TESTIMONY OF BURNET R. MAYBANK, III, DIRECTOR SOUTH CAROLINA DEPARTMENT OF REVENUE
BEFORE THE SENATE COMMITTEE ON FINANCE HEARING: "THE TAX CODE AND LAND CONSERVATION: REPORT ON INVESTIGATIONS AND PROPOSALS FOR REFORM"
June 8, 2005

I very much appreciate being given the opportunity to address the Senate Finance Committee and offer my views on conservation easements.

I am the Director of the South Carolina Department of Revenue. I have a law degree and a LLM in Taxation. I am the principal co-author of 2 books on conservation easements published by the South Carolina Department of Revenue. A copy of my biography is attached to my testimony.

The South Carolina Department of Revenue is in the midst of an audit of conservation easements granted in this state over a 3 year period, principally from 2001-03. I attach a copy of our Land Trust desk audit. We also recently published the attached second edition, *Local, State and Federal Tax Incentives for Conservation Easements.* I have been actively involved in this field, both in the public and private sector. My experience has been that conservation easements have been incredibly effective as a land planning tool and the percentage of abuses have been quite small. The dollar value of those few abuses has, however, been very high. Based on the foregoing, I wanted to add my own list of recommendations. I would encourage the Committee to adopt the specialized valuation rules stated below *only* for either conservation easements, or perhaps other non-cash charitable contributions, of over $100,000.

1. EXCESSIVE VALUATIONS

We have examined some 110 easements granted over a 3 year period from 2001-2003 in South Carolina with an appraised value of over $1 million. Collectively, they add up to over $240 million in charitable deductions. We are in the early stages of examining another 50. They total some $50 million. We expect easements granted during the last 2 years in South Carolina to easily surpass this amount.

States like South Carolina suffer from excessive valuations in two ways: (1) the charitable deduction taken on the federal return flows through to the state tax return, and thus lowers the taxable income subject to state income tax; and (2) South Carolina, like many states, has its own state tax credit for conservation easements.

While few in number, we have seen valuations which shock the conscience. For example, an easement was placed on a proposed golf course. The land was purchased for several million dollars three years earlier. The appraisal claims the land was worth $20 million before the easement and only $1.5 million after the easement – a reduction of 95%. The appraisal entitles the golf course developers to a deduction of $18.5 million. This is one of several golf course easements we have seen with a claimed 95% reduction in value.

Another example is a 4 acre lot on deep water in a residential subdivision in Charleston County. The donor reserved the right to build a 6,000 square foot home on the lot. The appraiser claimed the land was worth $1.5 million before the easement and only $6,000 after the easement – notwithstanding the donor's right to build a 6,000 square foot home on deep water in a very nice subdivision!

These excessive valuations result from a variety of factors, including:

a. Either total ignorance of the rules, or conduct bordering on tax fraud, by the appraiser;
b. By law, the donor is not required to list the valuation of the easement on the IRS Form 8283 at the time the Land Trust signs it; even if he does, and the valuation troubles the Land Trust, the federal tax law specifically states the Land Trust does not vouch for the value (see pages 105-106 in the attached DOR publication *Local, State and Federal Tax Incentives for Conservation Easements*); lastly, the Land Trust has no motive to question or police valuations;
c. an appraisal is as much an art as a science; Appraisers who do not reliably provide high valuations will not receive valuation assignments for golf courses and commercial developments from the Land Trusts who specialize in such easements;
d. there is an appraisal technique called the subdivision development analysis which can be easily manipulated to provide high valuations (see pages 95-98);
e. lack of audit resources together with the difficulty of challenging a MAI Appraisal of real estate when combined with the natural instinct of many tax court judges to "split the difference" inevitably leads to a lack of enthusiasm to audit or challenge valuations on the part of the IRS and state taxing authorities; and
f. The IRS has lost the vast majority of conservation easement cases in the Tax Court.

Most of the abuses can be combated by restricting or banning use of the subdivision development analysis.

In addition, the adoption of a specialized Form 8283 for conservation easements which will require disclosure of relevant problem areas will considerably help audit selection by the IRS and state DORs.

2. QUID PRO QUO

Real estate developers are using conservation easements as a tool to obtain preferential zoning, in most cases to increase the density of their proposed developments of farm land. Developers are also using conservation easements to fulfill certain mitigation and similar requirements imposed by state and federal environmental law. This has become almost a routine practice in the South Carolina low country. And they are taking large charitable deductions.

Indeed, we have seen the use of easements turned on their head. They are now used a tool to promote—rather than hinder—the development of relatively natural habitat.

This issue is covered at length in the *Washington Post* article, "Developers Find Payoff in Preservation" written by Joe Stephens and David Ottaway.

In theory, a donor is required to have the requisite donative intent in order to take a charitable deduction. Few would argue that a real estate developer who gives a conservation easement on a small percentage of his proposed development in order to settle a zoning dispute with the county as well as the neighbors has *any* donative intent. The law has, however, gradually changed to allow a charitable deduction in the amount of the net difference between that which the developer has received (preferential zoning, mitigation) and that what he has given up (the conservation easement.) (See pages 63-66 in the DOR publication.) Since this is a valuation issue we face the same problems as earlier stated (lack of audit resources, valuation is more an art than a science, etc.)

I encourage the Committee to adopt strict quid pro quo rules applicable to all gifts of non-cash charitable contributions of over $100,000. Attached is Virginia legislation which provides that dedications of land for the purpose of fulfilling density requirements do not qualify for conservation easement treatment.

I would encourage the Committee to adopt legislation which specifically provides that any conservation easement given pursuant to any zoning requests or for the purpose of fulfilling any state or federal environmental requirement does not qualify for charitable contribution purposes. Such legislation would need strong attribution rules. I attach a proposed draft.

3. SPECIAL VALUATION RULES FOR GOLF COURSES AND COMMERCIAL DEVELOPMENTS

I would add at the outset that in South Carolina the great majority of golf course and developer easements that we are aware of seem to involve the same donee and some of the same appraisers and consultants. To me this highlights the fact that the problem of abuse is very limited in scope, although significant where it does occur.

a. Golf Courses

The largest easements we have seen from a dollar standpoint have involved golf courses. In some cases the easement is granted before the golf course is built, in others an easement has been placed on an established course. In some cases the easement encompasses the course together with associated wetlands. In other cases the easement covers common areas. Golf course easements purportedly qualify on several grounds under IRC 170(h). Golf courses, which are open to the public, may qualify under the IRC § 170(h) provision for preservation of land areas for outdoor recreation by the general public. Golf courses not open to the general public may qualify under preservation of a relatively natural habitat.

b. Commercial Developments

It is not uncommon for real estate developers to place easements on common areas and wetlands. The developer advertises the easement, and clearly it is an attractive feature to prospective buyers.

c. Recommendations

We have seen astonishing valuations placed on these easements. Seven of the nine largest easements (from a dollar standpoint) currently under audit involve golf course developments. The appraisals include:

$40,000,000
$20,000,000
$18,000,000
$17,000,000
$16,000,000
$7,000,000
$7,000,000

All of the golf courses above are private, although several are currently open to the public. The five largest, however, are all in exclusive gated communities.

I seriously question whether the U.S. Treasury should subsidize any golf course development, public or private. In particular, I do not believe the U.S. Congress ever intended to give huge charitable deductions for the preservation of a golf course in an exclusive gated community.

Many of the above valuations result from an aggressive use of the subdivision development analysis. If the Committee chooses not to simply ban golf course easements, I would encourage the Committee to severely limit or ban the use of this appraisal technique.

Another idea would be for the Committee to adopt a broader version of the tax rules which apply to real estate "dealers" (see pages 5-6), along with strong attribution rules.

I attach an article by Stephen Small, the foremost attorney for conservation easements in America. He discusses several of the issues raised above.

4. LAND TRUST STANDARDS

The legal requirements to become a land trust (or other entity which accepts conservation easements) under both state and federal law are minimal.

a. Straw Land Trusts

Bingo may only be played under the South Carolina Constitution by a charity. Most, if not all, bingo games are run by for-profit bingo promoters who share a small portion of the revenue with the charity. Bingo promoters long ago discovered that they did not have to put up with pesky demands by real charities. Instead a few set up their own charities while others took over established but defunct charities.

No law requires golf course and commercial developers to utilize any particular land trust. They are largely free to set up their own land trusts, and it is only a matter of time before they do. We have seen commercial developers set up land trusts in South Carolina.

I would encourage the Committee to adopt specific self dealing rules.

In addition, as I noted above, we have seen several land trusts which have the look and feel of a commercial consulting enterprise (very similar to what the IRS is going through with Commercial Credit Counseling agencies.) They are active in golf course easements. There is no easy legislative solution.

b. Lack of Resources to Enforce Easements

Current IRC law (see pages 34-35) requires only that a land trust (or other donee) have a "commitment" and the "resources" to enforce the easements which they receive. There are NO minimum standards under current law. The IRC is almost completely silent regarding a Land Trust's duty to inspect and enforce the easements which they accept. I would encourage the Committee to adopt minimum resource standards, and to legislatively adopt the Land Trust Alliance standards regarding easement monitoring and enforcement. (See pages 79-80.)

5. AUTHORIZE THE STATES TO UTILIZE IRS PENALTY PROVISIONS

The IRS and Congress have been very active in adopting Tax Penalty provisions, and particularly with reference to valuations. The states have been much slower to adopt such provisions, even such states as South Carolina, which annually adopts federal tax conformity. I would encourage Congress to adopt a provision which authorized the states to use IRS penalty provisions.

6. ESTABLISH CONSERVATION EASEMENT ADVISORY COMMITTEE

I would encourage the IRS to establish a Conservation Easement Advisory Committee similar to its Arts Advisory Committee. Such Committee would be composed of state and federal tax agencies, Land Trusts, appraisers and perhaps environmental groups which do not accept easements. The Committee could meet yearly to discuss issues and develop legislative suggestions.

Respectfully submitted,

Burnet R. Maybank, III
maybankb@sctax.org
803-898-5040
Post Office Box 12265
Columbia, SC 29211