 (May 16, 2006) (see below) by noting that the easements here essentially doubled the setback provisions under the existing zoning ordinances, whereas in Turner, the easement simply mirrored the existing zoning protections.

Although the donors won on the reserved rights issue, the opinion suggests that easement drafters pay particular attention to reserved rights to ensure that they do not allow uses inconsistent with the conservation purposes of the easement. The Circuit Court conducted a careful analysis of the reserved rights and their likely effects. For example, the taxpayer's right to cut vegetation for safety and view maintenance purposes was deemed not to harm the threatened plant species because these plants grow only a few feet high and would not pose a safety or view concern. In addition, the right to build structures such as a boathouse and storage shed was acceptable because it was expressly limited to be conducted "in a manner and location which minimizes interference with the [Protected Property's] scenic and natural resource values" Finally, the right to cut vegetation for walking paths was found to enhance habitat protection by concentrating human use to a narrow corridor instead of allowing the widespread trampling of plants or disturbance of animals. An implicit conclusion of the opinion is that a loosely drafted easement that allowed overly generous reserved rights might not pass the "inconsistent uses" standard found in the federal regulations.