



TAX EXEMPT AND  
GOVERNMENT ENTITIES  
DIVISION

DEPARTMENT OF THE TREASURY  
INTERNAL REVENUE SERVICE  
WASHINGTON, D.C. 20224

**AUG 16 2007**

The Honorable Ken Salazar  
United States Senate  
Washington, DC 20510

Dear Senator Salazar:

Thank you for the opportunity to meet with you on July 25, 2007, about our conservation easement examination program in Colorado. When we met, we discussed that I had scheduled a meeting with representatives of three organizations involved with Colorado land trusts and conservation easements, and I offered to provide you with a report on that meeting.

Before beginning the report, however, let me assure you that I understand the importance of conservation easements in Colorado and across the country, and I fully share the view that our enforcement efforts should focus on those taxpayers who seek to misuse conservation tax incentives.

On July 27, 2007, I met with Jill Ozarski of the Colorado Coalition of Land Trusts (CCLT), Russ Shay of the Land Trust Alliance (LTA), and Michael Strugar of the Conservation Resource Center (CRC). Several members of the IRS conservation easement team were also present. Our meeting focused on two areas of mutual interest – designing a strategy to resolve those conservation easement examinations that involve minor issues between the taxpayer and the IRS, and soliciting ideas for guidance on key issues that would help future donors and donees comply with the Internal Revenue Code (the Code). I believe the meeting was very productive.

At the meeting, CCLT estimated that approximately one-third of the Colorado cases (100 of 290) involve donations to "mainstream conservation organizations" that are doing their best to comply with the law. As described below, the conservation groups also agreed that valuation and other tax issues are present in many of the cases currently under examination in Colorado.

The CCLT, LTA and CRC provided us with documents that served as the basis for our discussion. The documents focused on five items: identifying recurring problems in the conservation easement donation area, creating guidelines to address these problems, creating systems or strategies for resolving disputes between donors and the IRS, working with the conservation community to prevent abusive transactions, and resolving ongoing Colorado examinations.

Our land trust colleagues also identified four specific recurring problems: appraisals and valuation, questionable conservation benefits provided by the donation, absence of donative intent, and inappropriate donees. The "inappropriate donee" category generally involves governments or charities that do not regularly accept conservation easement donations and that lack the stewardship resources and experience to monitor and enforce an easement's terms.

They also identified seven areas as ripe for guidance. Three of these relate to appraisal problems: the improper use of the subdivision analysis method of valuation in certain cases, valuation involving recently acquired properties, and appraisals conducted by inexperienced appraisers. Four relate to Internal Revenue Code section 170(h) issues: government or charitable donees that are not conservation organizations, quid pro quo issues involving a return of a significant benefit to the donor, transactions involving syndicators and promoters, and the inappropriate retention of development rights by donors. The CCLT indicated that it might be willing and able to publicize a notice or issue a press release to highlight key problem areas that conservation donors should stay away from when they make conservation easement donations. We committed to work with them in this endeavor, and asked for more specifics on the requested guidance.

The land trust groups identified four areas for which resolution strategies could be developed to help expedite the resolution of current or future examinations of conservation easement donations. They include cases involving the significance of the habitat on the property, agricultural values or benefits of the property, scenic and open space attributes, and appraised value disagreements.

The groups also specifically recommended that we consider using the identified recurring problems and the areas ripe for guidance to classify the examination cases into two broad groups: valuation-only cases (cases in which valuation is the sole issue), and recurring problem cases (cases which involve donative intent, conservation benefit, or other non-valuation issues, generally in addition to valuation disagreements). We discussed several alternatives for disposing of valuation-only cases. The group also proposed that the IRS continue to develop the recurring problem group of cases. We generally agreed with their recommendations in this regard.

In addition to these topics, we also discussed the Great Outdoors Colorado Trust Fund (GOCO) program, and the federal income tax treatment of the sale of the state tax credits by the conservation easement donors. At the close of the meeting we agreed to meet again in September to continue our discussions of all of these topics.

This concludes my report on our meeting with CCLT, LTA and CRC. I believe that we are working hard to be responsive to the needs of the conservation easement community while also insuring that we identify and correct abuse, which the conservation easement community acknowledges is present within the program.

Since I am writing about Colorado conservation easements, I would also like to give you a brief report on the status of our conservation easement examination program, including a timeline for finishing the cases presently open in Colorado.

Last March, we reported that we had 290 open conservation easement cases in Colorado. By July, that number had been reduced to 232. These cases involve 336 returns (a case may involve a taxpayer's returns for more than one tax year). Thus far, in Colorado, we have issued 108 Revenue Agent Reports (RARs) involving 195 returns. Ninety-six RARs, involving 178 returns, proposed tax assessments. Twelve RARs, involving 17 returns, recommended no change, meaning the taxpayer owed no tax and we could close the case.

Of the currently open returns, a large number involve only the issue of valuation. We continue to work on possible resolution strategies for these returns. With taxpayer cooperation and the implementation of one of these strategies, we hope to close most of the valuation-only returns in early 2008.

The remaining open returns generally will require both an appraisal and the resolution of one or more non-valuation issues (e.g., issues involving section 170(h) of the Code; questionable conservation benefits; absence of donative intent; inappropriate donees). We expect to issue RARs with respect to most of these returns by August 2008.

Because these cases involve valuation and require us to perform appraisals, they are fact intensive and time-consuming. Therefore, we often must seek extensions of the statute of limitations to complete our work. Requests to extend the statute - even a second time - are not unusual in cases involving issues of valuation. Frequently the taxpayer, as well as the IRS, benefits from extending the statute for a return. Moreover, if the taxpayer decides to take a case to Appeals, an extension is often required. The statute of limitations for a majority of the returns currently on first extension will expire on April 15, 2008, and we expect to request second extensions for many of them.

Some have suggested that it would be helpful if we were to articulate bright line tests with respect to the valuation of conservation easements and the definition of "conservation purpose." I agree that clear standards are helpful, both to taxpayers and to the IRS, in resolving cases and in providing clarity and certainty for the future. However, I believe it would be very difficult for us to formulate a bright line test for either valuation or "conservation purpose." I am also concerned that the adoption of such tests might have the effect of discouraging rather than encouraging donations of conservation easements.

The valuation of a conservation easement inevitably depends on a unique set of facts, circumstances, and market conditions. Just as the value of a residence offered for sale cannot readily be determined in an economically meaningful way by a bright line, neither can the value of a conservation easement.

The same is true of a bright line for "conservation purpose." Here we look to the statute, the decisions of the courts, and the regulations. "Conservation purpose" may be found in a number of circumstances, and a bright line - if one could be drafted - would most likely have to be crafted in a way that would exclude much of what an appropriately nuanced understanding of "conservation purpose" would allow. Again, the result of such a bright line might well be to discourage donations.

Despite these considerations, guidance is still essential, and we are addressing issues pertinent to conservation easements. Last November, we issued transitional guidance (see Notice 2006-96, Guidance Regarding Appraisal Requirements for Non-cash Charitable Contributions, IRB 2006-46, November 13, 2006) that described minimum education and experience requirements for appraisers of real property under the Pension Protection Act (PPA) of 2006.

To encourage donations for conservation purposes, we recently issued Question and Answer guidance to enable taxpayers to take advantage of special incentives for qualified conservation easements under the PPA (see Notice 2007-50, Guidance Regarding Deductions by Individuals for Qualified Conservation Contributions, IRB 2007-25, June 18, 2007).

In addition, our 2007-2008 Priority Guidance Plan includes two items relating to charitable contributions. The Plan includes regulations under section 170 of the Code on substantiation and reporting requirements for cash and non-cash charitable contributions to reflect amendments made by the American Jobs Creation Act of 2004 and the PPA. As described above, we issued interim guidance on this subject as Notice 2006-96. Another item on the Plan is guidance under section 6695A of the Code, as added by the PPA, regarding the penalty applicable to appraisers.

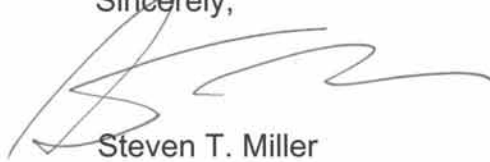
To foster a healthy and compliant conservation easement program in Colorado and elsewhere in the country, we plan to publish the items on the Guidance Plan by August 2008. In addition to those items, we are working with the conservation easement community to solicit discrete issues on which we can provide assistance.

We have provided other information as well to the conservation easement community. Late last year, we responded to the Land Trust Alliance about the definition of "natural habitat." On December 16, 2006, the Office of the Chief Counsel issued an information letter stating that an endangered species has never been a requirement for conservation purpose, although it is a factor that can help demonstrate the existence of a conservation purpose in a case involving "relatively natural habitat." The LTA welcomed this letter. The letter was distributed widely in Colorado and in the easement community, and the LTA posted it on the LTA website.

I share the belief that we must address abusive easement donations while avoiding a prolonged compliance initiative that has the potential to chill legitimate donations of conservation easements in Colorado and elsewhere. We will continue to move these

cases along and work with the land trust groups and other interested parties to identify resolution strategies and the need for additional guidance. If you have any questions, please contact me (202) 283-2500.

Sincerely,

A handwritten signature in black ink, appearing to read 'S. Miller', with a stylized flourish extending to the right.

Steven T. Miller