

## Notes

# **APPLYING THE PRIVATE BENEFIT DOCTRINE TO FARMLAND CONSERVATION EASEMENTS**

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### ABSTRACT

*Farmland or working-land conservation easements serve two purposes. One is charitable, to protect open space from development; the other is practical, to preserve the land in productive agricultural use. These purposes, however, create a tension in the easement itself that can force the land trust that holds the easement to choose between the two purposes when the easement, meant in part to protect the farm, threatens the farm's continued viability.*

*Neutral-impact amendments are amendments to working-land easements that allow farmers to improve farm production or viability without harming the conservation value of the easements. Such amendments seem beneficial: a land trust can advance one of its goals of keeping agricultural land productive—without sacrificing the other goal of preserving the conservation value of the land. By approving such an amendment, however, a land trust likely violates the private benefit doctrine and risks losing its tax-exempt status. This Note argues that the IRS should explicitly decide not to apply the private benefit doctrine to neutral-impact amendments of farmland and working-land conservation easements.*

### INTRODUCTION

Imagine this scenario: many years ago, a farmer, fearing that his lands might be turned into strip malls or housing subdivisions,

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decided to conserve his farmland.<sup>1</sup> Working with a conservation land trust, he protected his land through a conservation easement. The conservation easement allowed the farmer to continue farming the land, but it limited any future development of the land to ensure that the land would remain farmed in perpetuity. Today, the farmer is struggling—he has had a bad crop year and is worried about his income. A utility company approaches the farmer, asking to lease space inside the farmer's silo. The utility company wants to place its antennas inside the silo, removing the need to build cellular towers along nearby ridges. For both parties, this lease seems like the perfect opportunity—the farmer gains rental income and financial stability, and the utility company finds a place for its antennas while still protecting open space and scenic views.

Unfortunately, the terms of the conservation easement prohibit new development on the farm. These terms seem to prohibit the antennas, thus necessitating an amendment to the original easement. To both the land trust and the farmer, the amendment seems like a good idea. The amendment would allow the land trust to balance two different goals: the underlying conservation value of the land remains protected, and the extra income ensures that the farmer can continue the farming operation. To all sides, this arrangement seems like a no-brainer, until the parties examine tax law.

Under the private benefit doctrine, tax-exempt organizations<sup>2</sup> cannot confer a nonincidental benefit on private individuals or organizations.<sup>3</sup> A tax-exempt organization that does confer such a nonincidental benefit runs the risk of losing its federal tax-exempt status.<sup>4</sup> If the land trust amends its conservation easement covering the farmer's land, the IRS might find that the land trust conferred a primary private benefit to the farmer (the rental fees from the antennas inside the silo) and a secondary private benefit to the utility

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1. This hypothetical is derived from Darby Bradley, *Amending Perpetual Conservation Easements: Confronting the Dilemmas of Change: A Practitioner's View* 27 (Dec. 2007) (unpublished manuscript), available at [http://www.vlt.org/images/0\\_Temporary/Bradley\\_Amendments.pdf](http://www.vlt.org/images/0_Temporary/Bradley_Amendments.pdf).

2. For the purposes of this Note, the phrase *tax-exempt organization* refers to groups that receive tax-exempt status as a charitable organization under I.R.C. § 501(c)(3).

3. Andrew Megosh, Lary Scollick, Mary Jo Salins & Cheryl Chasin, *Private Benefit Under IRC 501(c)(3)*, in *EXEMPT ORGANIZATIONS: IRS TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 2001*, at 137, 138 (2000).

4. *E.g.*, I.R.S. Gen. Couns. Mem. 39,862, at 1 (Nov. 22, 1991).

company (the ability to install the antennas cheaply).<sup>5</sup> Under this reasoning, the amendment confers a nonincidental benefit to private interests, and the land trust could lose its tax-exempt status.

Because land trusts risk losing their tax-exempt status after a single violation of the private benefit doctrine,<sup>6</sup> it is important for land trusts to understand how to apply the doctrine and work within it. Although on its face the private benefit doctrine seems to be simple—tax-exempt organizations cannot confer a substantial benefit to noncharitable individuals or organizations—no one, not even the Internal Revenue Service (IRS), applies it consistently.<sup>7</sup> It can be quite challenging for a land trust to conform its activities to a doctrine that lacks clear or predictable guidelines.

Amendments to farmland conservation easements can create significant difficulties for land trusts trying to navigate both their charitable requirements and the needs of farmers. Farmland conservation easements, and working-land easements generally,<sup>8</sup> are specifically designed to conserve farmland while allowing the landowner to continue farming the land.<sup>9</sup> These easements serve two purposes. The primary purpose is to protect land from development for the greater public good,<sup>10</sup> and the secondary purpose is to preserve

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5. See *infra* Part III.A. Primary benefits are benefits that a tax-exempt organization confers directly on a noncharitable recipient. See *infra* note 88 and accompanying text. Secondary benefits are benefits indirectly received by a noncharitable recipient. See *infra* note 89 and accompanying text.

6. Cf., e.g., I.R.S. Gen. Couns. Mem. 39,862, at 1 (discussing the case of a hospital that "jeopardized its exempt status" because of problems with the private benefit doctrine).

7. See John D. Colombo, Private Benefit: What Is It—And What Do We Want It To Be? 2 (2011) (unpublished manuscript) (on file with the *Duke Law Journal*) ("[N]either the courts nor IRS personnel know what 'private benefit' means, and . . . there is no coherent doctrinal definition of the concept.").

8. This Note uses farmland conservation easement and working-land conservation easement interchangeably, although working-land easements are a broader category of conservation easements, encompassing easements on forested lands and ranchlands, as well as on farmland.

9. Judy Anderson & Jerry Cosgrove, *Agricultural Easements: Allowing a Working Landscape To Work*, EXCHANGE (Land Trust Alliance, Wash., D.C.), Fall 1998, at 9, 9.

10. See, e.g., EXHIBIT B: GRANT OF DEVELOPMENT RIGHTS, CONSERVATION RESTRICTIONS, OPTION TO PURCHASE AT AGRICULTURAL VALUE, AND CONTINGENT RIGHT OF THE UNITED STATES OF AMERICA § 1, cl. 2 (2006), available at [http://www.farmlandinfo.org/documents/31319/Exhibit\\_B\\_Vermont.pdf](http://www.farmlandinfo.org/documents/31319/Exhibit_B_Vermont.pdf) (noting that the purposes of granting development rights are "to conserve scenic and natural resources associated with the Protected Property, to improve the quality of life for Vermonters, and to maintain for the benefit of future generations the essential characteristics of the Vermont countryside.").

the land in productive agricultural use.<sup>11</sup> These dual purposes, however, create a tension in the easement: conservation easements protect the land from development in perpetuity, but land preservation sometimes conflicts with the needs of a productive farm, particularly as both land- and farm-management practices and technologies change over time.<sup>12</sup> A farmer's ability to adapt to changing technologies and farming methods may be limited by the terms of the conservation easement.

Although standard easement-amendment procedures prohibit a land trust from approving an amendment that creates a substantial private benefit for a private party,<sup>13</sup> there is very little discussion of the private benefit doctrine and its application to conservation easement amendments in practitioner and industry publications or legal scholarship.<sup>14</sup> In part, this is because the IRS, until recently, had rarely used the doctrine in relation to conservation land trusts. In March 2011, however, the IRS revoked a land trust's charitable status in part because the land trust violated the private benefit doctrine by approving several amendments that negatively impacted the

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11. See, e.g., *id.* § 1, cl. 1 (“[T]he primary purpose of this Grant is to conserve productive agricultural and forestry lands and soil resources in order to facilitate active and economically viable farm use of the Protected Property now and in the future.”).

12. Duncan M. Greene, Comment, *Dynamic Conservation Easements: Facing the Problem of Perpetuity in Land Conservation*, 28 SEATTLE U. L. REV. 883, 884–85 (2005).

13. LAND TRUST ALLIANCE, AMENDING CONSERVATION EASEMENTS: EVOLVING PRACTICES AND LEGAL PRINCIPLES 17 (2007), available at [http://learningcenter.lta.org/attached-files/0/65/6534/Amendment\\_Report\\_Final\\_web.pdf](http://learningcenter.lta.org/attached-files/0/65/6534/Amendment_Report_Final_web.pdf).

14. See *id.* at 25–26 (recommending that land trusts undertake a private benefit analysis of their activities but providing only one example of a private benefit and no other guidance); LESLIE RATLEY-BEACH, MANAGING CONSERVATION EASEMENTS IN PERPETUITY 162–63 (Sylvia Bates ed., 2009), available at [http://learningcenter.lta.org/attached-files/0/95/9569/DL\\_Managing\\_CE\\_05062010\\_lores.pdf](http://learningcenter.lta.org/attached-files/0/95/9569/DL_Managing_CE_05062010_lores.pdf) (noting that land trusts “should scrutinize every conservation easement amendment proposal” for violations of the private benefit doctrine and briefly outlining the rules of the doctrine); Chris Cline, *Inurement and Private Benefit: Avoidable Perils*, in THE BACK FORTY ANTHOLOGY: SELECTED ARTICLES FROM THE NEWSLETTER OF LAND CONSERVATION LAW (William T. Hutton, Darrin S. Brown, Lisa M. Burkdale, Ellen A. Fred, Audra M. Mai & Erika M. Muhl eds., 2d ed. 2003) (discussing the private benefit doctrine and its implications for land trusts without applying it to conservation-easement amendments); C. Timothy Lindstrom, *Hicks v. Dowd: The End of Perpetuity?*, 8 WYO. L. REV. 25, 52–54 (2008) (discussing the general rules of the private benefit doctrine and noting that it is not often used); Bill Silberstein & Jessica Jay, *Staying Within the Bounds of the Income Tax Code and Public Perception: Private Inurement and Private Benefit*, EXCHANGE, (Land Trust Alliance, Wash., D.C.), Spring 1999 (discussing the concepts of private inurement and private benefit).

conservation value of the land.<sup>15</sup> To make matters worse, the IRS and Congress have increased their scrutiny of land trusts, reviewing both the charitable purpose of land trusts and the validity of the charitable deductions received by donors of land.<sup>16</sup> Viewed together, the recent revocation of a land trust's tax-exempt status and the increased scrutiny of land trusts leave these organizations in a difficult place. They must be able to ensure that their policies do not violate a doctrine that has incoherent and inconsistent application by the IRS. Remedying this disconcerting situation requires a shift in the current understanding of the private benefit doctrine and, in particular, its application to neutral-impact amendments. Neutral-impact amendments, such as an amendment allowing a farmer to lease space inside his silo, are amendments that allow land trusts to balance the dual purposes of their working-land easements. A neutral-impact amendment does not negatively impact the conservation value of the land protected by an easement, thus preserving the easement's charitable purpose. But such an amendment does change the language of the easement to aid the farmer, thus allowing a land trust to help keep the covered land in productive use. Yet, by approving a neutral-impact amendment, a land trust runs the risk of losing its tax-exempt status.

This Note argues that the IRS should not apply the private benefit doctrine to neutral-impact amendments to conservation easements. By helping preserve the working landscape without reducing the land's conservation value, neutral-impact amendments actually serve the charitable purposes of land trusts. Instead, the private benefit doctrine should only be applied to amendments that abuse the nonprofit form, such as those that reduce the conservation value of the land.

Part I addresses the basis of a land trust's charitable status, the structure of conservation easements, and how amendments to

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15. I.R.S. Priv. Ltr. Rul. 2011-10020, at 26–27 (Mar. 11, 2011). The IRS also found that the land trust had violated the substantial-nonexempt-purpose test and the private inurement doctrine. *Id.*

16. See C. TIMOTHY LINDSTROM, A TAX GUIDE TO CONSERVATION EASEMENTS 11–12 (2008) (“[T]he IRS has dramatically increased its scrutiny of conservation transactions . . . . The days of benign neglect of conservation transactions by the government appear to be over.”); Jason A. Richardson, *Increased Scrutiny on Conservation Easement Donations: How a Crackdown on Tax Fraud by the IRS Could Impact Environmental Protection*, 1 ENVTL. & ENERGY L. & POL’Y J. 273, 273 (2006) (“In order to close the loophole that allowed for . . . tax fraud[,] the Internal Revenue Service . . . has increased its scrutiny of claims for these deductions.”).

easements put land trusts at risk of losing their tax-exempt status. Part II examines the private benefit doctrine. It notes the difficulties with the doctrine, outlines the basic tenets of the doctrine, and discusses the three main tests used to interpret and apply it. Part III applies these theories to neutral-impact amendments and finds that they likely violate the letter of the private benefit doctrine, even though the amendments do not negatively affect the conservation value of the land. Part IV argues that the private benefit doctrine should not apply to neutral-impact amendments because they do not violate the doctrine's spirit. At its core, the private benefit doctrine is an anti-abuse doctrine, designed to protect the government from subsidizing noncharitable endeavors. Neutral-impact amendments do not abuse the tax-exempt form. Instead, they seek to give equal weight to the dual purposes of a working-land easement, purposes that the IRS has already sanctioned.

#### I. THE CHARITABLE STATUS OF CONSERVATION LAND TRUSTS AND THE STRUCTURE OF CONSERVATION EASEMENTS

Conservation land trusts are private, tax-exempt organizations with a mission to preserve land and protect it from development.<sup>17</sup> Land trusts conserve land through a variety of methods, including deed restrictions, outright purchase, and the purchase or acceptance of donated conservation easements.<sup>18</sup> Of these three options, land trusts most commonly use conservation easements to preserve land.<sup>19</sup>

A conservation easement is a legal agreement that protects the conservation value of a particular property by restricting future development in perpetuity.<sup>20</sup> Land trusts use conservation easements to protect a variety of properties, including forests, wetlands, beaches, historical buildings, gardens, wildlife properties, ranches, and farmland.<sup>21</sup> Under a conservation easement, the landowner retains the ownership and certain rights of use of the land, but other uses are restricted.<sup>22</sup> For example, easements typically limit or prohibit new

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17. LAND TRUST ALLIANCE, FACT SHEET: WHAT IS A LAND TRUST? 1 (2008), available at <http://www.landtrustalliance.org/conservation/documents/what-is-land-trust.pdf>.

18. *Id.* at 1–2.

19. *Id.* at 1.

20. ELIZABETH BYERS & KARIN MARCHETTI PONTE, THE CONSERVATION EASEMENT HANDBOOK 14 (2d ed. 2005).

21. *Id.* at 17; C. Timothy Lindstrom, *Income Tax Aspects of Conservation Easements*, 5 WYO. L. REV. 1, 6 (2005).

22. BYERS & PONTE, *supra* note 20, at 17.

development but grandfather in existing development.<sup>23</sup> If the landowner sells land with a conservation easement in place, the restrictions remain with the property.<sup>24</sup>

Conservation easements can be donated or sold to either a government entity or a conservation land trust that holds the easement in perpetuity.<sup>25</sup> A landowner who donates a conservation easement can receive a charitable deduction for the value of the easement under § 170(h) of the Internal Revenue Code (I.R.C.).<sup>26</sup> As the holder of a conservation easement, a land trust has the right and the obligation to enforce the terms of the easement.<sup>27</sup> Land trusts must monitor the land to ensure that the landowner has not violated the terms of the easement and may remedy violations if necessary.<sup>28</sup> The land trust is thus responsible for ensuring that the underlying environmental and conservation value of the easement remains intact over time.

A land trust drafts its easements and enforces those easements' restrictions to remain consistent with its charitable purpose. This Part outlines the basis for a land trust's tax-exempt status, noting that the IRS does not consider farmland preservation alone to be a charitable purpose. This Part then highlights the relevant structures of a conservation easement that allow a land trust to meet its mission, focusing on amendment approval as an activity that puts a land trust at risk of losing its tax-exempt status.

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23. Anderson & Cosgrove, *supra* note 9, at 11–13.

24. Lindstrom, *supra* note 21, at 6.

25. *Id.* at 5.

26. See I.R.C. §§ 170(f)(3)(B), (h) (2006). The value of an easement is determined by subtracting the fair market value of the land with development restrictions from the fair market value of the land without the restrictions. Treas. Reg. § 1.170A-14(h)(3) (2003).

27. See Lindstrom, *supra* note 21, at 5 (noting that an obligation exists “if the donation of an easement is to qualify for federal tax benefits”).

28. See I.R.S. Priv. Ltr. Rul. 2011-10020, at 25 (Mar. 11, 2011) (“[A] qualified organization must be committed to protecting the conservation purposes of the donation and it must have the resources to enforce the restrictions. Furthermore, a qualified organization must be committed to protecting conservation easement contributions in perpetuity.”); RATLEY-BEACH, *supra* note 14, at 14 (“Good relationships with landowners, thorough baseline documentation reports, regular (at least annual) easement monitoring visits and sound recordkeeping systems are the foundation of your land trust’s land protection efforts and fundamental to upholding its obligations.”).

A. *Charitable Purpose of Land Trusts and Conservation Easements Under Federal Law*

To gain and maintain tax-exempt status, a land trust's purpose and activities must meet one of the definitions of "charitable" under IRS rules. Although the language of I.R.C. § 501(c)(3) does not mention land conservation, land trusts qualify for tax-exempt status if they have a charitable purpose of preserving and protecting "the natural environment for the benefit of the public."<sup>29</sup>

Because the IRS does not consider the preservation of farmland to be a charitable purpose, land trusts cannot have farmland preservation as their sole purpose.<sup>30</sup> Instead, land trusts can qualify for tax-exempt status if they preserve "ecologically significant" farmland.<sup>31</sup> The IRS views preserving ecologically significant farmland as a valid charitable purpose because doing so provides a significant public benefit and follows an "express national policy of conserving the nation's unique national resources."<sup>32</sup> Alternatively, a land trust can have a charitable purpose, and thus tax-exempt status, if its farmland-conservation activities provide certain educational or scientific value.<sup>33</sup>

Although I.R.C. § 170(h) sets forth the conditions under which a conservation easement qualifies as a charitable deduction for donors,<sup>34</sup> the IRS and land trusts also use § 170(h) as a guideline to determine if a land trust itself qualifies as a tax-exempt organization.<sup>35</sup>

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29. I.R.S. Gen. Couns. Mem. 39,055, at 3 (Nov. 7, 1983).

30. Rev. Rul. 78-384, 1978-2 C.B. 174.

31. Rev. Rul. 76-204, 1976-1 C.B. 152, 153.

32. *Id.*

33. See *Dumaine Farms v. Comm'r*, 73 T.C. 650, 653, 667-68 (1980) (holding that an experimental farm that did not have any ecologically significant attributes qualified for tax-exempt status because it conducted scientific and educational activities), *action on dec.*, 1980-45 (Feb. 11, 1980).

34. I.R.C. § 170(h) (2006).

35. See I.R.S. Priv. Ltr. Rul. 2011-10020, at 23 (Mar. 11, 2011) ("The legislative history of section 170(h) indicates that Congress intended for the requirements of deductibility under I.R.C. § 170(h) to be compatible with the requirements for exemption under section 501(c)(3). Thus, there is strong support for the conclusion that conservation purposes under section 170(h)(4)(A) may be considered exempt purposes under section 501(c)(3)."); I.R.S. Gen. Couns. Mem. 39,055, at 5 (Nov. 7, 1983) ("[T]he Trust considered herein does not meet the present standards for exemption for conservation organizations discussed in [Revenue Ruling 76-204, 1976-1 C.B. 152, and Revenue Ruling 78-384, 1978-2 C.B. 174.] nor the broader standards set out in section 170(h)."); William T. Hutton, *Agricultural Preservation: A Model Letter for Protesting Denial of Tax-Exempt Status*, in THE BACK FORTY ANTHOLOGY, *supra* note 14, at 1.13 (noting that although the IRS grounds its denials of exemption in Revenue



Under § 170(h), a conservation easement is a “qualified conservation contribution” when the donor contributes qualified real property to a qualified organization, such as a land trust, to be used exclusively for conservation purposes.<sup>36</sup> Valid conservation purposes under § 170(h) include preserving land for outdoor recreation, protecting natural habitats, preserving open space, and preserving historic sites.<sup>37</sup> By extension, these conservation purposes are considered tax-exempt purposes for the land trust under § 501(c)(3).<sup>38</sup> Additionally, the conserved land must be protected in perpetuity.<sup>39</sup> For a land trust to demonstrate that it has met this requirement, it must have appropriate policies and sufficient resources to assure the IRS that the land trust will be able to protect the conserved land in perpetuity.<sup>40</sup>

Farmland easements typically qualify for charitable status under the open-space requirement.<sup>41</sup> To meet this requirement, the land must be preserved either “for the scenic enjoyment of the general public” or “pursuant to a clearly delineated Federal, State, or local governmental conservation policy” and have a significant public benefit.<sup>42</sup> Land trusts most frequently qualify their farmland conservation easements as charitable under the latter requirement.<sup>43</sup>

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Ruling 78-384, it has reversed its position when land trusts have argued for tax-exempt status under § 170(h)).

36. I.R.C. § 170(h)(1).

37. *Id.* § 170(h)(4)(A).

38. I.R.S. Priv. Ltr. Rul. 2011-10020.

39. I.R.C. § 170(h)(5)(A).

40. *Cf.* I.R.S. Priv. Ltr. Rul. 2011-10020, at 23–26 (revoking a land trust’s tax-exempt status in part because it had insufficient financial resources and monitoring policies to protect the land that it was charged with protecting in perpetuity).

41. I.R.C. § 170(h)(4)(A)(iii).

42. *Id.*

43. LINDSTROM, *supra* note 16, at 47. To meet the test for a clearly delineated governmental policy, the policy in question must be more than just a general declaration that the state or local government supports conservation. Treas. Reg. § 1.170A-14(d)(4)(iii)(A) (2003). Instead, there should be a “specific, identified conservation project” or conservation plan within which the protected land fits. *Id.* The government entity must also be fully committed to the conservation program and can demonstrate its commitment through the use of preferential tax assessments or preferential zoning. *Id.* For example, a generalized agricultural zoning policy combined with a comprehensive plan designating some land as available for farming is likely too general to meet the requirement for a clearly delineated governmental policy. *See* LINDSTROM, *supra* note 16, at 47–48 (“In this case, the deduction would appear vulnerable because of the generalized nature of the governmental policies on which the easement relied.”). A combination of planning policies, zoning, and preferential tax treatment for agricultural areas, however, might be enough to satisfy the requirement. *Id.* at 48. The preserved land must also create a significant public benefit, defined in the regulations by eleven

*B. The Structure of Farmland Conservation Easements*

Because the preservation of farmland alone does not qualify as a charitable purpose, farmland conservation easements have dual purposes and a structure that reflects those purposes. Farmland conservation easements are written to ensure compliance with IRS guidelines for tax-exempt organizations and to keep the farmland in production. This duality creates an inherent tension within the easement itself—the goal of land preservation will sometimes conflict with the goal of maintaining productive farmland. Because of this tension, there will be instances in which the farmland conservation easement limits the ability of the farmer to keep the land in production. The conservation goals will always trump the agricultural-production goals because the land trust relies on the conservation goals for its tax-exempt status, and the easement donor relies on the preservation goals to retain his or her charitable deduction.

Farmland conservation easements do not explicitly acknowledge this tension, but they are structured to address these dual purposes. Four aspects of farmland conservation easements are relevant for this Note: (1) the purpose statement and recitals, (2) the restrictions and reserved rights, (3) the definition of agriculture, and (4) the administrative provisions, specifically the provisions on how to amend a conservation easement.<sup>44</sup>

1. *The Purpose Statement and Recitals.* A farmland conservation easement's purpose-statement and recitals clauses include at least two purposes. One is conservation-oriented and thus charitable; the other focuses on preserving existing productive uses and is thus not inherently charitable.<sup>45</sup> To ensure that the land trust is meeting its charitable requirements, one purpose statement will closely adhere to the IRS conservation purposes test.<sup>46</sup> For example, a purpose statement might include a reference to the protection of scenic and

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different factors, including the uniqueness of the property and the importance of the property in its ability to attract tourism or commerce. Treas. Reg. § 1.170A-14(d)(4)(iv).

44. BYERS & PONTE, *supra* note 20, at 302–07.

45. *See, e.g., supra* notes 10–11.

46. BYERS & PONTE, *supra* note 20, at 313; *see also* Lindstrom, *supra* note 21, at 14 (“In drafting a conservation easement it makes sense to include a description of the conservation purpose(s) of the conservation easement in terms that replicate the description of conservation purposes recognized by the Regulations.”).

open space or to the preservation of prime or unique soils.<sup>47</sup> A second purpose statement will address the need to conserve particular productive agricultural lands.<sup>48</sup> These two purposes demonstrate a land trust's commitment to achieving its charitable goals while remaining mindful of the need to preserve productive agricultural lands.

2. *Restrictions and Reserved Rights.* The section on restrictions and reserved rights must clearly state the restrictions on the land and the rights that remain with the landowner.<sup>49</sup> In a farmland conservation easement, this section is designed to strike a balance between the conservation purposes of the easement and the landowner's farming operation.<sup>50</sup> Common restrictions on farmland conservation easements include limits or prohibitions on subdivisions, new development, and new land uses.<sup>51</sup> These restrictions allow the land trust to achieve its charitable purpose to preserve land from further development.

To meet the second purpose of keeping farmland in production, a farmland conservation easement reserves several rights to the farmer, including the right to farm the land and the right to a farmstead complex.<sup>52</sup> A farmstead complex reserves several acres of land on which the landowner can build and maintain farm structures without requesting permission from the land trust.<sup>53</sup> Additional rights often reserved to the farmer include the right to develop a specific site in the future, particularly for farm-support housing,<sup>54</sup> and the right

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47. See BYERS & PONTE, *supra* note 20, at 313 (including "Other Open-Space Types" such as agriculture and forestry).

48. See *supra* note 11.

49. BYERS & PONTE, *supra* note 20, at 322–69.

50. See *supra* notes 8–12 and accompanying text.

51. Anderson & Cosgrove, *supra* note 9, at 11–13.

52. *E.g.*, EXHIBIT B: GRANT OF DEVELOPMENT RIGHTS, CONSERVATION RESTRICTIONS, OPTION TO PURCHASE AT AGRICULTURAL VALUE, AND CONTINGENT RIGHT OF THE UNITED STATES OF AMERICA, *supra* note 10, § 3, cl. 6.

53. See, *e.g.*, AGRICULTURAL CONSERVATION EASEMENT § 8(c) (2002), available at [http://www.farmlandinfo.org/documents/37237/Macedon\\_NY\\_Easement.pdf](http://www.farmlandinfo.org/documents/37237/Macedon_NY_Easement.pdf) ("New buildings and other structures and improvements to be used primarily for agricultural purposes may be built on the Property within the Farmstead Area. New agricultural buildings, structures or improvements proposed for locations outside the Farmstead Area may be built only with the permission of the Grantee.").

54. Anderson & Cosgrove, *supra* note 9, at 13; see also EXHIBIT B: GRANT OF DEVELOPMENT RIGHTS, CONSERVATION RESTRICTIONS, OPTION TO PURCHASE AT AGRICULTURAL VALUE, AND CONTINGENT RIGHT OF THE UNITED STATES OF AMERICA,

to utilize new technology on the farm even if it was not specifically named in the easement.<sup>55</sup>

3. *Definition of Agriculture.* Farmland conservation easements also often tie the definitions of agriculture and agricultural practices to federal or state standards.<sup>56</sup> This linkage gives the farmer and the land trust the ability to adapt to changing agricultural practices without violating the terms of the easement.<sup>57</sup>

4. *Amendments.* Despite the flexibility written into easements, the conservation land trusts that draft farmland conservation easements cannot contemplate every change in agricultural technology, land use, or land preservation.<sup>58</sup> Thus conservation easements frequently include a clause that allows the land trust to amend the easement upon the request of the landowner.<sup>59</sup> The right to amend the easement gives both the easement holder and the landowner some flexibility to adjust to changed or changing conditions.<sup>60</sup>

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*supra* note 10, § 3, cl. 8 (“The right to construct . . . and use one (1) farm labor housing unit (‘FLH’), together with appurtenant non-residential structures and improvements, including drives and utilities, normally associated with a residence; provided, however, that the FLH shall be (a) occupied by Grantor or at least one person who is a member of Grantor’s family or who is employed on the farm, and (b) located in the area depicted as ‘FLH Site’ on the . . . Farm Plan.” (emphasis omitted)).

55. Anderson & Cosgrove, *supra* note 9, at 11–12.

56. *Id.* at 10–11.

57. *See id.* (“These standards are flexible; often defined within state or federal programs . . . that are updated periodically to reflect changes in agricultural practices. By utilizing state-defined or federal standards, the easement grantee may avoid difficult discussions with farmers as to ‘who best knows’ how to farm.”).

58. *See* LAND TRUST ALLIANCE, *supra* note 13, at 9 (“The occasional need to amend an easement is rooted in our inability to predict all the circumstances that may arise in the future.”); Nancy A. McLaughlin, *Rethinking the Perpetual Nature of Conservation Easements*, 29 HARV. ENVTL. L. REV. 421, 470 (2005) (“[T]he need to make modifications and adjustments to account for changed conditions and societal needs may become acute.”).

59. McLaughlin, *supra* note 58, at 444.

60. There is some debate in the land trust community as to whether conservation easements should be amendable and, if so, how they should be amended. This Note assumes that for some land trusts, amendments are inescapable, and these debates are not relevant for the purposes of this Note. *See generally id.* (advocating the application of the charitable-trust doctrine in conservation easements); Andrew C. Dana, Conservation Easement Amendments: A View from the Field (2006) (unpublished manuscript), available at [http://learningcenter.lta.org/attached-files/0/57/5754/CE\\_Amendments-View\\_from\\_Field\\_\(ADana\\_5-5-06\).pdf](http://learningcenter.lta.org/attached-files/0/57/5754/CE_Amendments-View_from_Field_(ADana_5-5-06).pdf) (outlining “[l]egal problems with broad application of charitable trust rules” to conservation easements).

Because amendments change an easement that is meant to protect land in perpetuity, land trusts must be careful to ensure that a proposed amendment does not undermine the conservation purposes of the easement.<sup>61</sup> To ensure that conservation land trusts carefully analyze any amendment proposal that they receive, the Land Trust Alliance (LTA), an umbrella organization and land trust accreditor and resource center, gives guidance on how to structure amendments and amendment procedures.<sup>62</sup> The LTA developed seven principles to guide land trusts through an amendment-approval process. To approve an amendment using these principles, a land trust must show that the amendment:

1. Clearly serve[s] the public interest and [is] consistent with the land trust's mission.
2. Compl[ies] with all applicable federal, state and local laws.
3. [Does not] jeopardize the land trust's tax-exempt status or status as a charitable organization under federal or state law.
4. [Does not] result in private inurement or confer impermissible private benefit.
5. [Is] consistent with the conservation purpose(s) and intent of the easement.
6. [Is] consistent with the documented intent of the donor, grantor and any direct funding source.

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61. See Dana, *supra* note 60, at 3 (“[T]he tension between (a) land trusts’ conservation easement stewardship responsibilities to protect and preserve, in perpetuity, a complement of conservation values for the benefit of the public, and (b) changing social demands and values, poses perhaps the most difficult challenge that the private land conservation community has faced to date.”).

62. See Nancy A. McLaughlin & W. William Weeks, *In Defense of Conservation Easements: A Response to The End of Perpetuity*, 9 WYO. L. REV. 1, 9 (2009) (“The Land Trust Alliance is a nonprofit umbrella organization that provides training and education to, and develops policies and standards for, the over 1,700 local, state, and regional land trusts operating in the United States.”). Many of the LTA’s reports and policies are developed by legal scholars and its materials are widely cited, including by Professor Nancy McLaughlin and Timothy Lindstrom. See, e.g., LINDSTROM, *supra* note 16, at 38; Lindstrom, *supra* note 14, at 26; Lindstrom, *supra* note 21, at 4; Nancy A. McLaughlin, *Amending Perpetual Conservation Easements: A Case Study of the Myrtle Grove Controversy*, 40 U. RICH. L. REV. 1031, 1060 (2006); McLaughlin & Weeks, *supra*, at 9; McLaughlin, *supra* note 58, at 423. Additionally, the LTA has been cited in one case on conservation easements. See *Whitehouse Hotel L.P. v. Comm’r*, 615 F.3d 321, 329 (5th Cir. 2010) (citing LAND TRUST ALLIANCE & NATIONAL TRUST FOR HISTORICAL PRESERVATION, *APPRAISING EASEMENTS* (3d. ed. 1999), to illustrate the complicated nature of easement appraisals).

7. Ha[s] a net beneficial or neutral effect on the relevant conservation values protected by the easement.<sup>63</sup>

These principles are designed to ensure that the land trust and its amended easement remain true to its charitable purpose and do not violate any relevant laws.

### C. *Land Trusts and Amendments*

To maintain its charitable status, a land trust must always work to further its mission. It is particularly important for land trusts to keep their mission in the forefront during the amendment-approval process. The seven principles listed in the previous subsection are all different ways of asking the same question: Is the amendment consistent with the charitable purposes of the easement? Or, in other words, does the amendment protect or improve the conservation value furthered by the easement?

Amendment proposals can be grouped into three different types based on this question.<sup>64</sup> The first group includes amendments that have positive conservation impacts. For example, a land trust might approve an amendment that protects more land under the easement than what was originally protected. By protecting more land, these amendments further the land trust's charitable mission. Conversely, land trusts should not approve the second group of amendments—those that remove restrictions on development. Amendments with negative conservation impacts work directly against the land trust's charitable mission of preserving land. In both instances, it is relatively clear whether a land trust would advance or undermine its charitable purpose by approving an amendment.

This analysis becomes more complicated with a third group of amendments that have—in the words of the LTA's standard—“neutral effect[s].”<sup>65</sup> Neutral-impact amendments typically allow a farmer to add facilities or technologies that improve the viability or

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63. LAND TRUST ALLIANCE, *supra* note 13, at 17.

64. These groupings are based on work by Professor McLaughlin and the LTA. *See id.* at 78 (using a matrix to highlight the positive and negative conservation impacts of proposed easements); McLaughlin, *supra* note 62, at 1076 (“Although courts traditionally have been reluctant to find that a trustee has powers not expressly granted in the gift or trust instrument (hence the desirability of including an express amendment provision in conservation easement deeds), interpreting conservation easements as granting the holders the implied power to make clearly *neutral* or *enhancing* amendments would be consistent with the goals of the charitable trust rules.” (emphasis added) (citation omitted)).

65. *See supra* note 63 and accompanying text.

productivity of the farm with no impact on the conservation value of the easement.<sup>66</sup> Take, for example, a proposal for an amendment to increase and modernize a farmstead complex by ten acres in return for conserving ten additional acres with an equivalent conservation value.<sup>67</sup> The amendment has a neutral conservation impact because it neither decreases nor increases the conservation value of the land. In essence, a neutral-impact amendment allows the land trust to strike a difficult balance—it protects the underlying conservation value of the land and supports the additional goal of keeping farmland in production. In this light, a neutral-impact amendment seems like a win-win. Yet, surprisingly, if a land trust were to approve a neutral-impact amendment, it would run the risk of violating the private benefit doctrine and losing its charitable status.

## II. THE PRIVATE BENEFIT DOCTRINE

Under the private benefit doctrine, if the IRS finds that a tax-exempt organization conferred a substantial private benefit on another party, the organization's tax-exempt status will be revoked.<sup>68</sup> A private benefit is any benefit conferred on a disinterested individual or organization<sup>69</sup> that serves a private rather than a charitable or public interest.<sup>70</sup> On its face, this principle is clear, but the application of the doctrine is quite difficult.<sup>71</sup> One scholar has described the doctrine as simply a “mess.”<sup>72</sup> The messiness of the doctrine stems from two main issues. First, the private benefit doctrine is not directly codified in a statute but instead originates in IRS regulations. Second, the doctrine has an unclear purpose and

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66. See *infra* Part III.

67. See *infra* Part III.B.

68. See Megosh et al., *supra* note 3, at 139 (“[I]f private interests are served *other than incidentally*, exemption is precluded.”).

69. In the private benefit context, disinterested individuals and organizations include anyone who receives benefits from the tax-exempt organization other than the intended recipients of the charitable activity. *Id.* at 139.

70. *Am. Campaign Acad. v. Comm’r*, 92 T.C. 1053, 1068–69 (1989).

71. See John D. Colombo, *In Search of Private Benefit*, 58 FLA. L. REV. 1063, 1065 (2006) (“This is a quintessential balancing test under which the IRS both owns and reads the scale . . . [N]o one even knows what to balance, since practically any transaction undertaken by an exempt charity will result in benefit to some private party outside the charitable class.”); Megosh et al., *supra* note 3, at 143 (“In reality it is difficult to apply the private benefit analysis.”).

72. Colombo, *supra* note 71, at 1093.

lacks an articulable general theory.<sup>73</sup> To make matters worse, the IRS has been inconsistent in its application of the doctrine—applying it in some cases and not in others.<sup>74</sup> Additionally, no case law exists that would help clarify the doctrine; the case that would have provided the most promising chance at fully delineating the doctrine was settled.<sup>75</sup> Recognizing that the private benefit doctrine is unclear, this Part briefly outlines the generally agreed-upon tenets of the private benefit doctrine and discusses three existing theories on how to apply it. These theories are then used in Part III to analyze a land trust's risk of violating the private benefit doctrine if it approves a neutral-impact amendment.

#### A. *The Private Benefit Doctrine: Basic Tenets*

Although the motivations and contours of the private benefit doctrine remain vague, two aspects of the doctrine are clear. First, the overarching goal of the doctrine is to ensure that tax-exempt organizations operate for a charitable purpose; and second, tax-exempt organizations cannot, directly or indirectly, confer a substantial private benefit on noncharitable individuals or organizations.<sup>76</sup>

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73. *See id.* at 1067–80 (detailing the history, origins, and inconsistent application of the private benefit doctrine); *see also* Colombo, *supra* note 7, at 47 (“Even the Treasury Regulations apply the term to at least two distinct analytical paradigms, one involving the size of the charitable class and two involving economic arrangements with third parties. A review of private rulings and cases indicates that neither the courts nor the IRS really know what the phrase ‘private benefit’ means.”).

74. *Compare* Rev. Rul. 2004-51, 2004-1 C.B. 974, 976 (ruling on the tax-exempt status of ancillary partnerships between for-profit and tax-exempt entities without undertaking an analysis of the private benefit doctrine), *and* Colombo, *supra* note 7, at 12–13 (finding that the “private benefit analysis disappeared” in Revenue Ruling 2004-51, 2004-1 C.B. 974, “one of the most anticipated exemption rulings of the new millennium,” even though it had been used in a similar ruling on joint ventures), *with* Rev. Rul. 98-15, 1998-1 C.B. 718, 719 (discussing the private benefit doctrine in the context of joint ventures between for-profit and tax-exempt entities).

75. *See* *United Cancer Council v. Comm’r*, 165 F.3d 1173, 1180 (7th Cir. 1999) (remanding the case to consider whether application of the private benefit doctrine was appropriate).

76. *See generally* INTERNAL REVENUE SERV., *Overview of Inurement/Private Benefit Issues in IRC 501(c)(3)*, in IRS EXEMPT ORGANIZATIONS CONTINUING PROFESSIONAL EDUCATION TECHNICAL INSTRUCTION PROGRAM FOR FISCAL YEAR 1990, at 3 (1990), *available at* <http://www.irs.gov/pub/irs-tege/eotopic90.pdf> (explaining that there is no single means to assess whether a tax-exempt organization has conferred an impermissible benefit to a private entity); Megosh et al., *supra* note 3, at 137 (“This article discusses the concept of ‘private benefit’ under IRC 501(c)(3) and then describes how it applies to specific fact patterns that raise private benefit issues in two areas: housing and charter schools.”).



1. *Operating for a Charitable Purpose.* The private benefit doctrine is designed to ensure that a tax-exempt organization actually operates as a charitable organization. To gain or maintain its tax-exempt status, an organization must be “organized and operated exclusively” for one of the charitable purposes listed in § 501(c)(3), which includes religious, charitable, scientific, or educational purposes.<sup>77</sup>

As § 501(c)(3) entities, tax-exempt organizations are exempt from federal income tax and often receive exemptions from state property taxes, and their donors can take charitable deductions.<sup>78</sup> These various tax benefits constitute a government subsidy for tax-exempt organizations.<sup>79</sup> The benefits also create an incentive for abuse. For instance, a tax-exempt organization could be used as a tax shelter<sup>80</sup> or as a moneymaking strategy,<sup>81</sup> or it could be used to avoid taxation of an otherwise commercial business.<sup>82</sup> In any of these instances, the federal government wants to ensure that the implicit subsidy of these organizations goes only toward charitable purposes and the public good.<sup>83</sup> The private benefit doctrine is a key check on tax-exempt organizations because it is one way the IRS ensures that a nonprofit is in fact charitable<sup>84</sup> and not a “for-profit[] in disguise.”<sup>85</sup>

2. *Derivation and General Rules.* Although the private benefit doctrine is not written into § 501(c)(3) of the I.R.C., the IRS derives it from Treasury Regulation § 1.501(c)(3)-1(d)(1)(ii), which interprets

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77. I.R.C. § 501(c)(3) (2006 & Supp. IV 2011).

78. JAMES J. FISHMAN & STEPHEN SCHWARZ, *TAXATION OF NONPROFIT ORGANIZATIONS: CASES AND MATERIALS* 52, 75 (3d ed. 2010).

79. *Id.* at 75–76.

80. *Id.* at 7.

81. *See, e.g., id.* (“[T]he Foundation for New Era Philanthropy, a Pennsylvania charity that promised to double the money of donors and charities who entrusted New Era with millions of dollars, was a classic Ponzi scheme.”).

82. *See, e.g., id.* at 8 (“The Atlantic Monthly chronicled the increasing commercialism of American higher education, such as lucrative research alliances and licensing deals with for-profit companies, sales of naming rights for professorships, buildings and athletic facilities, and forays into distance learning and other ‘dot com’ businesses.”).

83. *See, e.g., id.* at 9–10 (discussing increased scrutiny of tax-exempt organizations by Congress and the IRS to ensure that tax-exempt status is not abused).

84. *See id.* at 221 (“[The private benefit doctrine] is just another way of saying that an organization must be operated exclusively for exempt purposes . . .”).

85. Burton A. Weisbrod, *The Nonprofit Mission and Its Financing: Growing Links Between Nonprofits and the Rest of the Economy*, in *TO PROFIT OR NOT TO PROFIT: THE COMMERCIAL TRANSFORMATION OF THE NONPROFIT SECTOR* 1, 11 (Burton A. Weisbrod ed., 1998).

§ 501(c)(3) to provide that “[a]n organization is not organized or operated exclusively for [exempt purposes] unless it serves a public rather than a private interest.”<sup>86</sup> In *American Campaign Academy v. Commissioner*,<sup>87</sup> the Tax Court further defined a private benefit as the conveyance by a tax-exempt organization of “nonincidental benefits conferred on disinterested persons.”<sup>88</sup> Secondary private benefits, benefits that are conferred on individuals or entities whom the organization does not directly serve, are also sufficient for the IRS to find a tax-exempt organization to be in violation of the private benefit doctrine.<sup>89</sup>

Because tax-exempt organizations will unavoidably create some private benefit to others through their charitable operations, creating an incidental private benefit is permissible.<sup>90</sup> For example, a soup kitchen that buys food for the homeless families that it serves conveys a private benefit to a supermarket. Likewise, volunteers at tax-exempt organizations receive noneconomic private benefits such as the satisfaction of serving their community. In each of these instances, however, the organization primarily serves a public interest, and the private benefit is incidental.

Conferring a substantial private benefit, on the other hand, is impermissible.<sup>91</sup> According to the IRS, whether a benefit is substantial is measured on a transaction-by-transaction basis. If an individual receives a benefit from the tax-exempt organization that is greater than the charitable or public benefit created by that transaction, the organization can lose its tax-exempt status.<sup>92</sup> The IRS uses both a qualitative and a quantitative analysis to determine whether or not a

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86. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii) (as amended in 2008).

87. *Am. Campaign Acad. v. Comm’r*, 92 T.C. 1053 (1989).

88. *Id.* at 1069.

89. *See, e.g., id.* at 1073–75 (denying tax-exempt status to an educational organization because it created a substantial “secondary” private benefit to the Republican Party, as most of its graduates worked for the party upon graduation).

90. *See* Darryll K. Jones, *Private Benefit and the Unanswered Questions from Redlands Surgical Services*, 29 EXEMPT ORG. TAX REV. 433, 443 (2000) (“[I]n many instances, an entity must benefit somebody in particular to achieve its charitable purpose.”).

91. *Better Bus. Bureau of Wash., D.C., Inc. v. United States*, 326 U.S. 279, 283 (1945) (finding that the creation of a private benefit, “if substantial in nature, will destroy the exemption regardless of the number or importance” of an organization’s other charitable purposes or activities).

92. *See* I.R.S. Gen. Couns. Mem. 39,862, at 9 (Nov. 21, 1991) (“It bears emphasis that, even though exemption of the entire organization may be at stake, the private benefit conferred by an activity or arrangement is balanced only against the public benefit conferred by that activity or arrangement, not the overall good accomplished by the organization.”).

private benefit is incidental or substantial.<sup>93</sup> Under the qualitative analysis, a private benefit is incidental when it is an unavoidable result or a “mere byproduct of the public benefit.”<sup>94</sup> For example, the IRS found that an increase in property values and personal enjoyment generated by an organization formed to preserve and beautify a lake for recreation constituted an insubstantial private benefit because the increase was an unavoidable result of the lake beautification.<sup>95</sup> Thus, the private benefit was merely incidental to the public benefit of the lake beautification.

The quantitative private benefit analysis weighs the private benefit against the public benefit. Under this analysis, the private benefit must be quantitatively less than the public benefit created by the activity.<sup>96</sup> The IRS uses two different factors to measure the quantitative private benefit: the number of individuals or organizations benefited and the net financial benefit received by those organizations.<sup>97</sup> If a small number of individuals or organizations receive a benefit, the IRS is likely to find that a private benefit is substantial.<sup>98</sup> If the financial benefit to an individual or organization is greater than the financial benefit to the public, the IRS will also likely find that the private benefit is substantial.<sup>99</sup>

#### *B. Defining and Applying the Private Benefit Doctrine: Three Theories and Tests*

Although some general rules and principles behind the private benefit doctrine do exist, the practical application of the doctrine is difficult because no unifying or coherent test exists.<sup>100</sup> Instead, three different tests attempt to interpret and apply the private benefit doctrine. Under one test, the doctrine is violated when a tax-exempt organization’s activities demonstrate a lack of a charitable class.<sup>101</sup> Under another test, the doctrine simply applies as one part of the IRS’s operational test.<sup>102</sup> Under the third test, the doctrine is violated

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93. I.R.S. Gen. Couns. Mem. 37,789, at 3 (Dec. 18, 1978).

94. Megosh et al., *supra* note 3, at 139.

95. Rev. Rul. 70-186, 1970-1 C.B. 129.

96. I.R.S. Gen. Couns. Mem. 39,862, at 9.

97. Megosh et al., *supra* note 3, at 139–40.

98. *Id.*

99. *Id.*

100. *See supra* note 71.

101. Colombo, *supra* note 7, at 20.

102. *See infra* notes 110–111 and accompanying text.

when a tax-exempt organization's activities demonstrate a failure to conserve charitable assets.<sup>103</sup> Each test is based on its own distinct theory about the purpose of the private benefit doctrine.

1. *The Private Benefit Doctrine as an Assessment of the Lack of a Charitable Class.* Under this theory, the private benefit doctrine restates the common-law rule that "a charity must serve a broad charitable class."<sup>104</sup> The test focuses on the size of the charitable class to determine whether or not a transaction conveys a private benefit. If the charitable class for a given benefit is too small or does not exist, the IRS will find that the tax-exempt organization conferred a substantial private benefit.<sup>105</sup> The example commonly cited to support this theory is a revenue ruling in which the IRS denied tax-exempt status to an organization created to improve one city block,<sup>106</sup> even though the IRS had previously granted tax-exempt status to an organization created to beautify an entire city.<sup>107</sup> Under this theory, the organization created to improve one city block was denied tax-exempt status because the organization had too few beneficiaries.<sup>108</sup>

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103. Colombo, *supra* note 71, at 1088–89. Professor Colombo briefly notes a fourth theory, the "failure of duty of care." See Colombo, *supra* note 7, at 22–25 (discussing private benefit as the federal incorporation of a duty of care); see also *United Cancer Council v. Comm'r*, 165 F.3d 1173, 1180 (7th Cir. 1999) ("[T]he board of a charity has a duty of care, just like the board of an ordinary business corporation, and a violation of that duty which involved the dissipation of the charity's assets might . . . support a finding that the charity was conferring a private benefit, even if the contracting party did not control, or exercise undue influence over, the charity." (citations omitted)). This theory, however, is only briefly mentioned in one case and does not seem to have been used or further explained in any IRS writings. This Note thus does not discuss it further.

104. Colombo, *supra* note 7, at 4.

105. See, e.g., *id.* ("[F]or example, a trust to maintain a public graveyard was considered charitable, but not one to maintain a[n] individual's private tomb.").

106. Rev. Rul. 75-286, 1975-2 C.B. 210, 210; see also Colombo, *supra* note 7, at 4 (using the ruling as an example of the theory that a "charity must serve a broad charitable class").

107. Rev. Rul. 68-14, 1968-1 C.B. 243.

108. Rev. Rul. 75-286, 1975-2 C.B. at 210. One problem with using this example to support this theory is that the IRS, in Revenue Ruling 75-286, 1975-2 C.B. 210, examined not only the size of a tax-exempt organization's charitable class, but also the amount of financial private benefit given to the landowners, *id.* In the revenue ruling, the IRS specifically noted that the beautification of one city block would give a substantial private benefit to adjacent landowners who would see an increase in their property values. *Id.* The IRS examined not merely the size of the charitable class, but also how the size of the financial private benefit compared to the overall public benefit. It is unclear whether the IRS would have come to the same result had it solely discussed the size of the nonprofit's charitable class.

One way to address this ambiguity would be to expand the charitable-class theory by combining it with the IRS's existing quantitative analysis. See *supra* notes 97–99 and accompanying text. Under this expanded theory, "substantial" private benefit can be measured

2. *The Private Benefit Doctrine as a Part of the Operational Test.* Under this theory, the private benefit doctrine is part of the operational test that the IRS uses to determine whether or not an organization is operated for a charitable purpose.<sup>109</sup> The operational test is composed of three different parts: the substantial-nonexempt-purpose test, the private inurement test, and the private benefit doctrine.<sup>110</sup> These parts overlap to some degree, but each serves its own distinct purpose, allowing the IRS to revoke or deny an organization's charitable status based on the presence of many different factors.<sup>111</sup>

As part of the operational test, the private benefit doctrine weighs the charitable purpose of the organization against the benefit received by private, noncharitable interests.<sup>112</sup> For example, a hospital that provides services to a large charitable class and that fulfills its charitable purpose may be found to have conveyed a substantial private benefit if the hospital's structure creates a private benefit for the controlling physicians such that they have a "closed, preferential system in which to practice medicine."<sup>113</sup> In this instance a charitable purpose exists, but the private benefit given to the physicians is too

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both by the size of the charitable class and by comparing the amount of financially quantifiable private benefit to the financial benefit to the public. *See supra* notes 97-99 and accompanying text. Under the expanded version of the theory, the block's beautification organization in Revenue Ruling 75-286 created a substantial private benefit because it benefitted a small charitable class and increased the landowners' property values, outweighing the increase in the value to the public. The organization dedicated to beautifying an entire city, however, did not create a substantial private benefit because its charitable class was the entire public, and the private benefits did not outweigh the public benefits because they were unquantifiable and an unavoidable result of the public benefit.

109. I.R.C. § 501(c)(3) (2006 & Supp. IV 2011); *see also* INTERNAL REVENUE SERV., *supra* note 76, at 12 ("[T]he operational test standard prohibiting a substantial non-exempt purpose is broad enough to include inurement, private benefit, and operations which further nonprofit goals outside the scope of IRC 501(c)(3).").

110. *See* I.R.S. Priv. Ltr. Rul. 2011-10020, at 22 (Mar. 11, 2011) ("The operational test is not satisfied where any part of the organization's earnings inure to the benefit of private shareholders or individuals, and where the organization serves a private benefit rather than public interests.").

111. *See* I.R.S. Chief Couns. Adv. 2004-31023, at 20 (July 30, 2004) ("The private benefit theory and the substantial nonexempt purpose theory overlap substantially. They both are rooted in the operational test. The differences are not so much ones of legal principle as they are ones of the types of facts that tend to lead to the conclusion that the operational test has not been met.").

112. I.R.S. Gen. Couns. Mem. 39,862, at 9 (Nov. 21, 1991) ("Determining whether a benefit flowing to private individuals evidences a substantial noncharitable purpose frequently requires balancing [the private benefit against the public benefit].").

113. Colombo, *supra* note 71, at 1082.

great in comparison. The nonprofit hospital with such a structure would not operate charitably but rather for the benefit of the physicians.

One criticism of this theory is that it makes the private benefit doctrine no different than the substantial-nonexempt-purpose test because the existence of a substantial private benefit can result in the revocation or denial of an organization's charitable status, even if the organization's overall charitable purposes outweigh the private benefit created by the transaction.<sup>114</sup> Thus, if the private benefit doctrine is to be useful as a stand-alone doctrine, it must be more than shorthand for the substantial-nonexempt-purpose test.<sup>115</sup>

But the private benefit doctrine is not just a substitute for another test. Instead, it is an expansion of the methods with which the IRS can either revoke or deny an organization's tax-exempt status. Each part of the operational test addresses a different area of abuse. The first part, the substantial-nonexempt-purpose test, specifically looks at the purpose of the charity: does it qualify under § 501(c)(3)?<sup>116</sup> If there are multiple purposes, are a substantial number of those purposes tax-exempt?<sup>117</sup> If not, the organization's tax-exempt status will be revoked or denied. The second part of the operational test—examining private inurement and excess-benefit transactions—is designed to ensure that insiders of a tax-exempt organization do not “unjustly enrich” themselves at a cost to the organization.<sup>118</sup> The private inurement doctrine prohibits the inurement of net earnings to insiders.<sup>119</sup> If the IRS finds private inurement, it will sanction the nonprofit by revoking or denying its tax-exempt status.<sup>120</sup> The prohibition of excess-benefit transactions supplements the private inurement test by expanding the definition of insiders to include “disqualified individuals”<sup>121</sup> and by allowing the IRS to use excise

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114. *Id.*

115. *Id.*

116. I.R.S. Priv. Ltr. Rul. 2011-10020, at 24–26 (Mar. 11, 2011).

117. *Id.*

118. INTERNAL REVENUE SERV., *supra* note 76, at 1–3.

119. I.R.C. § 501(c)(3) (2006 & Supp. IV 2011).

120. See Michael Folz Wexler & Alvin J. Geske, *The Private Benefit Rule and Interaction of Excess Benefit Transaction Taxes with Revocation*, 104 J. TAX'N 304, 304 (2006) (“These excise tax sanctions were thought to be a more effective way to enforce the no-inurement requirement than revocation of exemption in most instances where the transgression was relatively minor in comparison with the charitable activities of the organization.”).

121. The excess-benefit-transaction regulations prohibit the provision of an excess economic benefit to “disqualified person[s],” which include anyone who can “exercise substantial

taxes as intermediate sanctions if the IRS finds an excess-benefit transaction to have occurred.<sup>122</sup>

The substantial purpose and private inurement tests alone, however, only address abuses of an organization's tax-exempt status by insiders or disqualified individuals. There are still opportunities for abuse in ways that benefit those unrelated to a nonprofit. The private benefit doctrine gives the IRS the ability to catch those abuses that do not violate either the substantial-nonexempt-purpose or the private inurement tests. Thus the operational test in its entirety helps the IRS address multiple types of abusive organizations.<sup>123</sup> Each part of the test addresses a different type of abuse—noncharitable purposes, insider transactions, and financial and nonfinancial benefits to disinterested individuals or organizations—that outweighs the benefits conferred on the public or the relevant charitable class.

3. *The Private Benefit Doctrine as an Assessment of a Failure To Conserve Charitable Assets.* The third theory, developed by Professor John Colombo, views the private benefit doctrine as a tool for policing joint ventures between tax-exempt and for-profit organizations by splitting an organization's activities into routine and core services.<sup>124</sup> Under this theory, the private benefit doctrine does not apply to a tax-exempt organization's routine services<sup>125</sup> but may apply to its core services depending on the circumstances of the transaction.<sup>126</sup> This theory begins with a presumption that creating a private benefit is incidental for routine services.<sup>127</sup> Routine services are those services that are unrelated to the charitable mission of the

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influence over the affairs of the organization" as well as their family members, and any corporation in which the individual or his or her family has more than a 35 percent stake. I.R.C. § 4958(f)(1) (2006) (internal quotation marks omitted).

122. Treas. Reg. § 53.4958-1(a) (as amended in 2002). For the first violation, the tax is equivalent to 25 percent of the excess benefit against the individual who received the benefit, and the person who authorized the transaction is taxed 10 percent on the benefit. *Id.* § 53.4958-1(c)(1). If the organization does not fix the private inurement issue, the tax for the recipient increases to 200 percent of the total benefit received. *Id.* § 53.4958-1(c)(2).

123. On first glance, it can be difficult to rationalize why a tax-exempt organization would confer benefits to an outsider who is not part of the charitable class. Yet, there are instances in which such organizations give inappropriate benefits to noninsiders. *See, e.g.*, I.R.S. Priv. Ltr. Rul. 2011-10020, at 26–27 (Mar. 11, 2011) (finding that a land trust gave excessive financial benefits to landowners and donors who were not insiders).

124. Colombo, *supra* note 71, at 1087.

125. *See id.*

126. *Id.* at 1087–88.

127. Colombo, *supra* note 7, at 28.

organization but that are necessary for the organization to function.<sup>128</sup> For example, hiring for-profit janitorial services or contracting with utilities to provide heat and electricity are routine services that create an unavoidable private benefit.<sup>129</sup> The theory presumes that the type of private benefit created by routine services is incidental because the benefit conferred allows the nonprofit to focus the majority of its funds on its mission.<sup>130</sup> For example, a soup kitchen would not invest in building its own power source when it could pay a utility company for electricity and spend more of its resources on feeding the hungry.<sup>131</sup> Because arms-length contracts for routine services are economically efficient and are unlikely to create large opportunities for abuse, the theory presumes that these contracts create only incidental private benefit.<sup>132</sup>

This presumption of incidental private benefit, however, does not apply when the transaction relates to the core services of the tax-exempt organization.<sup>133</sup> Core services are “services that form the core primary charitable purpose” of the organization.<sup>134</sup> Under this theory, the private benefit doctrine should apply when a tax-exempt organization “outsources the delivery of its core services” or when it enters into an economic transaction that gives a for-profit firm a competitive advantage.<sup>135</sup> In each instance the tax-exempt organization runs the risk of failing to conserve charitable assets because they are used in for-profit transactions when those assets could instead be used to benefit a charitable class.<sup>136</sup> A tax-exempt organization can avoid a finding of failing to conserve charitable assets if it shows a reasonable justification for why the transaction is in the best interests of the charitable class, namely that the arrangement is a “more efficient or ‘better’ way to deliver services to the charitable class.”<sup>137</sup>

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128. *Id.*

129. *Id.*

130. *Id.* at 28, 30.

131. *Id.* at 28.

132. *Id.*

133. *Id.* at 30.

134. Colombo, *supra* note 71, at 1087.

135. *Id.* at 1089.

136. Colombo, *supra* note 7, at 30.

137. Colombo, *supra* note 71, at 1089.



In short, the private benefit doctrine is indeed a mess.<sup>138</sup> When amending farmland conservation easements, land trusts are left wondering how the private benefit doctrine might be applied. A land trust has no way to know if it will be judged based on the size of the charitable class, how it will be viewed under the operational test, or if it might be viewed as a joint venture that is outsourcing its core services or giving for-profit organizations a competitive advantage.

### III. THE PRIVATE BENEFIT DOCTRINE AND NEUTRAL-IMPACT AMENDMENTS

Neutral-impact amendments—amendments that help balance a working-land easement’s goal of keeping farmland in production without sacrificing conservation value—likely violate the private benefit doctrine under all three theories that were discussed in the previous Part. This is an unfortunate outcome. By approving a neutral-impact amendment, a land trust does not reduce the conservation value of the land. Neither does a land trust, in approving such an amendment, abuse the organization’s tax-exempt status because the amendment does not undermine the land trust’s charitable purpose and because the land trust’s earnings do not inure to the benefit of insiders. Instead the amendment fulfills the other goal of the underlying conservation easement by keeping farmland in production and addressing the needs of the farmer. A neutral-impact amendment allows the farmer to modify farming operations without negatively impacting the conservation value of the land—a good way for the land trust to meet one of its goals without sacrificing the other.

The analysis in the two examples below, however, suggests that a neutral-impact amendment will likely violate the private benefit doctrine. But this outcome seems counterintuitive, particularly because the amendment attempts to balance the competing purposes inherent in farmland and working-land conservation easements by fulfilling the needs of the farmer without injuring the conservation value of the land itself.

#### A. *Example One: Installing Cell Antennas in Silos*

The first example of a neutral-impact amendment that is likely to violate the private benefit doctrine is an amendment allowing a local

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138. See *supra* note 72 and accompanying text.

utility to install cellular antennas on conserved farms. In this example, a local utility asked several farmers if it could install cellular antennas on or inside the farmers' silos.<sup>139</sup> The installed antennas would have zero conservation impact. They would be "virtually invisible," keeping open space and scenic views intact, and they would not require additional land to be released from existing development restrictions.<sup>140</sup> Additionally, the antennas would not impede the farmers' use of the silos, and their installation would allow the utility to use existing structures rather than build new cellular towers on previously undeveloped land.<sup>141</sup> In many ways this would seem like a straightforward decision—the farmers would gain additional income from leasing the silo, other land would remain protected from the new development for cellular towers, scenic views would be preserved, and the antennas would improve overall cellular coverage for the general public.<sup>142</sup>

Several of the farmers in this example, however, had conserved their land through conservation easements. As written, these easements prohibit commercial uses on the farm, except those specifically named in the easement.<sup>143</sup> For example, an easement limits the farm to "agriculture, forestry, home occupations, and 'accessory uses,' such as making cheese from milk produced on the farm."<sup>144</sup> To install the antennas, the farmers and the land trust would need to amend the easement.<sup>145</sup> Although the benefits of the proposed amendment would be many, a review of the three theories of the private benefit doctrine seems to indicate that an amendment like this would violate the private benefit doctrine.

1. *Examining the Size of the Charitable Class.* Under the theory that the IRS must assess the size of a nonprofit's charitable class, the approval of this request to install an antenna seems immediately to violate the private benefit doctrine. The amendment would directly benefit only one farmer and would indirectly benefit the utility company. The general public may recognize some benefit through the preservation of the scenic view, but the primary purpose of the

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139. This hypothetical is derived from Bradley, *supra* note 1, at 27.

140. *Id.*

141. *Id.*

142. *Id.*

143. *Id.*

144. *Id.*

145. *Id.*

amendment is not to protect the scenic view. Rather, the amendment is meant to allow the farmer, who is not a member of the land trust's charitable class, to install an antenna on his farm.

2. *Applying the Private Benefit Doctrine as Part of the Operational Test.* The transaction also likely fails under the operational test because it creates a substantial private benefit that probably outweighs the public benefit created by the amendment. In this transaction, a quantifiable primary private benefit would be conferred on the landowner because the silo would generate rental income. The utility company would receive a quantifiable secondary private benefit in the form of decreased antenna-construction costs and an extended network. Both of these private benefits are quite substantial, particularly when weighed against the fact that the amendment did not further the conservation purposes of the easement. Yet, the amendment would also create some positive public benefit—it would protect other lands from being developed and would preserve scenic views from being broken up by larger cellular towers. It is unclear, however, if this public benefit would outweigh the substantial private benefit conferred on both the farmer and the utility.

Viewing the private benefit doctrine in relation to the other parts of the operational test, the land trust is still operating primarily for a charitable purpose, and its net earnings do not inure to any insiders. Even so, because this single transaction created a substantial private benefit, the IRS has the authority to revoke the tax-exempt status of the land trust if it were to approve this amendment.<sup>146</sup> But should this private benefit jeopardize the land trust's tax-exempt status when the amendment would not negatively impact the conservation value of the easement and would not otherwise violate the operational test?

3. *Testing a Failure To Conserve Charitable Assets.* It is difficult to determine how this amendment fits into the third test, which inquires into a tax-exempt organization's failure to conserve charitable assets. The first question under this test is whether amending a conservation easement would be considered a core service related directly to the entity's charitable purpose.<sup>147</sup> In this case, the core service of the land trust is to protect land. One could

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146. See *supra* note 92 and accompanying text.

147. Colombo, *supra* note 7, at 30.

argue that the proposed amendment is directly related to the core services of the land trust because it would change the conservation easement, which is the main method that a land trust uses to preserve land.<sup>148</sup> Conversely, perhaps the amendment is not related to the core services of the land trust because it would not have any effect on the purposes or conservation value of the easement. Under this understanding of core services, an amendment would only be related to the core services of the land trust if the amendment had a negative or a positive conservation impact.

If an analysis determined that approving neutral-impact amendments is a routine service of a land trust, the examination under the private benefit doctrine would stop there.<sup>149</sup> If approving the amendments is determined to be a land trust's core service, the amendment would violate the private benefit doctrine if the transaction allowed the land trust to do one of two things: either outsource its core services or enter into an economic transaction that creates a competitive advantage for a for-profit entity.<sup>150</sup> The transaction in this hypothetical would not fit into the first category because the land trust would not be outsourcing its work. The land trust would not be contracting with another for-profit entity to provide land preservation services in its place. The transaction may fit into the second category, but it is unclear if an economic transaction would be present. The land trust merely would be giving the farmer permission to enter into a transaction that created an economic benefit for both the farmer and the utility. Is giving permission to someone else to enter into an economic transaction the same as entering into an economic transaction?<sup>151</sup> If this amendment were considered an economic transaction, it would create a competitive advantage for two for-profit parties. It would offer the farmer supplemental income and would provide the utility a better

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148. See *supra* note 19 and accompanying text.

149. See Colombo, *supra* note 7, at 30 (positing that the IRS should not apply the private benefit doctrine to "routine transactions for 'incidental' services").

150. *Id.*

151. A similar question to the one posed in this discussion is whether a land trust that gives permission to a farmer to grant a benefit to another entity should be treated the same as a land trust that confers a private benefit on the farmer. Although this Note does not delve into this question, it may be worth future scholarly exploration.

distribution network, both of which would violate the private benefit doctrine.<sup>152</sup>

*B. Example Two: Land Swap To Increase Farm Viability*

Another common example of a neutral-impact amendment that likely violates the private benefit doctrine is a land swap used to increase farm viability. In this example, a dairy farm was conserved thirty years ago. The original conservation easement conserved 125 acres of land and set aside fifteen acres for the farmstead complex.<sup>153</sup> Initially the fifteen acres were sufficient for the farmer to operate and run a successful farm. As technology and the dairy market changed, however, the farmstead complex eventually became too small to support the farm structures necessary to sustain the farming operation. If the farmer could not expand his operations, the farm would likely go out of business.

The farmer then proposed a land swap, asking the land trust to release the conservation easement's restrictions on ten acres of land adjoining the existing farmstead complex in return for conserving an additional ten acres of land with comparable conservation value.<sup>154</sup> This land swap would have a neutral conservation impact: while ten acres would be opened to development, an additional ten acres would be preserved. Again, similar to the antenna example, this seems to be a mutually beneficial transaction—the farm would remain viable, it could adapt to changing circumstances, and there would be no net loss to the conservation value of the land trust's easement.

1. *Examining the Size of the Charitable Class.* The land trust's approval of the land swap would likely violate the private benefit doctrine under the theory that examines the size of the tax-exempt organization's charitable class. The amendment would benefit only one farmer who is not a member of the charitable class. Nor would the amendment seem to create a benefit for the public because the net sum of land preserved, and thus the total conservation value protected, would remain the same.

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152. The land trust would be at risk of violating the private benefit doctrine with respect to both the farmer and the utility, as the utility would receive a secondary private benefit. See *supra* notes 83–89 and accompanying text.

153. For the definition of farmstead complex, see *supra* text accompanying note 53.

154. The author developed this example through conversations with Dennis Shaffer, Director of Stewardship, and Rick Peterson, Project Counsel, at the Vermont Land Trust.

2. *Applying the Private Benefit Doctrine as Part of the Operational Test.* The land-swap amendment would also likely violate the private benefit doctrine under the operational test. Under this test, the amendment would not further the conservation purposes of the easement and would confer a seemingly substantial private benefit on a disinterested individual: the increase in the size of the farmstead complex would allow the farmer to increase the production and viability of the farm. This private benefit would outweigh the seemingly nonexistent public benefit. If, however, public benefits are judged on a broader scale—that is, if protecting working lands and balancing land uses create a public benefit—perhaps this transaction would not violate the private benefit doctrine.<sup>155</sup> Once again, this predicament highlights the following question: should the creation of a private benefit be enough to revoke a land trust's tax-exempt status when it would not negatively impact the conservation value of the easement and would not violate any other part of the operational test?

3. *Testing a Failure To Conserve Charitable Assets.* The land-swap example would also likely violate the theory of the public benefit doctrine based on a failure to conserve charitable assets. The core-service debate remains the same as in the previous example.<sup>156</sup> If approving the amendment is determined to be a core service, the land trust would not seem to have outsourced its core services, but rather would seem to have entered into an economic transaction. The land trust would participate in an exchange of land, removing restrictions on ten acres of land in return for adding new restrictions on a different ten acres. The economic transaction would likely create a competitive advantage for the farmer, which violates the private benefit doctrine under Professor Colombo's theory.<sup>157</sup> Increasing the size of the farmstead complex would allow the farmer to adapt to and compete in the changing economy, but this would give the farmer a competitive advantage and thus violating the private benefit doctrine.

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155. See *infra* Part IV.D.

156. See *supra* Part III.A.3.

157. See *supra* note 135 and accompanying text.

Both examples in this Part illustrate the counterintuitive results created by the application of the private benefit doctrine to neutral-impact amendments. In each example, the land trust approves an amendment that furthers one of the easement's goals: supporting agricultural use. Plus, the amendment does not negatively impact the conservation value of the land. A land trust should not run the risk of violating the private benefit doctrine with such an amendment. As such, this Note argues that the IRS should consider the private benefit doctrine to be a doctrine that protects against abuse and should not apply it to neutral-impact amendments.

#### IV. MOVING THE PRIVATE BENEFIT DOCTRINE FORWARD

The application of the private benefit doctrine to neutral-impact amendments creates undesirable results. It makes little sense to put a land trust at risk of losing its tax-exempt status when an amendment gives farmers the flexibility under the easement to keep the land in production without decreasing the underlying conservation value of the land. Through such an amendment, the land trust can further one purpose of the easement without sacrificing the other. Thus, the IRS should not apply the private benefit doctrine to neutral-impact amendments. The messiness of the private benefit doctrine itself would justify efforts by the IRS to clarify the doctrine, particularly in areas in which its application is unclear or would create undesirable results. The existing theories behind the doctrine are targeted to address very different circumstances than those created by the approval of a neutral-impact amendment. Two of the three theories behind the private benefit doctrine—the theory based on the lack of a charitable class and the theory that places the private benefit doctrine as part of the operational test—seem to be designed to prevent clear abuses of the nonprofit status. These theories test for organizations that do not violate the substantial-nonexempt-purpose test or the private inurement doctrine yet still do not seem entirely charitable or else are for-profit organizations in disguise.<sup>158</sup> The third theory, the

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158. See, e.g., Rev. Rul. 76-206, 1976-1 C.B. 154 (finding that an organization that sought to preserve and maintain classical music programming did have a valid charitable purpose and did not violate the private inurement doctrine, but did violate the private benefit doctrine because “[i]t was formed in response to an announcement by a local for-profit radio station that the station intended to cease broadcasting classical music because of financial difficulty” and because “[t]he organization accomplishe[d] its purpose by engaging in a variety of activities designed to stimulate public interest in the classical music programs of the for-profit station, and thereby enable the station to continue broadcasting such music”).

failure to preserve charitable assets, was developed to address the private benefit doctrine in relation to joint ventures.<sup>159</sup> Land trusts, if following all other rules, do not fit under any of these theories when approving a neutral-impact amendment—they are neither a for-profit in disguise nor a joint venture.

The IRS has also been inconsistent in its application of the private benefit doctrine. Not only do the theories behind the doctrine vary, but the IRS has also chosen not to apply the doctrine in instances in which common sense would expect it to be applied.<sup>160</sup> With a doctrine as open for interpretation as this one, the IRS has the ability to choose not to apply the private benefit doctrine to neutral-impact amendments, and it should decline to do so. But this decision should not be ad hoc. Instead, the IRS should use formal guidance such as a revenue ruling to acknowledge that neutral-impact amendments do not violate the private benefit doctrine. This would create a clear standard for land trusts and reduce confusion.<sup>161</sup>

The IRS should not apply the private benefit doctrine to neutral-impact amendments for several reasons. First, the private benefit doctrine should be used only to curb abuses. Second, these amendments allow land trusts and the IRS to recognize and balance the inherent tension in preserving working lands as open space. Third, some neutral-impact amendments merely update an easement to reflect current easement-drafting standards. Fourth, the preservation of working lands creates a public benefit that outweighs the conveyance of a private benefit. And finally, allowing such amendments may encourage the use of working-land conservation easements in general.

#### A. *Private Benefit as an Anti-Abuse Doctrine*

The private benefit doctrine should only be used to curb abuses. In the case of conservation easements, the private benefit doctrine

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159. See Colombo, *supra* note 71, at 1092 (discussing the private benefit doctrine in relation to joint ventures).

160. See *supra* note 74 and accompanying text.

161. Instead of using a revenue ruling, the IRS could create intermediate sanctions for a tax-exempt organization that violates the private benefit doctrine similar to the sanctions the IRS gives for a violation of the excess-benefit-transaction test. See *supra* notes 121–122 and accompanying text. Depending on which factors the IRS decided to use, neutral impact amendments might not violate the private benefit doctrine. The implications of creating a formal set of factors for discerning violations of the private benefit doctrine would be fertile ground for further scholarly investigation.



should apply only to amendments that negatively impact the conservation value of an easement. For example, a recent revocation of a land trust's tax-exempt status, based in part on the approval of several negative conservation impact amendments, illustrates a clear violation and the proper application of the private benefit doctrine.<sup>162</sup> In this example, a land trust approved several amendments that allowed the landowners to subdivide and build on their property.<sup>163</sup> These amendments dramatically increased the value of the land to the landowners and significantly reduced the amount of land protected from development.<sup>164</sup>

Unlike approving an amendment that negatively impacts an easement's conservation value, approving a neutral-impact amendment, unless accompanied by other violations, is not an abuse of an organization's tax-exempt status. A land trust that follows the LTA amendment policies, works toward a charitable end, and does not inure its net earnings to insiders should not be at risk of losing its tax-exempt status simply because it approves a neutral-impact amendment. It is one thing when a land trust allows the landowner to subdivide and develop conserved land. It is another when the amendment helps further one of the easement's twin goals—to keep the land in productive agricultural use—without negatively impacting the land's conservation value.

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162. I.R.S. Priv. Ltr. Rul. 2011-10020, at 27–29 (Mar. 11, 2011). This revenue ruling also provides an excellent example of a conservation land trust that clearly abused its nonprofit status. In addition to finding substantial private benefit in regard to the amendments, the IRS found that: (1) “[m]ore than an insubstantial part of [the land trust’s] activities” were in “furtherance of a non-exempt purpose,” *id.* at 1; (2) private inurement existed; and (3) the land trust conferred a private benefit to its donors, *id.* at 27–29. The IRS based this finding on the following facts: First, the land trust did not have any of the policies, procedures, or resources in place to ensure that the land was used for conservation purposes alone. *Id.* at 25. Without the commitment to protect the conservation easements, land owners were free to gain a deduction on their donation while still using the land however they chose. Second, the net earnings of the organization inured to the benefit of the president of the organization, including unreported fringe benefits and consultant fees. *Id.* at 22. Third, the IRS found that there was significant private benefit given to each donor. *Id.* at 27. The donors improperly received a charitable contribution deduction because the organization was not a “qualified organization.” *Id.* In addition to failing the entire operational test, the organization failed to follow filing requirements and donated to a mayoral race, which violated § 501(c)(3) prohibitions on participating in a political campaign. *Id.* at 28.

163. *Id.* at 27.

164. *Id.*

*B. Balancing the Tensions Inherent in Preserving Working Lands*

Over the years, the IRS has allowed tax-exempt land trusts to preserve farmland and working lands,<sup>165</sup> but it has not focused on the inherent tensions in allowing such preservation. By not applying the private benefit doctrine to neutral-impact amendments, the IRS can acknowledge this tension and give land trusts due flexibility to balance the needs of land preservation with the needs of a working, productive farm—as directed by the conservation easement itself.

In essence, the IRS, by approving the tax-exempt status of a land trust and by permitting a charitable deduction for donations of working-land easements to land trusts, has approved the conferral of some private benefit: the donor retains current and future rights to benefit from the working land. For example, an easement may allow the landowner to build an additional building on the preserved land.<sup>166</sup> These sorts of benefits are negotiated into an easement and are themselves in service of the overall charitable pursuit of conserving land.<sup>167</sup> Without providing some current and future benefit to the landowner, the landowner has little incentive to donate a conservation easement. Thus, some private benefit is already baked into a working-land easement; they are just generally seen as insubstantial in light of the larger charitable purpose of preserving land.

Further, by allowing farmland easements that explicitly state two purposes, the IRS has implicitly sanctioned the benefit that preservation of agricultural use creates for farmers. This agricultural use, however, is an unavoidable benefit created to preserve the land for charitable purposes. A neutral-impact amendment merely allows the land trust to better meet the secondary goal of productive agricultural use—a private benefit already integrated within the easement and certified by the IRS's approval of the easement.

If a land trust is able to approve a neutral-impact amendment without risk of violating the private benefit doctrine, the land trust can help a farm adjust to new situations or technologies that may not have been contemplated when the easement was created. Such

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165. See *supra* notes 30–38 and accompanying text.

166. See *supra* note 54 and accompanying text.

167. See Hutton, *supra* note 35, at 1.17 (“[T]he activities of the Conservancy are exclusively aimed at the production of public benefit, and acquisitions from landowners through donations or via purchases not in excess of fair market value can hardly be said to confer any unwarranted benefit to participating landowners.”).

support for the farmer, however, would not remove or reduce the conservation value of the land. Instead, the amendment addresses the needs of the farmer without impacting the charitable purpose of preservation, thereby meeting both goals of a farmland easement.

### C. *Updating the Easement*

A neutral-impact amendment that is used to bring an easement up to current best practices should not create a risk of violating the private benefit doctrine. Some neutral-impact amendments, such as the amendment described in the cellular-antenna example,<sup>168</sup> merely update the farmer's easement to include rights developed or recognized after the easement is donated or sold to the land trust. For instance, many of today's easements include rural-enterprises or new-technologies clauses. These clauses allow a farmer to use the land for nonagricultural activities if the land used is within the farmstead complex and the activity has a neutral conservation impact.<sup>169</sup> A farmer with a newer conservation easement that included these clauses who wanted to add antennas to his farm's silos would be able to do so without an amendment, and the land trust would not risk violating the private benefit doctrine.<sup>170</sup> Land trusts that hold older easements, however, run the risk of conferring a substantial private benefit by amending the easement in this situation even though the same benefit would be permissible under other easements. Amending the conservation easement to bring the easement up to current drafting standards—as long as the amendment does not negatively impact the conservation value of the land—should not violate the private benefit doctrine.

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168. See *supra* Part III.A.

169. See Anderson & Cosgrove, *supra* note 9, at 11–12 (noting that rural enterprise clauses generally take one of two approaches to permitting “diversification of the farm business”—they either “[a]llow the rural enterprise as long as it is a subordinate business to the farming operation,” or they allow the enterprise “to operate within the farm building envelope”); Bradley, *supra* note 1, at 27 (“[The Vermont Land Trust’s] easements now include a ‘New Technologies’ clause, which allows the land trust to approve the use of a technological advance, when it does not damage the conservation purpose of the easement.”).

170. This provision would not violate the private benefit doctrine because the benefit had already been negotiated into the conservation easement and thus was an unavoidable benefit created as part of the overall charitable pursuit of conserving land. See *supra* note 167.

*D. Public Benefits from Neutral-Impact Amendments*

Although not commonly framed this way, neutral-impact amendments that help a farm remain in production provide a significant public benefit. Although research in this area is still developing, the theory is that a public benefit is created when competing land uses are balanced with each other.<sup>171</sup> Working lands, including farmlands, are part of this balance.<sup>172</sup> Under this theory, allowing conserved farmland to evolve and remain productive without negatively impacting the conservation value of the land provides a public benefit because it ensures that a state or locality retains a good mix and balance of land uses.<sup>173</sup>

As communities evolve and as land resources become increasingly scarce, land planning will become even more critical. Cities, states, and even the country, will need to determine the correct balance of land uses to best meet a variety of needs. Unfortunately, farmland is particularly prone to development pressures: the land is flat, has good drainage, and is well-suited to development.<sup>174</sup> Preserving farmland is crucial—farms provide food and fiber for the nation, agriculture employs 17 percent of the labor force, and well-managed farms protect the environment and provide other natural goods and services.<sup>175</sup> Preservation efforts such as conservation easements are a key part of providing a public good: sustaining the correct balance of farmland and developed land.<sup>176</sup>

Neutral-impact amendments can help keep farmland in production, thus helping to maintain the fragile balance between new development and working lands. An amendment that helps a farmer keep the land in production ensures that an appropriate mix of land uses will be maintained—a public good itself—while still keeping the conservation value of the land intact. Without a neutral-impact amendment that benefits the farmer, a farm may no longer be able to

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171. Interview with Bradford S. Gentry, Professor of Practice, Yale Sch. of Forestry & Env'tl. Studies, in Cheshire, Conn. (Nov. 23, 2011).

172. *Id.*

173. *Id.*

174. Todd W. Daloz, *Farm Preservation: A Vermont Land-Use Perspective*, 12 VT. J. ENVTL. L. 427, 431–32 (2011).

175. *Farmland Protection*, AM. FARMLAND TRUST, <http://farmland.org/programs/protection/default.asp> (last visited Mar. 6, 2013).

176. Other farmland-protection tools include agricultural zoning, agricultural districts, purchase of development rights, and use-value assessments. Jesse J. Richardson, Jr., *Beyond Fairness: What Really Works To Protect Farmland*, 21 DRAKE J. AGRIC. L. 163, 166–69 (2007).

remain in production, which would remove the land from productive use and thus disrupt the balance of land uses. If, however, the private benefit doctrine did not apply to neutral-impact amendments, the land trust could maintain the private benefit that the conservation easement granted to the farmer, which would allow the farmer to keep the land in production and serve the public good of balanced land uses.<sup>177</sup>

#### *E. Encouraging Greater Use of Conservation Easements*

Conservation easements are often criticized for not being flexible enough,<sup>178</sup> and many farmers are loath to add more restrictions to their land use. Allowing a land trust to approve neutral-impact amendments that benefit the productivity of the farm gives the land trust additional flexibility within the easement. This added flexibility might encourage other farmers and landowners to donate or sell a conservation easement on their property when they otherwise might not have. A private benefit doctrine that sanctions the flexibility that neutral conservation impact amendments offer, therefore, might incentivize conservation through working-land easements in a way that could drastically outweigh the private benefits that these amendments create for any individual farmers.

### CONCLUSION

The application of the private benefit doctrine to farmland and working-land conservation easements illustrates how law can create undesirable and unexpected outcomes when applied to a specific situation. When examined separately, both the private benefit doctrine and neutral-impact amendments are useful and desirable. At its core, the private benefit doctrine is designed to prevent abuses of tax-exempt status and successfully does so in the case of amendments that have a *negative* impact on an easement's conservation value. Neutral-impact amendments, however, allow a farmer to adjust to

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177. Interesting questions arise as to whether the preservation of farmland itself should be considered a charitable purpose under the IRS guidelines. Given the enormity of this question and the variety of farms throughout the nation, these questions are best saved for exploration in another paper.

178. See generally Adena R. Rissman, *Evaluating Conservation Effectiveness and Adaptation in Dynamic Landscapes*, 74 LAW & CONTEMP. PROBS. 145 (2011) (positing adaptive easements as a more flexible option than easements currently in use); Greene, *supra* note 12 (advocating for dynamic easements that adapt to changing conditions as opposed to more static conservation easements).

changing technologies and circumstances without harming the conservation value of the land. Yet, as the legal rule stands, a land trust risks losing its tax-exempt status under the private benefit doctrine if it approves a neutral-impact amendment, such as one that would allow a farmer to put an antenna inside a silo or increase the size of the farming operation. This scenario makes little sense. Why prohibit an amendment that advances one of the stated goals of the easement and that does not harm the easement's other stated goal?

Conservation land trusts should not run the risk of losing their charitable status if they approve a neutral-impact amendment. To remedy this unfortunate outcome, the IRS should rule that the private benefit doctrine does not apply to neutral-impact amendments. The IRS has already bestowed its approval on working-land easements that allow farmers, land trusts, and communities to work together to preserve farms and conserve the environment. These parties, therefore, should also be given flexibility to continue to work the land, as long as this flexibility does not come at the expense of the conservation purpose itself. Neutral-impact amendments allow a land trust and a farmer to strike this balance.