

AN UPDATED LOOK AT CONSERVATION EASEMENTS

The increasing awareness of climate change has greatly increased peoples' awareness of the environment. On a less global level, many environmental organizations promote the conservation of natural habitats. One method for doing so is charitable conservation easements.

Basic restrictions

A conservation easement is a voluntary restriction placed on the use of land for a conservation purpose. Valid conservation purposes can include the protection of open space, timberland, farmland, scenic views, wetlands, or other significant natural resource values. The easement need not restrict the sale of the property.

Conservation easements generally are not required to provide the public with a right of access or use of the land subject to the easement, unless the purpose of the easement is a public benefit that requires public access (i.e., preservation of the land for outdoor recreation or education of the general public). The easement generally is donated to a charitable organization or government agency. Its terms ordinarily are negotiated between the landowner and the organization or agency. In negotiating the terms of the easement, the Code's requirements should be taken into account.

'Qualified'

A qualified conservation contribution is a contribution of a qualified real property interest, made to a qualified organization, exclusively for conservation purposes.¹ A failure to meet any of these requirements can result in denial of the charitable deduction for the contribution, and in some cases can result in gift tax. Furthermore, in making a qualified conservation contribution, the donor must have a "donative intent" (in other words, an intent to make a charitable contribution).²

A "qualified real property interest" is defined as the donor's entire real property interest other than a "qualified mineral interest," a remainder interest in real property, or a perpetual restriction on the use which may be made of the real property (in other words, a perpetual easement or other restrictive interest in real property).³

This definition adds one more requirement for tax purposes: the easement must be granted *in perpetuity* to be considered a "qualified real property interest."

The donee must be a "qualified organization," having a commitment to protect the conservation purposes of the donation and the resources to enforce the restrictions.⁴ Qualified organizations include local, state, or federal governmental agencies, and public charities defined in Sections 501(c)(3) and 509(a).

Commitment and resources

While a "commitment to protect the conservation purposes of the donation" is not defined in the Code, a public charity's commitment to protect the conservation purposes of the donation generally can be found in its articles of incorporation or by-laws. Potential donors should examine whether charitable organizations they are considering as donors have the resources to enforce the restrictions of the contemplated easement. The level of resources an organization must have available to enforce the restrictions of the conservation easements is not defined in the Code. The regulations, however, make clear that organizations are not required to earmark funds specifically for enforcement of conservation easements.⁵

Nonetheless, the IRS keeps an eye on qualified organizations' efforts to monitor and enforce conservation easements. The Form 990 that exempt organizations must file annually with the IRS requires those holding conservation easements to report the amount of staff hours and expenses spent in monitoring and enforcing easements for the preceding year. Thus, while the resources an organization must spend to monitor and enforce conservation easements is undefined, a qualified

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organization must document the time and money it spends each year on these tasks.

Conservation purposes

There are four broad categories of conservation purposes:⁶

1. The preservation of land areas for outdoor recreation by, or the education of, the general public.
2. The protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem
3. The preservation of certain open space (including farmland and forest land).
4. The preservation of an historically important land area or a certified historic structure.

If the conservation purpose of the easement is for outdoor recreation, or education of the general public, the regulations require that the recreation or education must be for the “substantial and regular use” of the general public.⁷ Accordingly, the easement must provide access to the real property for the general public.

The regulations take a liberal view of what constitutes a significant, relatively natural habitat for fish, wildlife, or plants. Examples provided by the regulations include lakes formed by man-made dams; salt ponds; habitats for rare, endangered, or threatened species of animals, fish, or plants; and natural areas that represent high quality examples of a terrestrial or an aquatic community.⁸

Furthermore, the regulations explicitly state that the fact that the habitat or environment has been altered to some extent by human activity does not result in a deduction being denied as long as the fish, wildlife, or plants continue to exist there in a *relatively* natural state.⁹

The Tax Court, too, has taken a liberal view. In *Glass*,¹⁰ for example, the taxpayers donated two individual conservation easements with the conservation purpose of protecting a significant, relatively natural habitat. The easements were on two small strips of shoreline. One covered an area of 150 feet by 120 feet, and the other covered an area of 260 feet by 120 feet. The taxpayers also presented evidence that a bald eagle “roost” (a perch on which the birds could temporarily rest or sleep) was located on the property, and that one type of endangered plant grew on the property. The Tax Court held that both conservation easements met the conservation purpose requirement.

There is an important distinction between this conservation purpose and the conservation purpose of recreation or education of the general public. The regulations state specifically that limitations on public access to property donated for the preservation of a significant, relatively natural habitat for fish, wildlife, or plants do not jeopardize the tax deduction.

Other definitions

Conservation easements to preserve “open space” qualify as having a conservation purpose if they meet either of the following criteria:¹¹

- The preservation is pursuant to a clearly delineated federal, state, or local governmental conservation policy, and will yield a significant public benefit.
- The preservation is for the scenic enjoyment of the general public, and will yield a significant public benefit.

There is not much guidance about what constitutes a “clearly delineated government conservation policy.” The regulations make it clear, however, that a “clearly delineated federal, state, or local governmental conservation policy” is something more than a “general declaration of conservation goals by a single official or legislative body.”¹² They also state that where a governmental entity adopts a resolution specifically endorsing protection of a particular property as “worthy of protection for conservation purposes,” a conservation easement granted for that property will be respected.¹³

Whether or not an easement is for the “scenic enjoyment of the general public” is determined by a facts-and-circumstances test. Factors such

¹ Section 170(h).

² *American Bar Endowment*, 477 U.S. 105, 58 AFTR2d 86-5190 (1986); *Hernandez*, 490 U.S. 680, 63 AFTR2d 89-1395 (1989); Rev. Rul. 67-246, 1967-2 CB 104.

³ Section 170(h)(2). State laws govern the creation and enforcement of easements, so donated easements also must comply with all state statutory requirements in order to qualify as qualified real property interests.

⁴ Reg. 1.170A-14(c)(1).

⁵ Reg. 1.170A-14(c)(1).

⁶ Reg. 1.170A-14(c)(2).

⁷ Reg. 1.170A-14(d)(2)(i).

⁸ Regs. 1.170A-14(d)(3)(i), (ii).

⁹ Reg. 1.170A-14(d)(3)(i).

¹⁰ 124 TC 258 (2005), *aff'd*, 471 F.3d 698, 98 AFTR2d 2006-8309 (CA-6, 2006).

¹¹ Reg. 1.170A-14(d)(4)(i).

¹² Reg. 1.170A-14(d)(4)(iii)(A).

¹³ Reg. 1.170A-14(d)(4)(iii)(A).

as topography, geology, biology, cultural, and economic conditions are relevant.¹⁴ The regulations list eight specific factors to be considered:

- The compatibility of the land use with other land in the vicinity.
- The degree of contrast and variety provided by the visual scene.
- The openness of the land.
- Relief from urban closeness.
- The harmonious variety of shapes and textures.
- The degree to which the land use maintains the scale and character of the urban landscape to preserve open space, visual enjoyment, and sunlight for the surrounding area.
- The consistency of the proposed scenic view with a methodical state scenic identification program, such as a state landscape inventory.
- The consistency of the proposed scenic view with a regional or local landscape inventory made pursuant to a sufficiently rigorous review process, especially if the donation is endorsed by an appropriate state or local governmental agency.

Of course, to qualify as scenic enjoyment, the easement must grant visual access to the general public over a significant portion of the property.¹⁵ In some ways, this is intuitive. There cannot be a scenic view if no one can see it.

Public benefits

The regulations list several criteria for evaluating whether the open space conservation easement yields a “significant public benefit.” They are:¹⁶

- The uniqueness of the property to the area.
- The consistency of the proposed open space use with public programs (whether, federal, state, or local) for conservation in the region.
- The intensity of land development in the vicinity of the property.
- The consistency of the proposed open space use with existing private conservation programs in the area.

¹⁴ Reg. 1.170A-14(d)(4)(ii)(A).

¹⁵ Reg. 1.170A-14(d)(4)(ii)(B).

¹⁶ Reg. 1.170A-14(d)(4)(iv)(A).

¹⁷ Reg. 1.170A-14(d)(4)(v).

¹⁸ Reg. 1.170A-14(d)(5)(ii).

¹⁹ Sections 170(h)(4)(B), (C).

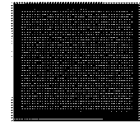
- The likelihood that development of the property would lead to or contribute to degradation of the scenic, natural, or historic character of the area.
- The opportunity for the general public to use the property or enjoy its scenic values.
- The importance of the property in preserving the local or regional landscape or a resource that attracts tourism or commerce to the area.
- The likelihood that the donee will acquire equally desirable and valuable substitute property or property rights.
- The cost to the donee of enforcing the conservation easement.
- The population density in the area of the property.
- The consistency of the proposed open space with a legislatively mandated program identifying particular parcels of land for future protection.

Some landowners may wish to have the current tax deduction for the easement, but retain a right to develop the property in the future. The regulations do not allow this. An easement for the preservation of open space cannot permit “a degree of intrusion or future development that would interfere with the essential scenic quality of the land or with the governmental conservation policy” which the easement allegedly promotes.¹⁷

The preservation of an historic land area or structure is another valid conservation purpose. Historic land areas are defined as any that meet the National Register Criteria for Evaluation in 36 C.F.R. section 60.4, any land area within a registered historic district, and any land area adjacent to a property listed in the National Register of Historic Places where the physical or environmental features of the land area contribute to the historic or cultural integrity of the property.¹⁸ An historic structure is defined as any building, structure, or land area listed in the National Register, or any building located in a registered historic district, and certified by the Secretary of the Interior as being of historic significance to the district.¹⁹

Recent restrictions

Claiming a tax deduction for a conservation easement to preserve an historic structure became more difficult in 2006 with the passage of the Pension Protection Act. New Section 170(h)(4)(B) adds such requirements as requir-



CLAIMING A DEDUCTION FOR AN EASEMENT TO PRESERVE AN HISTORIC STRUCTURE HAS BECOME MORE DIFFICULT.

ing the easement to include a restriction that preserves the entire exterior of the building, requiring the easement to prohibit any change in the exterior of the building that is inconsistent with the historic character of such exterior, and requiring a written agreement between the donor and donee where the donee certifies that it is an eligible donee. In addition, the donor must include, with his or her tax return for the year of the donation, a qualified appraisal, photographs of the exterior of the building, and a description of all the restrictions on the development of the building.

Separately, the Act requires the donor to make a \$500 payment with the filing of any tax return claiming a deduction in excess of \$10,000 for conservation easements contributed to protect historically significant structures.²⁰

Transfers

The regulations restrict the transfer of easements to certain organizations. For example, it is not enough that the easement must be conveyed initially to a qualified organization. In addition, the grant of the easement must prohibit its transfer to any organization that is not “an eligible donee.”²¹ An eligible donee is defined as a qualified organization that has both a commitment to protect the conservation purposes of the donation and have the resources to enforce the restrictions.²²

The grant of a conservation easement must include provisions prohibiting the donee from subsequently transferring the easement unless, as a condition of the subsequent transfer, the donee requires “that the conservation purposes which the contribution was originally intended to advance continue to be carried out.”²³

The regulations also impose a requirement based on the *cy pres* doctrine.²⁴ If there is an unexpected change in the conditions surrounding the property subject to the easement making impossible or impractical the continued use of the property for conservation pur-

poses, any proceeds resulting from the sale or exchange of the property must be used in a manner consistent with the conservation purposes of the original contribution.²⁵

Other matters

Existing mortgages on the property must be subordinated to the easement.²⁶ Uses of the property that are inconsistent with any conservation purpose (whether or not the purpose is specifically identified by the easement) must be prohibited.²⁷ As indicated above, the easement may not allow the donor to retain surface mining rights or any other mineral extraction rights in the property.²⁸ There are also substantiation requirements and reporting requirements.²⁹

The donor must reduce his or her adjusted basis in the property that is subject to the easement by the proportion of the easement’s value over the fair market value of the property before the contribution of the easement.³⁰

Conclusion

Charitable conservation easements are experiencing significant current interest. Their benefits to clients holding land make navigating their detailed rules and requirements worthwhile. It is important, though, that those clients are fully informed of, and comply with, those rules and requirements. ■

²⁰ Section 170(f)(13).

²¹ Reg. 1.170A-14(c)(2).

²² Reg. 1.170A-14(c)(1).

²³ Reg. 1.170A-14(c)(2).

²⁴ The *cy pres* doctrine, emanating from English and French law, holds that where the donor’s original intent becomes illegal or impossible to perform, the court may amend a charitable trust to conform as closely as possible to the donor’s original intent.

²⁵ Reg. 1.170A-14(c)(2).

²⁶ Reg. 1.170A-14(g)(2).

²⁷ Reg. 1.170A-14(e)(2).

²⁸ Reg. 1.170A-14(g)(4).

²⁹ Reg. 1.170A-13(c)(3). See also IRS Form 8283, “Noncash Charitable Contributions.”

³⁰ Reg. 1.170A-14(h)(3)(iii).