IN THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

No. 06-1398

CHARLES F. GLASS, SUSAN GLASS,

Petitioners-Appellees

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent-Appellant

ON APPEAL FROM THE DECISION OF THE UNITED STATES TAX COURT

PROOF BRIEF FOR THE APPELLANT

STATEMENT OF JURISDICTION

On August 27, 1999, the Commissioner of Internal Revenue (Commissioner) mailed a notice of deficiency to taxpayers Charles F. Glass and Susan G. Glass, asserting deficiencies for their 1992, 1993, 1994, and 1995 tax years in the amounts of $26,539, $40,175, $26,193, and $22,771, respectively. (R. 31 Stipulation at 2 and Ex. 7-J at 3, Apx.

pp.__,__.)[1] On November 29, 1999, taxpayers filed a Tax Court petition contesting the deficiencies. (R. 1 Petition at 1, Apx. p.__.) Because the petition was postmarked November 24, 1999, it was timely under Internal Revenue Code (26 U.S.C.) (I.R.C.) §§ 7502 and 6213(a). The Tax Court had jurisdiction under I.R.C. §§ 6213(a) and 7442.

The Tax Court entered its decision on December 28, 2005. (R. 64 Decision, Apx. p.__.) The decision was a final decision resolving all claims of all parties. On March 23, 2006, within 90 days after the Tax Court's entry of decision, the Commissioner filed a notice of appeal. (R. 65 Notice of appeal, Apx. p.__.) The notice was timely under I.R.C. § 7483 and Fed. R. App. P. 13(a). This Court has jurisdiction over the appeal pursuant to I.R.C. § 7482(a)(1).

STATEMENT OF THE ISSUE

Whether the Tax Court erred in holding that easements on their real property that taxpayers gave to the Little Traverse Conservancy Conservation Trust in 1992 and 1993 were for "the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem" within the meaning of I.R.C. § 170(h)(4)(A)(ii) and were

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[1] "R." references are to the documents contained in the record on appeal. "TR" references are to the trial transcript.

"exclusively for conservation purposes" within the meaning of I.R.C. § 170(h)(1)(C), and therefore that taxpayers were entitled to charitable deductions for "qualified conservation contributions" under I.R.C. §§ 170(a) and (f)(3)(B)(iii).

STATEMENT OF THE CASE

Taxpayers brought this Tax Court suit challenging deficiencies determined by the Commissioner for their 1992, 1993, 1994, and 1995 tax years. The deficiencies stemmed from the Commissioner's denial of taxpayers' claimed deductions for contributions of easements over two portions of their property to a land trust. The court severed the valuation issue from the issue whether the contribution of the easements constituted "qualifying conservation contributions" deductible under I.R.C. § 170(a) and (f)(3)(B)(iii).

After a trial, the Tax Court (Judge Laro) issued an opinion, published at 124 T.C. 258 (2005), determining that the contribution of the easements qualified as "qualified conservation contributions." After the parties came to an agreement regarding the value of the easements, the Tax Court entered decisions determining deficiencies for each of the stipulated years in issue. The Commissioner now brings this appeal.

STATEMENT OF THE FACTS

1. Taxpayers' property

Taxpayers Charles F. and Susan G. Glass own in fee simple a piece of property in the Township of Readmond, in Emmet County, Michigan, which is in the northern part of the lower peninsula of Michigan. (R. 53 Opinion at 4, Apx. p. __.) The property is a rectangle about ten acres in size, measuring approximately 460 feet from north to south, and approximately 1,055 feet from east to west. (R. 31 Stipulation at 3, Apx. p. __.) It is bounded on the east by the right-of-way for Highway M-119 (*id.*), to the north and south by private landowners (R. 53 Opinion at 8, Apx. p. __), and to the west by the ordinary high water mark of Lake Michigan (*Id.* at 6, Apx. p. __). Taxpayers used this property as a vacation home in 1992 and 1993, and made it their primary residence in 1994. (R. 31 Stipulation at 3, Apx. p. __.)

Along the shore of Lake Michigan, and thus across the width of taxpayers' property, a bluff rises from the shore of Lake Michigan. (R. 31 Stipulation at 3, Apx. p. __.) The bluff continues for some distance on either side of taxpayers' property. (R. 53 Opinion at 7, Apx. p. __.) On taxpayers' property, the bluff is relatively steep: it gains

about 100 vertical feet in space of only about 155 horizontal feet. (R. 31 Stipulation at 3, Apx. p. __; R. 53 Opinion at 6, Apx. p. __.) At the base of the bluff, along the shoreline, there is a level beach consisting of sand, rock, grass, and weeds. (R. 31 Stipulation at 3, Apx. p. __.) Between the top of the bluff and the highway right of way, taxpayers' property consists of roughly 900 feet of relatively flat land. (*Id.*)

Throughout the period at issue, three buildings were located on taxpayers' property: a house of about 1,278 square feet, a guest cottage of about 512 square feet, and a single-story garage of about 525 square feet. (R. 53 Opinion at 5, Apx. p. __.) The buildings are connected to a septic system. (*See* R. 31 Stipulation, Ex. 11-J at 3, Apx. p. __, and Ex. 12-J at 3, Apx. p. __.) All three buildings are located on the high, flat portion of the property, roughly 50 feet back from the edge of the bluff. (R. 53 Opinion at 7, Apx. p. __.) Taxpayers maintain a lawn around the house, and keep chairs at the top of the bluff, to enjoy the view and socialize. (*Id.* at 6-7, Apx. p. __.) There is a staircase running down the bluff to the beach. (Thomas Bailey at TR 50, 105, Apx. p.__.) A sketch of the property, showing the locations of the buildings, is included in the record. (R. 42 Transcript of 8/18/04, Ex. 31-R, Apx. p. __.)

Taxpayers' use of their land as a single-family residence or vacation home is typical of landowners in their neighborhood. (R. 53 Opinion at 8, Apx. p. ___.) Taxpayers' neighbors to the north have a single home on a 400-foot stretch of lakefront. (*Id.* at 8, Apx. p. ___.) Typically, however, homes along the shore within half-a-mile of taxpayers' property are sited somewhat closer together, about 250 feet apart. (*Id.*) Some of these homes are built on the side of the bluff. (*Id.* at 12, Apx. p. ___.)

There are at least three high-density developments within two miles of taxpayers' property. (R. 53 Opinion at 8-9, Apx. p. ___.) One of these, the Sequoia Yacht Club subdivision, which Mr. Glass helped to develop, consists of three lakefront lots and 19 or 20 back lots on a piece of real estate that, at 300 feet of lakefront by 1,000 feet deep, is less than two-thirds the size of taxpayers' property. (*Id.*)

In the summer, many people walk along the shore of Lake Michigan in Emmet County. (R. 53 Opinion at 13, Apx. p. ___.) There is public access to the lakeshore at Readmond Township Park, which is about one-and-a-half miles south of taxpayers' property, and at Cross Village, which is about four miles north. (*Id.* at 9-10, Apx. p. ___.) Taxpayers and their neighbors have an informal understanding that

they may walk along the lake on each others' land. (*Id.* at 14, Apx. p. __.) In addition, taxpayers (and their neighbors) are legally powerless to prohibit the public from walking across any unsubmerged land between the ordinary high water mark of Lake Michigan and the actual water's edge. *Glass v. Goeckel*, 703 N.W.2d 58, 72-73 (Mich. 2005), *cert. denied*, 126 S. Ct. 1340 (2006).

Plants that are considered threatened that grow along the shore of Lake Michigan in northern Emmet County are Lake Huron tansy and pitcher's thistle, both of which require undisturbed habitats to grow. (Thomas Bailey at TR 50, 63-64, Apx. pp. __-__.) The shoreline in the area is also home to bald eagles — which are "very sensitive to human activity" — and piping plovers. (*Id.* at 63, 78-79, Apx. pp. __,__-__.) Taxpayers' property does not provide an ideal habitat for piping plovers. (*Id.* at 80, Apx. p. __.)

2. Pre-existing legal restrictions on the use of the property

The local zoning code for Emmet County imposed certain building restrictions on taxpayers' property. A sketch of the property showing the local zoning districts, the top of the bluff, and the 1986 high water

mark is included in the record. (R. 43, Transcript of 8/19/04, Ex. 35-R, Apx. p.__.)

Starting from the highway right-of-way, the first 400 feet of taxpayers' property was zoned "scenic resource 2" ("SR-2"), a low-density residential classification. (R. 53 Opinion at 10, Apx. p.__.) Of these 400 feet, the first 40 were further restricted as a "scenic greenbelt setback," in which tree removal, clearing, and construction were restricted. (*Id.* at 11, Apx. p.__.) Each building lot in the SR-2 zone must be at least 30,000 square feet, with at least 150 feet of frontage, but the scenic greenback setback may be included in ascertaining the size of the building lot. (*Id.* at 10, Apx. p.__.) Under local zoning rules, then, this portion of taxpayers' property could have been subdivided into four building lots. (*Id.* at 10-11, Apx. p.__.)

The remainder of taxpayers' property, from the end of the SR-2 zone to the ordinary high water mark of Lake Michigan, was zoned "recreation residential 2" ("RR-2"), a higher density zone permitting the development of cottages and seasonal homes. (R.53 Opinion at 11, Apx. p.__.) Of this part of taxpayer's property, the first 60 feet from the 1986 high water mark of Lake Michigan — the lake having been unusually high in 1986 — was a waterfront setback, in which building

and development were not allowed. (*Id.* at 11, Apx. p.__.) Each building lot in the RR-2 zone must be at least 22,000 square feet, with frontage of at least 100 feet, but the waterfront setback may be included in ascertaining the size of the building lot. (*Id.* at 11-12, Apx. p.__.) Under local zoning rules, then, this portion of taxpayers' property could have been subdivided into as many as eight building lots. (R. 43 Transcript of 8/19/04, Ex. 35-R, Apx. p.__.)

Yes, ?-

3. Taxpayers' grant of easements

The Little Traverse Conservancy Conservation Trust (LTC) is a Michigan nonprofit organization exempt from federal income tax under I.R.C. § 501(c)(3). (R. 31 Stipulation at 3, 5, Apx. pp.__,__.) LTC's purpose is to protect the natural integrity and scenic beauty of the northern lower peninsula of Michigan. (Thomas Bailey at TR 50, 502, Apx. p.__.) In furtherance of its purpose, it acquires property and conservation easements by purchase and donation. (*Id.* at 51, Apx. p.__.) LTC does not formally monitor easements it receives on an annual basis, but on an informal, occasional basis. (R. 53 Opinion at 27, Apx. p.__.)

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See Bailey's Testimony -

a. The 1990 easement

On December 31, 1990, taxpayers created and contributed to LTC a conservation easement in perpetuity that covers the width of their property and extends 250 feet from the highway right-of-way towards the lake ("1990 easement"). (R. 53 Opinion at 14, Apx. p.__.) The deed creating the easement recognizes that an access road runs through the easement to taxpayers' garage. (*Id.*) The deed generally restricts building, construction, development, and the removal of trees in the encumbered area, but allows for the construction of (and removal of trees for) a garage/work space/studio of up to 3,200 square feet — that is, larger than all the buildings presently on the property combined — and a related access road. (*Id.*)

b. The 1992 and 1993 easements

On December 29, 1992, taxpayers created and contributed another conservation easement in perpetuity to LTC ("1992 easement"). (R. 31 Stipulation at 3, Apx. p.__, and Ex. 11-J at 1, Apx. p.__.) This easement covers the northernmost 150 feet of shoreline and all portions landward for 120 feet from the ordinary high water mark of Lake Michigan. (R. 31 Stipulation, Ex. 11-J at 8, Apx. p.__.) On December 30, 1993, taxpayers created and contributed a third conservation

easement in perpetuity to LTC ("1993 easement"). (R. 31 Stipulation at 4, Apx. p.__, and Ex. 12-J at 1, Apx. p.__.) This easement covers the southernmost 260 feet of shoreline and all portions landward for 120 feet from the ordinary high water mark. (R. 31 Stipulation, Ex. 12-J at 8, Apx. p.__.)

After the 1992 and 1993 easements were contributed to LTC, as taxpayers knew and intended, there remained unencumbered a strip of land 50 feet wide between the two easements, from the shoreline going landward. (Charles Glass at TR 246, 296-297, Apx. pp.__-__.) Taxpayers imagined they might use this strip to provide access to the beach from back lots. (*Id.* at 297, Apx. p.__.) In addition, all of taxpayers' property east of the 1992 and 1993 easements to the border of the 1990 easement remained unencumbered. (R. 43 Transcript of 8/19/04, Ex. 35-R, Apx. p.__.) The easements covered the waterfront setback on the encumbered land. (*Id.*; Charles Glass at TR 246, 346, Apx. p.__; Max Putters at TR 391, 407, Apx. p.__.) Neither the 1992 nor the 1993 easement reached the top of the bluff.[2] (Charles Glass at

[2] No survey was conducted when taxpayers purchased the property, or when they created the easement. (R. 31 Stipulation at 2, Apx. p.__; Thomas Bailey at TR 50, 101, Apx. p.__.) According to Mr. (continued...)

TR 246, 345, 347, Apx. pp.__,__.) Taxpayers were entitled develop the unencumbered portions of their property in any manner they chose, subject to local zoning ordinances, as described above. (R. 53 Opinion at 18, 21, Apx. pp.__,__.) There are no conservation easements restricting the development of the property immediately to the north or south of taxpayers' property. (R. 53 Opinion at 25, Apx. p.__.)

Not true – Judy Englehard

The 1992 and 1993 easements contained virtually identical language. Thus, the easements noted that the general area was under intense development pressure, which was detrimental to "rare and protected flora and fauna of the area" including piping plovers and Lake Huron tansy. (R. 31 Stipulation, Ex. 11-J at 1, Ex. 12-J at 1, Apx. pp.__,__.) The easements provided that, except as expressly allowed, there was to be no development on the encumbered property, no disturbance of the surface of the encumbered property, and no removal

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[2](...continued)
Glass, when the 1992 and 1993 easements were created, taxpayers believed they extended over the top of the bluff. (Charles Glass at TR 246, 345, Apx. p.__.) In 2004, well after the instant litigation was underway, taxpayers filed a state court suit seeking to enlarge the area covered by the easement. (*Id.* at 253, Apx. p.__.) As the Tax Court correctly held (R. 53 Opinion at 27, Apx. p.__), only the specific property actually contributed in 1992 and 1993 is relevant here.

of living trees, shrubs or other vegetation. (R. 31 Stipulation, Ex. 1 at 2-3, Ex. 12-J at 2-3, Apx. pp.__-__,__-__.)

As relevant here, the easements expressly reserved to taxpaye "all rights arising from their ownership of [encumbered] Property w are not prohibited by or inconsistent with the Purpose and other provisions of this Conservation Easement." (R. 31 Stipulation, Ex. at 3, Ex. 12-J at 3, Apx. pp.__,__.) In addition, each easement expressly provided that taxpayers were permitted (1) "to selectively move, prune, trim or cut trees, shrubs or other vegetation" in order provide views of Lake Michigan," for "safety purposes," and if incide to other uses authorized by the respective easement; (2) "to maintai repair and replace the existing foot path to the beach, as well as the right to construct, maintain, repair and replace additional foot path the beach"; (3) "to construct, maintain, repair and replace a day shelte storage shed, scenic overlook deck, patio or similar structures in a manner and location which minimizes interference with the scenic a natural resource values of the [encumbered] Property"; (4) "to construct, maintain, repair and replace a wooden boat house in a manner and location which minimizes interference with the scenic a natural resource values of the [encumbered] Property." (*Id.*) The

easement further permitted taxpayers to "build addition(s)" onto their house and guesthouse, so long as any encroachment is "incidental to the original [structures'] sized and location," and the existing house plus any addition does not exceed a stated square foot limitation (5,000 square feet for the house and 2,500 square feet for the guest house); and, if the existing house or guest house is replaced, "to build a portion of such replacement structure on the [encumbered] Property," so long as the encroachment is only incidental to the replacement structure's overall size and location and the replacement structure does not exceed a stated square foot limitation (5,000 square feet for the house and 2,500 square feet for the guest house). (*Id.*) The easements do not restrict use of the area by people or pets. (R. 31 Stipulation, Ex. 11-J, Ex. 12-J, pp.__-__,__-__.) Both easements may be terminated "[i]f subsequent, unexpected changes in the Property, or nearby property, render the Purpose of this Conservation Easement impossible to achieve." (R. 31 Stipulation, Ex. 11-J at 5, Ex. 12-J at 6, Apx. pp.__, __.)

On their 1992 federal income tax return, taxpayers claimed that the 1992 easement to LTC was a noncash charitable contribution with a fair market value of $99,000. (R. 31 Stipulation at 4, Apx. p.__.)

They also claimed other cash charitable contributions totaling $9,957 ($2,000 of which was given to LTC). (*Id.*; Thomas Bailey at TR 50, 84, Apx. p.__.) They were able to utilize $95,569 of the claimed contributions in 1992, and carried over $13,388 to 1993. (R. 31 Stipulation at 4, Apx. p.__.)

On their 1993 federal income tax return, taxpayers claimed that the donation of the 1993 easement to LTC was a noncash charitable contribution with a fair market value of $241,800. (R. 31 Stipulation at 5, Apx. p.__.) They also claimed $11,414 in cash charitable contributions, and the $13,388 carryover. (*Id.*) They were able to utilize $128,473 of the total on their 1993 return, and carried over the balance to 1994 and 1995. (R. 31 Stipulation at 5-6, Apx. pp.__-__.)

4. The Tax Court proceedings

The IRS issued taxpayers a notice of deficiency with respect to their 1992 through 1995 taxable years. (R. 31 Stipulation, Ex. 7-J, Apx. p.__.) The IRS determined that taxpayers were not entitled to the claimed charitable deductions for the donation of the 1992 and 1993 easements.[3] As relevant here, the IRS determined that the

[3] As the statute of limitations on determining a deficiency with (continued...)

contribution of the easements to LTC in 1992 and 1993 did not qualify as "qualified conservation contributions" within the meaning of I.R.C. § 170(h), and thus the claimed deductions were barred by I.R.C. § 170(f)(3)(A), which prohibits a charitable deduction for a donation of a partial interest in property. In this regard, the IRS asserted that the easements were not donated for a "conservation purpose" as defined by I.R.C. § 170(h)(4)(A) and were not "exclusively" for any such purpose within the meaning of I.R.C. §§ 170(h)(1)(C). The IRS further determined that even if allowable, the claimed deductions were based on inflated fair market values for the easements. – Now Resolved by settlement –

but they went ahead & settled

Taxpayers filed a petition for a redetermination of the deficiencies asserted against them in the Tax Court. (R. 1 Petition at 1, Apx. p.__.) Taxpayers asserted that the easements protected a relatively natural habitat of wildlife and plants, and also preserved open space, thus qualifying as being for a conservation purpose under both I.R.C. §§ 170(h)(4)(A)(ii) and (iii). Taxpayers further argued that the=

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[3](...continued)
respect to the claimed deduction for the donation of the 1990 easement had expired, taxpayers' 1990 tax year was not at issue in the Tax Court.

easements were donated "exclusively" for such purposes and had been correctly valued.

The Tax Court severed the question of the easements' fair market value from whether the easements constituted "qualified conservation contributions." (R. 43 Transcript of 8/19/04 at 619-620, Apx. pp.__-__.) At trial, Thomas Bailey, the executive director of LTC, testified that the entire Lake Michigan shoreline was a habitat for Lake Huron tansy, pitcher's thistle, bald eagles, and piping plovers. (Thomas Bailey at TR 50, 78-79, Apx. pp.__-__.) He stated that Lake Huron tansy and pitcher's thistle require a relatively undisturbed habitat to grow and that the easements provide a place for these plants to grow. (*Id.* at 63-65, Apx. p.__-__.) He testified that his staff had seen Lake Huron tansy on taxpayers' property. (*Id.* at 77-78, Apx. p.__.) As to piping plovers, he asserted that taxpayers' property "wouldn't have been ideal habitat, but it would have been a possible place." (*Id.* at 80, Apx. p.__.) He testified that he had not seen any bald eagles, but further stated that taxpayers' "property is famous for a roosting site for bald eagles." (*Id.* at 72, Apx. p.__.) He also testified that bald eagles are "very sensitive to human activity." (*Id.* at 63, Apx. p.__.) He opined that none of the rights taxpayers reserved would impair accomplishing the

purpose of the easements. (*Id.* at 70-71, Apx. p.__.) He agreed that building on the bluff would "interfere with and destroy the natural habitat" of "endangered and protected species." (*Id.* at 137, Apx. p.__.) Sally Churchill, who at the time of the donations was a land protection specialist for LTC, testified that LTC accepted the easements for erosion control. (Sally Churchill at TR 222, 235-236, Apx. pp.__-__.) In this regard, she noted that the property contained a very steep bluff and was heavily wooded with a lot of vegetation, and that without the trees and vegetation there would be severe eroding of the bluff. (*Id.*) She further opined that taxpayers' property was "a good wildlife habitat." (*Id.* at 236, Apx. p.__.)

Charles Glass testified that taxpayers granted the easements to LTC to protect the bluff. (Charles Glass at TR 246, 258, Apx. p.__.) He stated that the fact that the easements did not reach the top of the bluff was a mistake. (*Id.* at 349, Apx. p.__.) Susan Glass testified that she had seen bald eagles and Lake Huron tansy on the property, and that she may have seen piping plovers. (Susan Glass at TR 364, 370, Apx. p.__.) She further stated that she had seen an eagle roost on a tree that was at the northernmost corner of the property, (which was part of the 1992 easement.) (*Id.* at 370-371, Apx. p.__-__.) She later testified,

however, that the tree was at the top of the bluff. (*Id.* at 379, Apx. p.__.)

The Tax Court held that the 1992 and 1993 easements constituted "qualified conservation contributions" and therefore taxpayers were entitled to charitable deductions for the fair market value of the easements. (R. 53 Opinion at 2-3, Apx. p.__.) In this regard, the court held that the 1992 and 1993 easements were donated to LTC exclusively for the conservation purpose of protecting a relatively natural habitat of wildlife and plants. (*Id.* at 42, Apx. p.__.) The court first noted that Lake Huron tansy and pitcher's thistle grow on the shoreline of Lake Michigan and that they "require undisturbed habitats to survive." (*Id.* at 7, Apx. p.__.) The court further noted that bald eagles and piping plovers can be found on the shoreline. (*Id.*) The court stated that "[a]n exceptionally old and high tree on the top of the bluff of the property covered by easement 1 [the 1992 easement] (the highest tree on the bluff for some miles) is an occasional roosting site for at least one bald eagle." (*Id.*) The court noted that the property had Lake Huron tansy growing on it, and stated that "[t]he property is not an ideal habitat for Lake Huron tansy or pitcher's thistle, another threatened species of plant, but the property, in its natural state,

allows for the creation or promotion of the habitat of those species as well as the habitat of bald eagles and piping plovers." (*Id.* at 8, Apx. p.__.)

The Tax Court next observed that, under Treas. Reg. § 1.170A-14(d)(3)(i), an easement is donated for a qualified conservation purpose only if it is contributed "to protect a significant relatively natural habitat in which a fish, wildlife, or plant community, or similar ecosystem, normally lives." (R. 53 Opinion at 36, Apx. p.__.) The court stated that it "read sec. 170(h)(4)(A)(ii) to mean that the protection of a relatively natural habitat of wildlife or plants, in and of itself, is a significant conservation purpose within the intent of the statute." (*Id.* at 39 n.17, Apx. p.__.) The court held that taxpayers satisfied Treas. Reg. § 1.170A-14(d)(3)(i), observing that, according to LTC's executive director, Thomas Bailey, "the property is a 'famous' roosting spot for bald eagles and that the conservation easements establish a proper place for the growth and existence of Lake Huron tansy and pitcher's thistle." (*Id.* at 37, Apx. p.__.) The court further observed that both Bailey and Ms. Glass testified that Lake Huron tansy grew on the property, that Ms. Glass testified that she saw bald eagles there, and that "at least one of those eagles roosts on a tree growing on

encumbered shoreline 1." (*Id.*) The court concluded that "[i]n its natural undeveloped state, [the encumbered shoreline] is a 'relatively natural habitat' for a community of Lake Huron tansy, of pitcher's thistle, and of bald eagles," and that "[e]ach of the conservation easements will therefore protect and preserve significant natural habitats by limiting the development or use of the encumbered shoreline." (*Id.* at 39, Apx. p.__.) The court further held that the "contributions of the conservation easements operate to protect or enhance the viability of an area or environment in which a wildlife community and a plant community normally live or occur" in that "[b]oth portions of encumbered shoreline also have natural values that make them possible places to create or promote the habitat of Lake Huron tansy as well as the habitat of bald eagles." (*Id.* at 39, Apx. p.__.)

The Tax Court next turned its attention to the requirement of I.R.C. § 170(h)(1)(C) that the contribution be "exclusively for conservation purposes." (R. 53 Opinion at 39, Apx. p.__.) In this regard, it read the term "exclusively" to "place a focus on the contributee's holding of a qualified real property interest and, more specifically, to require that the contributee hold such an interest in

perpetuity exclusively for one or more of the conservation purposes listed in section 170(h)(4)." (*Id.* at pp. 39-40, Apx. pp.__-__.) In this regard, the court relied on H. Conf. Rep. 95-263 at 30-31 (1977), 1977-1 C.B. 519, 523, which involved a predecessor provision to the statute at issue here.

The court observed that LTC "is a legitimate, longstanding nature conservancy dealing at arm's length with petitioners"; that it "agreed (and has the commitment and financial resources) to enforce the preservation-related restrictions included in [the 1992 and 1993 easements] in perpetuity"; and that this agreement was "directly related to [LTC's] tax-exempt purposes." (R. 53 Opinion at 41, Apx. p.__.) Accordingly, the court held that the easements were "exclusively for conservation purposes." (*Id.*)

The court declined to consider the Government's argument that easements were not exclusively for conservation purposes because taxpayers reserved all rights to develop portions of their property not covered by the easements. (R. 53 Opinion at 42-43 n.20, Apx. pp.__-__.) The court opined that the small size of the easements, and the potential future development of the surrounding land, "relat[ed] not to the characterization of the conservation easements as qualified

conservation contributions," but rather were "most directly related to a determination of those contributions' fair market value." (*Id.* at 42 n.20, Apx. p.__.)

The parties thereafter stipulated to the fair market value of each easement, and the consequent deficiencies. (R. 64 Decision at 2, Apx. p.__.) The Tax Court entered decision consistent with this agreement and with its opinion.[4] (R. 64 Decision at 1, Apx. p.__.)

SUMMARY OF ARGUMENT

This federal income tax case concerns taxpayers' efforts to deduct, as charitable contributions, two easements over a portion of their property that they gave to LTC. Donations of partial interests in land generally are not deductible as charitable contributions. An exception exists, however, for donations of partial interests that are "qualified conservation contributions," as that term is defined in the Internal Revenue Code. At issue here is whether the easements were "qualified

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[4] Because the Tax Court held that the donations of the easements were exclusively for the conservation purpose of protecting a relatively natural habitat of wildlife and plants under I.R.C. § 501(h)(4)(A)(ii), it did not reach taxpayers' argument that the easements were for the conservation purpose of preserving open space under I.R.C. § 501(h)(4)(A)(iii). (R. 53 Opinion at 39 n.18, Apx. p.__.) As we explain *infra* at n.9, we submit that no remand is necessary here.

conservation contributions." The burden is on taxpayers to show that they are entitled to their claimed deduction.

As relevant here, easements are qualified conservation contributions if they are "exclusively for conservation purposes."

1. Here, the Tax Court held that the easements protected a significant natural habitat of wildlife and plants, specifically Lake Huron tansy, pitcher's thistle, and bald eagles. In reaching this conclusion, the Tax Court made several errors.

First, the Tax Court erred in its construction of the requirement found in Treas. Reg. § 1.170A-14(d)(3)(i) that the easement protect a "significant" habitat. The Tax Court effectively eliminated this requirement by reading the regulation to mean that the protection of any relatively natural habitat is itself a significant conservation purpose. The focus of the regulation is on the significance of the "relatively natural habitat" of wildlife or plants. Not every relatively natural habitat of wildlife or plants is necessarily significant. This reading disregards the legislative history, which provides that the deductions are "directed at the preservation of unique or otherwise significant land areas," both to prevent abusive deductions, and to avoid providing a tax incentive for the encumbrance of all land areas in

the country. It also ignores Treas. Reg. § 1.170A-14(d)(3)(ii), which provides that, to give rise to a deduction, an easement must protect, e.g., a unique habitat or the habitat of a rare, endangered, or threatened species of animal or plant. And, it gives short shrift to the notion of conservation, which implies that the thing to be conserved is in some way unique, rare, endangered, or threatened. It would undermine the purposes of permitting charitable contributions generally, by creating an opportunity for tax evasion. Accordingly, the Tax Court's reading should be rejected.

Second, the Tax Court erred by focusing its attention on the endangered flora and fauna that exists in the general area of taxpayers' property rather than on whether that flora or fauna can actually be found on the property subject to the easements. Section 170(h) and Treas. Reg. § 1.170A-14(d)(3)(i) do not provide a deduction based upon the speculative possibility that the land could one day serve a conservation goal. Rather, the easement must protect property that actually is the home to endangered species of flora or fauna.

Taxpayers failed to carry their burden of proving that rare, endangered, or threatened species normally live in the areas encumbered by the easements. The evidence of threatened species

within the easements was sparse and inconsistent. For example, one of the witnesses testified that taxpayers' property was "famous" as a roosting site for bald eagles, but admitted he had never seen one there. Ms. Glass testified that she had seen a bald eagle roosting on a tree within the easement, but later testified that the tree was at the top of the bluff — and it is undisputed that the easements do not reach the top of the bluff. On this record, then, taxpayers have not met their burden of showing that threatened species normally live in the encumbered areas.

Moreover, even if threatened species did normally live within the encumbered areas, the Tax Court erred in concluding that the easements could "protect" their habitat. The easements themselves are quite small, both in absolute terms and relative to taxpayers' unencumbered property, and there are no restrictions on how taxpayers may develop the unencumbered portions of their property. Within the encumbered areas, taxpayers (and their successors in interest) retained numerous rights, including the right to cut trees and move shrubs and other vegetation in order to provide views of the lake, for safety, or incidental to permitted construction. And they were permitted to construct numerous structures within the easements, including sheds,

boathouses, patios, and scenic overlook decks, and to construct and maintain footpaths. Further, the property surrounding taxpayers' property was unencumbered and could be developed. The threatened plants and animals whose habitats taxpayers ostensibly sought to protect required an undisturbed environment, in its natural state, and were sensitive to human activity. Accordingly, the terms of the easements offered these plants and animals no real protection.

2. Even if it serves an enumerated conservation purpose, an easement will not give rise to a deduction unless it is "exclusively for conservation purposes." The Tax Court read the requirement of exclusivity to focus solely on the donee, and specifically on whether the donee would hold the easement in perpetuity. This reading is erroneous.

As a general matter, from a donee's perspective, the donation of any easement will further its purpose. This can hardly be the standard intended by Congress to support a deduction. Instead, contrary to the Tax Court's holding, an easement cannot be "exclusively for conservation purposes" unless it excludes inconsistent purposes. Thus, a donation of an easement does not qualify as being "exclusively" for conservation purposes, and thus being eligible for a deduction, if it is

riddled with retained rights that allow for development inconsistent with the asserted conservation purpose. After all, the question is not whether the donee is entitled to the easement, but whether the donation rises to the level of supporting a deduction for the donor.

Here, far from excluding inconsistent purposes, the easements were riddled with exceptions permitting taxpayers (and their successors in interest) to disturb the encumbered areas by constructing structures, cutting trees, and removing vegetation for their safety, pleasure, and convenience. Furthermore, the possibility of future development on the unencumbered portions of taxpayers' property adjacent to the easements, as well as the neighboring properties, meant that even if LTC held the easements in perpetuity, the easements could not protect the encumbered area in perpetuity.

For these reasons, the Tax Court's holding that the easements were "exclusively for conservation purposes" is incorrect, and should be reversed.

ARGUMENT

The Tax Court erred in holding that the 1992 and 1993 easements were "qualified conservation contributions"

Standard of review

The Tax Court's findings of fact are reviewed for clear error, and its application of the law to the facts is reviewed de novo. *Ekman v. Commissioner*, 184 F.3d 522, 524 (6th Cir. 1999).

A. Introduction

At issue in this case is taxpayers' attempt to deduct as charitable contributions under I.R.C. § 170 two easements they gave to LTC on land that taxpayers owned. It is well-settled that provisions "granting a deduction are matters of 'legislative grace'" and as such, should be "strictly construed in favor of the government." *Chrysler Corp. v. Commissioner*, 436 F.3d 644, 654 (6th Cir. 2006). *See also Deputy v. DuPont*, 308 U.S. 488, 493 (1940). Thus "deductions are strictly construed and allowed only 'as there is a clear provision therefor.'" *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992) (quoting *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934)). A taxpayer who claims a deduction bears the burden of proving that he or she has satisfied all of the requirements for that deduction under the Code. *See*

Welch v. Helvering, 290 U.S. 111 (1933). The Tax Court recognized this rule of narrow construction here (R.53 Opinion at 28-29, Apx. pp.__-__), but then adopted an extremely broad reading of the statute. As we demonstrate below, however, whether interpreted broadly or (as we believe correct) narrowly, the Tax Court's decision here is erroneous.[5]

Section 170(a) of the Code provides for the deduction of charitable contributions. No deduction is allowable, however, for contributions to

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[5] We note that in *Weingarden v. Commissioner*, 825 F.2d 1027, 1029 (6th Cir. 1987), this Court, in a 2-1 decision, stated that provisions allowing charitable deductions should be liberally construed because such deductions are an expression of public policy. It is well-settled, however, that exemptions from tax are strictly construed, notwithstanding that such exemptions are also expressions of public policy. *See, e.g., Commissioner v. Schleier*, 515 U.S. 323, 327-328 (1995); *United States v. Wells Fargo Bank*, 485 U.S. 351, 354 (1988). In any event, subsequent to this Court's decision in *Weingarden*, the Supreme Court rejected a taxpayer's assertion that I.R.C. § 170 should be given a broad interpretation and held that the narrow reading put forth by the Government was correct, notwithstanding that both readings were consistent with the statutory language. *Davis v. United States*, 495 U.S. 472 (1990). The Supreme Court there observed that "[a]lthough the language of the statute may also bear petitioners' interpretation, they have failed to establish that their interpretation is compelled by the statutory language." 495 U.S. at 484. The Supreme Court deferred to the Government's reading where it was "consistent with the statutory language and fully implement[ed] Congress' apparent purpose in adopting it." *Id.* at 485. Consistent with *Davis*, we submit that the rule that deductions are construed narrowly controls here. In any event, whether construed broadly or narrowly, the Tax Court's construction of the relevant provisions of I.R.C. § 170 is incorrect.

charity of less than the taxpayer's entire interest in property. I.R.C. § 170(f)(3)(A). An exception to this rule, provided in I.R.C. § 170(f)(3)(B)(iii), allows a deduction for a partial interest in property which constitutes a "qualified conservation contribution." The term "qualified conservation contribution" is defined in I.R.C. § 170(h).

Present I.R.C. § 170(h) was enacted by the Tax Treatment Extension Act of 1980, Pub. L. 96-541, § 6(a), 94 Stat. 3206. Prior to that enactment, deductions for conservation easements were available under less comprehensive statutory schemes. When Congress initially prohibited the deduction of partial interests in property in the Tax Reform Act of 1969, Pub. L. 91-172, § 201(a), 83 Stat. 549, it carved out an exception for "an undivided portion of the taxpayer's entire interest in property." I.R.C. § 170(f)(3)(B)(ii) (1969). The legislative history indicates that Congress "intend[ed] that a gift of an open space easement in gross is to be considered a gift of an undivided interest in property where the easement is in perpetuity." H.R. Rep. No. 91-782, at 294 (1969), 1969-3 C.B. 644, 654 (Conf. Rep.). Seven years later, Congress added two items to the list of exceptions from the general rule that gifts of partial interests are not deductible: first, a lease, option to purchase, or easement over real property of not less than 30 years

duration granted exclusively for conservation purposes; and second, a remainder interest granted exclusively for conservation purposes. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2124(e)(1)(C) & (D); enacted as I.R.C. § 170(f)(3)(B)(iii) and (iv) (1976). The statute also defined the term "conservation purposes" to include "the protection of natural environmental systems." I.R.C. § 170(f)(3)(C)(iii) (1976). Both changes were part of an amendment proposed on the Senate floor, for the purpose of altering the tax incentives relating to historical structures. *See* 122 Cong. Rec. S24317-24323 (daily ed. July 28, 1976) (discussion of amendment 1905). All these provisions were set to expire on June 14, 1977, one year after they became effective. Tax Reform Act of 1976, Pub. L. No. 94-455, § 2124(e)(4). The next year, Congress substituted, for the requirement that the partial interest be "of not less than 30 years duration," the requirement that the interest be granted "in perpetuity." Tax Reduction and Simplification Act of 1977, P.L. 95-30, § 309(a) (enacted as I.R.C. § 170(f)(3)(B)(iii) (1977)). Congress also extended the sunset date for an additional four years, to June 14, 1981. *Id.* § 309(b).

As part of the Tax Treatment Extension Act of 1980, Congress modified and reorganized these provisions and reenacted them as

present I.R.C. § 170(h). Pub. L. 96-541, § 6(a), 94 Stat. 3206. The Tax Treatment Extension Act of 1980 also made the provision permanent for the first time. In this final enactment,[6] Congress recognized that, in permitting deductions for conservation easements, it was necessary to balance the importance of preserving this country's natural resources and cultural heritage against the "recogni[tion] that it is not in the country's best interest to restrict or prohibit the development of all land areas and existing structures," S. Rep. No. 96-1007, at 9 (1980), 1980-2 C.B. 599, 603, and further to balance the potential public benefit from conservation easements against the potential for abuse, *id.*; *see also* H.R. Rep. No. 96-1278, at 15 (1980). To balance these considerations, the Senate Committee on Finance indicated that "provisions allowing deductions for conservation easements should be directed at the preservation of unique or otherwise significant land areas or structures," S. Rep. No. 96-1007, at 9-10, 1980-2 C.B. at 603, and explained that "the committee bill would restrict the qualifying contributions where there is no assurance that the public benefit, if

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[6] Though there have been minor changes to I.R.C. § 170(h) since 1980, the provisions at issue here have not been modified since that time.

any, furthered by the contribution would be substantial enough to justify the allowance of a deduction," *id.*; *see also* H.R. Rep. No. 96-1278, at 15 (1980).

The term "qualified conservation contribution" is defined in present I.R.C. § 170(h) as a contribution "of a qualified real property interest" (I.R.C. § 170(h)(1)(A)), "to a qualified organization" (I.R.C. § 170(h)(1)(B)), "exclusively for conservation purposes" (I.R.C. § 170(h)(1)(C)). The term "qualified real property interest" is defined, as relevant here, as "a restriction (granted in perpetuity) on the use which may be made of the real property." I.R.C. § 170(h)(2)(C). There is no dispute that the easements here at issue are qualified real property interests. The term "qualified organization" is defined as an organization exempt from federal income tax under I.R.C. § 501(c)(3). I.R.C. § 170(h)(3)(B). There is no dispute that LTC was a qualified organization.

The term "conservation purpose" is defined as any of four statutory purposes: (1) "the preservation of land areas for outdoor recreation by, or the education of, the general public" (I.R.C. § 170(h)(4)(A)(i)); (2) "the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem" (I.R.C. § 170(h)(4)(A)(ii));

(3) "the preservation of open space . . . where such preservation . . . will yield a significant public benefit" (I.R.C. § 170(h)(4)(A)(iii)); and (4) "the preservation of an historically important land area or a certified historic structure" (I.R.C. § 170(h)(4)(A)(iv)). Taxpayers argued that the easements here at issue fulfilled the second and third conservation purposes, but the Tax Court addressed only the second purpose. (R. 53 Opinion at 39 and n.18, Apx. p.__.) Accordingly, only that purpose is at issue in this appeal.

The IRS regulations, which echo the statutory language, provide that an easement fulfills the second conservation purpose if it "protect[s] a significant relatively natural habitat in which a fish, wildlife, or plant community, or similar ecosystem normally lives." Treas. Reg. § 1.170A-14(d)(1)(ii), (d)(3)(i). The regulation also provides examples of "significant habitats and ecosystems," including "habitats for rare, endangered, or threatened species of animal, fish, or plants"; properties that are "high quality examples" of relatively intact ecosystems; and areas included in or contributing to the ecological viability of a local park or conservation area. Treas. Reg. § 1.170A-14(d)(3)(ii).

As noted above, to give rise to a deduction, an easement must not only serve a "conservation purpose," it must also be "exclusively for conservation purposes." I.R.C. § 170(h)(1)(C). I.R.C. § 170(h)(5) gives some content to this requirement by providing that "[a] contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity." In this regard, the regulations permit an easement to be treated as protecting its purpose in perpetuity even if the easement may be defeated by a future event, provided that "on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible." Treas. Reg. § 1.170A-14(g)(3); *see also* Treas. Reg. § 1.170A-14(g)(6) (concerning extinguishment by judicial proceeding).

The regulations give further content to the term "exclusively" by providing that "a deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests," except where the destructive use is "necessary" to the primary purpose (as an archeological excavation at an historic site). Treas. Reg. § 1.170A-14(e)(2)&(3). Similarly, "when the donor reserves rights the exercise of which may impair the conservation interests associated with

the property," no deduction will be allowed unless certain protective requirements are met. Treas. Reg. § 1.170A-14(g)(5)(i). Among these, the donee must have the "right to require the restoration of the property to its condition at the time of the donation." Treas. Reg. § 1.170A-14(g)(5)(ii).

The Tax Court held that the contributions here served a conservation purpose, because they protected a significant relatively natural habitat of wildlife and plants, specifically Lake Huron tansy, pitcher's thistle, and bald eagles. (R. 53 Opinion at 37, Apx. p.__.) As we shall demonstrate, the Tax Court erred in its construction of the term "significant" in the requirement of Treas. Reg. § 1.170A-14(d)(3)(i) that the habitat being protected be "significant." Moreover, taxpayers failed to meet their burden of showing that the easements would protect the habitat of Lake Huron tansy, pitcher's thistle, or bald eagles. To begin with, taxpayers did not produce any evidence that these species normally live on the encumbered portion of taxpayers' property, rather than on the unencumbered portions. And, the uses retained by taxpayers even within the encumbered areas undermine the ostensible purpose of the easements, so that the easements fail to protect any Lake Huron tansy or pitcher's thistle that might grow, or

eagles that might roost, in those areas. Absent the ability to protect the habitat of plants and wildlife, the easements do not fulfill a conservation purpose.

The Tax Court also held that the easements could be found to serve conservation purposes "exclusively" simply because they were granted to a conservation organization in perpetuity, without considering the inconsistent uses reserved by taxpayers, or the possible future development of the unencumbered portion of taxpayers' property. (R. 53 Opinion at 40-41, 42-43 n.20, Apx. pp.__-__.) As we shall demonstrate, this holding gives an erroneous meaning to the term "exclusively" that is inconsistent with both the regulations and the legislative history. Contrary to the Tax Court's holding, the statutory requirement that an easement serve conservation purposes "exclusively" means that the terms of the easement must exclude inconsistent uses, including inconsistent uses of the donor's retained interest in property. Because the easements here expressly permit uses inconsistent with the protection of wildlife and plants, and do not limit in any way the development of the unencumbered part of taxpayers' property, the easements do not fulfill the requirement that they be "exclusively for conservation purposes."

B. The easements were not for "the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem"

1. The Tax Court erred in concluding that the preservation of any natural habitat is inherently significant

To satisfy the conservation purpose of protecting a natural habitat under I.R.C. § 170(h)(4)(A)(ii), the regulations require that the habitat be "significant." Treas. Reg. § 1.170A-14(d)(3)(i). The nonexhaustive list of significant habitats includes "habitats for rare, endangered, or threatened species of animal, fish, or plants." Treas. Reg. § 1.170A-14(d)(3)(ii).

The regulation's requirement that the habitat be "significant" reflects Congress' understanding of the statute it was enacting. Congress expected that "provisions allowing deductions for conservation easements [w]ould be directed at the preservation of unique or otherwise significant land areas . . ." S. Rep. No. 96-1007, at 9-10. And it believed the statute would not encourage taxpayers to restrict or prohibit development of all land areas. S. Rep. 96-1007, at 9. It also believed that the statute would ensure that conservation easements would produce a public benefit "substantial enough to justify the allowance of a deduction." *Id.*; H.R. Rep. No. 96-1278, at 15.

The Tax Court here effectively eliminated this significance requirement by reading I.R.C. § 170(h)(4)(A)(ii) "to mean that the protection of a relatively natural habitat of wildlife or plants, in and of itself, is a significant conservation purpose within the intent of the statute." (Op. 39 n.17.) The Tax Court erred in failing to recognize that the focus of the regulation is on the significance of the "relatively natural habitat" of wildlife or plants. Not every relatively natural habitat of wildlife or plants is necessarily significant. Indeed, as noted above, the legislative history indicates that, to protect against potential abuse, the deduction was "directed at the preservation of unique or otherwise significant land areas." S. Rep. No. 96-1007 at 9. The requirement that the habitat to be preserved be significant follows from very idea of conservation: one does not speak of "conserving" a resource unless that resource is in some way unique, rare, endangered, or threatened. The requirement of significance thus follows from the notion of a "conservation purpose."

The Tax Court's interpretation of the regulation's requirement would permit a tax deduction for an easement, no matter how small, that protected an area in which any animal or plant, no matter how common, resided. It would thus undermine the Congressional intent

that tax deductions be matched to public benefits, and would provide an unintended incentive for taxpayers to encumber lands that, being without ecological significance, might better be used for other purposes. Indeed, the Tax Court's construction of the "significant" requirement of the regulation "would tend to undermine the purposes of § 170 by . . . creat[ing] an opportunity for tax evasion that others might exploit," *Davis*, 495 U.S. at 485, and thus should be rejected. The Tax Court erred as a matter of law by effectively reading the term "significant" out of the regulation.[7]

2. The Tax Court erred in concluding that the easements served to protect the habitat of certain threatened species

1. The regulations provide that, to fulfill the conservation purpose of habitat preservation, a conservation easement must protect a habitat where a rare, endangered, or threatened animal or plant "normally lives." Treas. Reg. § 1.170A-14(d)(1)(ii). Here, the Tax Court did not find that threatened plants or animals "normally live" in the areas subject to the easements; instead, it found that those areas "have

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[7] We also note that the Commissioner's construction of his regulation is entitled to substantial deference. *See United States v. Cleveland Indians Baseball Co.*, 532 U.S. 200, 219 (2001).

natural values that make them possible places to create or promote the habitat of Lake Huron tansy as well as the habitat of bald eagles." (Op. 39.) The statute does not permit a deduction based on the speculative possibility that the area might one day serve a conservation purpose. Rather, the easement must protect an area that actually is home to endangered plants or animals. Because it is taxpayers' burden to establish their entitlement to the claimed deductions, it was incumbent upon them to establish that endangered plants or animals normally lived in the areas subject to the easements. Taxpayers failed to meet their burden.

The only evidence of threatened or endangered species on taxpayers' property was the testimony of Thomas Bailey and Susan Glass. Bailey only testified that his staff had seen Lake Huron tansy on taxpayers' property; he did not testify that it was growing in the areas subject to the easements. (Thomas Bailey at TR 50, 77-78, Apx. pp. __- __.) And, while he stated that taxpayers' property was a "famous" roosting site for bald eagles, he did not specify which part of the property, and he admitted that he had never seen any bald eagles there. (*Id.* at 72, 79, Apx. pp. __,__.) Susan Glass testified that she had seen Lake Huron tansy on the property and that she may have

seen piping plover, but in both cases did not specify where on the property she had seen them. (Susan Glass at TR 364, 370, Apx. p. __.) She testified that she had seen a bald eagle roost on a tree on the portion of the property subject to an easement (*id.* at 370-371, Apx. pp.__-__), but later stated that the tree was "on the very top of the bluff" (*id.* at 379). It is undisputed that neither of the easements reached the top of the bluff. (Charles Glass at TR 246, 345, Apx. p.__.) Finally, there was no evidence that anyone had ever seen pitcher's thistle on any part of taxpayer's property. On this evidence, taxpayers cannot meet their burden of showing that the property subject to the easements is a significant habitat for endangered flora or fauna, i.e., that a threatened species "normally lives" within either of the areas covered by the easements. Instead, taxpayers at most have established the speculative possibility that the encumbered property could, one day, be such a habitat. Congress did not intend to grant a deduction in such circumstances.

2. Moreover, even if Lake Huron tansy, pitcher's thistle, bald eagles, or piping plover did inhabit the areas covered by the easements, the terms of the easements did not protect their habitat in any real sense. Even within the encumbered areas, taxpayers (and their

successors in interest) retained the right to "selectively move, prune, trim or cut trees, shrubs or other vegetation" to provide views of the lake, for safety, or incidental to permitted construction or maintenance, and they had extensive rights to construct and maintain structures. (R. 31 Stipulation, Exs. 11-J at 3, 12-J at 3, Apx. pp. __,__.) By constructing a boathouse or a footpath, taxpayers could easily have removed Lake Huron tansy or pitcher's thistle without violating the terms of the easement. Indeed, because these plants require "undisturbed habitats to survive" (R. 53 Opinion at 7, Apx. p.__), taxpayers (or their successors in interest) could have killed them merely by walking, or permitting others to walk, along the shore. Similarly, even if the tree upon which an eagle purportedly roosted was located within the area covered by an easement (which it was not), nothing in the terms of the easement would have prevented taxpayers from cutting down that tree to provide a better view of the lake, or to construct a boathouse, scenic overlook deck, or patio. (R. 31 Stipulation, Exs. 11-J at 3, 12-J at 3, Apx. pp. __,__.)

The Tax Court agreed that the property would have to be maintained "in its natural state" to create or promote the habitat of Lake Huron tansy, pitcher's thistle, bald eagles, and piping plovers.

(Op. 39.) But taxpayers' property was not in a natural state to begin with: it already contained three buildings and a long access road, a staircase down the bluff, and a septic system, and had been otherwise altered by many years of vacation and residential use. (R. 42 Transcript of 8/18/04, Ex. 31-R, Apx. p. __; Thomas Bailey at TR 50, 105, Apx. p. __; R. 31 Stipulation, Exs. 11-J at 3, 12-J at 3, Apx. pp. __, __.) Moreover, even assuming the areas covered by the easements were in a natural state at the time the easements were created, the court erred in not considering whether the easements could preserve the encumbered areas in a natural state. It did not even mention many of the uses retained by taxpayers, let alone address how the easements could preserve the area in a natural state, given the extensive use and construction permitted under the terms of the easements.

Nor can an emphasis on the word "relatively" in the statute save the conservation purpose here. *See* I.R.C. § 170(h)(4)(A)(ii). To be sure, the phrase "relatively natural state" permits deductions for easements over areas that have "been altered to some extent by human activity," but only if the area continues to provide habitat for "rare, endangered or threatened native species." Treas. Reg. § 1.170A-14(d)(3)(i) (giving as an example a lake formed by a man-made dam). But there is no

suggestion that further alteration of the encumbered area is permissible. To the contrary, the regulations do not permit a deduction for an easement that would undermine conservation purposes, even if the easement would in some way limit development. *See* Treas. Reg. § 1.170A-14(f), Example (3) (no deduction for easement that permits construction of ten homes on land that might otherwise have supported more than twenty, where construction of any homes would undermine conservation purpose). The court's holding that it was enough for the easements to "limit[ ] the development or use of the encumbered shoreline" (Op. 39), without requiring that they be able to preserve the shoreline in a state conducive to inhabitation by the threatened species, is in conflict with this regulation.

Moreover, the easements here limited development along the lake shore little more than did the zoning restrictions already imposed by Emmet County. The county waterfront setback prevented construction within 60 feet of the 1986 high water mark. (R. 53 Opinion at 11, Apx. p.___.) It thus prevented development in more than half of the area covered by the easements (which extended back 120 feet from the ordinary high water mark). (R. 53 Opinion at 11, 16, 19, Apx. pp.___, ___, ___.) An easement that purports to restrict development in an

unbuildable floodplain hardly serves a conservation purpose. *Turner v. Commissioner*, 126 T.C. No. 16, 2006 WL 1330084, at Opinion B.2.b(1) and (2)n.11 (May 15, 2006). Just so here, the putative restriction against development in the waterfront setback serves no conservation purpose, because taxpayers had no right to develop the area in the first place.

The easements' ability to protect the habitat of the threatened species is also called into question by the small size of the easements, and the possible development there and the possible and existing development of neighboring land. The easements here, taken together, are smaller than a football field. Taxpayers retained the right to develop the property abutting the encumbered area. Under local zoning rules, and even taking the 1990 easement into account, their property could have been divided into as many as ten lots. (R. 43 Transcript of 8/19/04, Ex. 35-R, Apx. p.__; R. 53 Opinion at 10-11, Apx. pp.__-__.) Indeed, taxpayers left some of the bluff unencumbered with the idea of providing access to the beach from back lots. (Charles Glass at TR 246, 297, Apx. p.__.) Neighboring properties could also be developed. Taxpayers' neighbors to the north, for example, had one house on two parcels with a combined 400 feet of lake frontage,

whereas properties in the area were typically somewhat smaller, with the houses about 250 feet apart. (R. 53 Opinion at 8, 12, Apx. pp.__, __.) Mr. Glass himself was involved in the development of a high-density subdivision within a few miles of his property, where roughly twenty lots were located on a property two-thirds the size of taxpayers'. (R. 53 Opinion at 8-9, Apx. p. __.) Every additional home built in the area would increase the number of neighbors walking along the encumbered shoreline. (R. 53 Opinion at 13-14, Apx. p. __.) *And see Glass v. Goeckel*, 703 N.W.2d 58, 72-73 (Mich. 2005), *cert. denied*, 126 S. Ct. 1340 (2006) (taxpayers powerless to prevent the public from walking between the ordinary high water mark and the water). Such increase in human activity — an increase in activity that the easements did nothing to prevent — would disturb the bald eagles and plants whose habitats taxpayers ostensibly sought to protect. (Thomas Bailey at TR 50, 63-64, Apx. __,__.)

Indeed, given the small size of the easements and the possible development thereon and on the neighboring land, it is, at best, a stretch to even consider the land covered by the easements to be a "habitat." As the Tax Court pointed out, the term "habitat" can be defined as "the aquatic and terrestrial environments required for

wildlife to complete their life cycles, including air, food, cover, water, and spatial requirements." (R. 53 at 38, Apx.__ (citing 7 C.F.R. § 636.3 (2002)). The extremely limited area that is subject to restriction, under possible assault from all sides, is hardly an environment that allows the threatened species to complete their life cycles.

C. The Tax Court also erred in holding that the easements were "exclusively for conservation purposes"

1. An easement is not "exclusively for conservation purposes" if it is riddled with exceptions allowing development of the encumbered property

The Tax Court failed properly to apply the requirement of I.R.C. § 170(h)(1) that the donation be "*exclusively* for conservation purposes." The Tax Court gathered support for its view from the legislative history, not of the Tax Reform Act of 1976, where the term "exclusively for conservation purposes" was coined, but of the Tax Reduction and Simplification Act of 1977, Pub. L. 95-30, § 309(a), 91 Stat. 154, which modified related text. (*Id.* at 33, 40, Apx. pp.__,__.) The passage cited by the Tax court (*see* R. 53 Opinion at 40, Apx. p.__) states that:

> it is intended that a contribution of a conservation easement . . . qualify for a deduction only if the holding of the easement . . . is related to the donee's purpose for exemption — . . . and the donee is able to enforce its rights as holder of the

> easement . . . and protect the conservation purposes which the contribution is intended to advance. The requirement that the contribution be exclusively for conservation purposes is also intended to limit deductible contributions to those transfers which require that the donee hold the easement . . . exclusively for conservation purposes (i.e., that they not be transferable by the donee in exchange for money, other property, or services).

H.R. Rep. 95-263 at 30-31, 1977-1 C.B. 523 (Conf. Rep.). Relying on this passage, the Tax Court focused solely on the donee. (*Id.*) Thus, the court held that since LTC held the easements in perpetuity, taxpayers' conveyance of the easements to LTC necessarily was exclusively for conservation purposes. (*Id.* at 41, Apx. p.__.)

To be sure, the Conference Report speaks generally in terms of an easement qualifying for a deduction only if it furthers the conservation purpose of the donee. But, as a general matter, from a donee's perspective, the donation of any easement will further its purpose. This can hardly be the standard intended by Congress to support a deduction. After all, the question is not whether the donee is entitled to the easement, but whether the donation rises to the level of supporting a deduction for the donor.

Furthermore, the Tax Court's apparent understanding that I.R.C. § 170(h)(5) defines the term "exclusively" when it states that for an

easement to be exclusively for conservation purposes it must be held in perpetuity is incorrect. The terms of I.R.C. § 170(h) indicate that the requirement of I.R.C. § 170(h)(1)(C), that a contribution be "exclusively for conservation purposes," requires more than satisfaction of the tests contained in I.R.C. §§ 170(h)(5). The first four subsections of I.R.C. § 170(h) begin with the formulation "the term . . . means . . ." I.R.C. § 170(h)(1) (defining "qualified conservation contribution"), (h)(2) (defining "qualified real property interest"), (h)(3) (defining "qualified organization"), (h)(4)(A) (defining "conservation purpose"). Subsection (h)(5), in contrast, does not purport to define a term and does not use the formulation "the term . . . means . . ." Instead, it stipulates that at all events, an easement may not be treated as "exclusively for conservation purposes" unless it meets certain requirements: that the conservation purpose be protected in perpetuity, I.R.C. § 170(h)(5)(A), and that no surface mining be permitted, I.R.C. § 170(h)(5)(B). Thus, in contrast to the first four subsections of I.R.C. § 170(h), subsection (h)(5) does not purport to exhaust the meaning of the term it addresses.

Rather, a donation of an easement does not qualify as being "exclusively" for conservation purposes, thus being eligible for a deduction, if it is riddled with retained rights that allow for

development inconsistent with the asserted conservation purpose. It is not Indeed, like the structure of the statute, the legislative history reflects the belief of the enacting Congress that the exclusivity requirement of I.R.C. § 170(h)(1)(C) required more than satisfaction of the conservation purpose requirement of I.R.C. § 170(h)(1)(B) and (h)(4)(A) and the perpetuity and surface-mining provisions of I.R.C. § 170(h)(5). To the contrary, Congress believed that an easement could not satisfy the requirement that it be "exclusively for conservation purposes" if the donors retained the right to uses inconsistent with conservation purposes:

> The bill retains the present law requirement that contributions be made "exclusively for conservation purposes." Moreover, the bill explicitly provides that this requirement is not satisfied unless the conservation purpose is protected in perpetuity. The contribution must involve legally enforceable restrictions on the interest in the property retained by the donor that would prevent uses of the retained interest inconsistent with the conservation purposes. In the case of a contribution of a remainder interest, the contribution will not qualify if the tenants, whether they are tenants for life or a term of years, can use the property in a manner that diminishes the conservation values which are intended to be protected by the contribution.

S. Rep. No. 96-1007, at 13 (1980), 1980-2 C.B. at 605; H.R. Rep. No. 96-1278, at 18 (1980). By insisting that "the contribution must involve

legally enforceable restrictions on the interest in the property retained by the donor that would prevent uses of the retained interest inconsistent with the conservation purposes," *id.*, Congress indicated its understanding that the term "exclusively" also required the exclusion of inconsistent uses.

Nor does the legislative history from the 1977 Act, upon which the Tax Court relied (R. 53 Opinion at 40, Apx. p.__), undercut this view. That history does not purport to limit the term "exclusively," and is thus also consistent with a broader reading of the term. *See* H.R. Rep. No. 95-263, at 30-31 (1977), 1977-1 C.B. at 523 (Conf. Rep.).

Here, the donation of the easements plainly were riddled with retained rights that allowed for development inconsistent with the asserted conservation purpose of preserving an undisturbed habitat for Lake Huron tansy, pitcher's thistle, bald eagles and piping plovers. Indeed, not only did the easements expressly reserve to taxpayers all rights not granted away, but they expressly permitted taxpayers to move, prune, trim or cut trees, shrubs or other vegetation in order to provide views of the lake, or if incidental to other authorized activities; "to maintain, repair and replace the existing foot path to the beach, as well as the right to construct, maintain, repair and replace additional

foot paths to the beach"; "to construct, maintain, repair and replace a day shelter, storage shed, scenic overlook deck, patio or similar structures"; "to construct, maintain, repair and replace a wooden boat house"; "to build addition(s) onto the existing cottage"; and if the existing cottage is replaced, "to build a portion of such replacement structure on the [encumbered] Property." (R. 31 Stipulation, Exs. 11-J at 3, 12-J at 3, Apx. pp. __,__.) Such retained rights are hardly consistent with maintaining a habitat for endangered species of flora and fauna. Instead, taxpayers clearly retained extensive rights that directly conflicted with the asserted conservation purpose of the easements.

Furthermore, the court erred by turning a blind eye to the fact that the portion of taxpayers' property that was not subject to easements, as well as the neighboring property, could be developed in any manner consistent with local zoning provisions. The fact of the matter is that the area of land covered by the easements is small. The development of the unrestricted areas would adversely affect the encumbered land, defeating the purpose of the deduction. See discussion, *supra* at pp. 47-48. Indeed, even the Tax Court recognized

(R. 53 Opinion at 7, Apx. p.__) that the endangered flora found in the general area required an undisturbed habitat to survive.[8]

2. The easements did not protect threatened species in perpetuity

As the Tax Court noted, I.R.C. § 170(h)(5) requires that a conservation purpose be "protected in perpetuity." The Tax Court read this requirement to require only "that the contributee hold [a qualified] interest in perpetuity exclusively for one or more of the conservation purposes listed in section 170(h)(4)." (Op. 39-40.) But, this reading effectively reads the word "protect[ ]" out of I.R.C. § 170(h)(5). Contrary to the Tax Court's reading, for an easement to *protect* a conservation purpose in perpetuity, "any interest in the property

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[8] The Tax Court disregarded the potential for future development of the unencumbered land, stating that it was "most directly related" to the issue of valuation, not to whether the easements were qualified conservation contributions. (R. 53 Opinion at 42-43 n.20, Apx. pp.__-__.) That analysis presents a false dichotomy. To be sure, the possibility of future development is relevant to valuation. But it is also relevant to whether the easements will serve a conservation purpose in perpetuity, by protecting the encumbered area against the effects of possible future development on neighboring land. Any realistic assessment of the ability of a conservation easement to protect any conservation purpose in perpetuity must take into consideration the possible future development of the neighboring land — especially where, as here, the areas subject to the easement are small and are bordered by unencumbered property.

retained by the donor (and the donor's successors in interest) must be subject to legally enforceable restrictions (. . .) that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation.". Treas. Reg. § 1.170A-14(g)(1). That is, an easement that does not have the power to "prevent uses of the retained interest inconsistent with conservation purposes," cannot satisfy the requirement that the conservation purpose be protected in perpetuity. *See* S. Rep. No. 96-1007, at 13 (1980); H.R. Rep. No. 96-1278, at 18 (1980).

The easements here do not meet this requirement because, as noted above, they do not prevent taxpayers (or their successors in interest) from subdividing and developing the unencumbered portions of their property. Nothing about the easements would prevent the purchasers of any lots into which taxpayers' property might be divided from using the encumbered areas in the same way. Moreover, as noted above, taxpayers here retained numerous rights inconsistent with their asserted conservation purpose, including the rights to trim and remove plants, to walk over all parts of the easements, to move boats across the beach, and to construct decks, patios, boathouses, and similar structures. Because the easement cannot protect the encumbered areas

from the increased traffic that could result from future development, it cannot *protect* the areas in perpetuity.[9]

In sum, taxpayers may not deduct as charitable contributions the easements it gave to LTC because those easements are not for the protection of a significant, relatively natural habitat of wildlife or plants, and because they were not exclusively for conservation purposes. As we have demonstrated, the easements did not serve a conservation purpose because the encumbered areas were not significant natural habitats. Moreover, the terms of the easements did not protect the encumbered areas against uses that would tend to destroy the habitat. Furthermore, the easements were not exclusively for conservation purposes because they were riddled with exceptions allowing taxpayers (and their successors in interest) to use and develop

[9] As noted above, taxpayers also argued that the easements served the conservation purpose of preserving open space, but the Tax Court did not reach that argument. (*See* R. 53 Opinion at 39 n.18, Apx. p.__.) We submit that it is not necessary to remand this case for consideration of taxpayers' alternate argument. Even assuming *arguendo* that the easements served the purpose of preserving open space within the meaning of I.R.C. § 170(h)(4)(A)(iii), because of the inconsistent uses retained by taxpayers, and the possible future development of the encumbered area as well as the unencumbered portions of taxpayers' property, as discussed above, taxpayers could not establish that the easements were exclusively for conservation purposes.

the encumbered property in ways inconsistent with the protection of the wildlife and plant communities living there.

CONCLUSION

For the reasons stated above, the Tax Court's decision is incorrect and should be reversed.

Respectfully submitted,

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