

Income Tax Consequences and Requirements

- A. Background on the income tax deductibility of gifts of conservation easements.
1. Tax law allows taxpayers to take deduction from taxable income for charitable contributions. IRC §170
 2. Donative intent
 - intent to make a charitable gift is required for all tax deductions
 - no deduction for easement given in exchange for other benefits or for easement granted as condition of subdivision approval, COE permit under Clean Water Act, etc.
 3. Contributions of partial interests (less than the taxpayer's entire interest in the property) are generally NOT deductible. IRC §170(f)(3)(A). e.g., Landowner gives property to the Conservancy but reserves the right to plow all the native prairie and farm it for 10 years.
 4. EXCEPTIONS: IRC§170(f)(3)(B). Gifts of the following partial interests are deductible:
 - remainder interest in a personal residence or farm
 - undivided portion of the taxpayer's entire interest in property
 - qualified conservation contribution
- B. Internal Revenue Code defines qualified conservation contribution. Treasury Regulations expand on that definition. Compliance with both Code and Regs is required.
- C. IRC§170(h)(1): Qualified conservation contribution means a contribution of:
1. a qualified real property interest
 2. to a qualified organization
 3. exclusively for conservation purposes
- D. Qualified real property interest (IRC§170(h)(2)) means any of:
1. the entire interest of the donor other than a qualified mineral interest
 2. a remainder interest (for certain types of property), and

3. a restriction (granted in perpetuity) on the use which may be made of the real property--- otherwise known as a conservation easement.

E. Qualified organization.

1. Definition. Regs. §1.170A-14(c)(1). To be an eligible donee of tax deductible contributions, an organization must be:
 - A public charity under IRC§501(c)(3) and 509(a)(2) (organized for charitable purpose and supported by donations from variety of sources) or be a government unit (or an organization controlled by either). IRC§170(h)(3)
 - Have a commitment to protect the conservation purposes of the donation.
 - Have the resources to enforce the restrictions.
2. Assignment. Regs. §1.170A-14(c)(2). No deduction is allowed unless the easement document prohibits the donee from assigning the easement unless:
 - the donee organization, as a condition of the subsequent transfer, requires that the conservation purposes continue to be carried out
 - the subsequent transferee is a qualified organization.

F. Exclusively for conservation purposes - Short clause, many rules.

1. Acceptable conservation purposes (IRC§170(h)(4)):
 - preservation of land areas for public outdoor recreation or public education
 - protection of relatively natural habitat of fish, wildlife, or plants, or similar ecosystem
 - preservation of open space (including farmland and forest land) where such preservation is for the scenic enjoyment of the general public or pursuant to a clearly delineated governmental conservation policy and will yield a significant public benefit.
 - historic preservation
2. Recitals and purpose. The specific conservation purposes that the

easement is designed to advance should be articulated in the easement recitals and statement of purpose and the restrictions/permitted uses should be drafted to implement that purpose.

3. Exclusively for conservation purposes - Inconsistent use prohibited. Regs. §1.170A-14(e)(2) and (3).
 - a. Restrictions on use must relate to the conservation purpose and prohibit uses inconsistent with that purpose.
 - b. Easement may also not permit uses that would defeat any of the other allowable conservation purposes.

4. Exclusively for conservation purposes - Protected in perpetuity
 - a. A contribution is not exclusively for a conservation purpose unless it is protected in perpetuity. IRC §170(h)(5)(A).

Some state laws may set limits on duration of easements or use restrictions that would defeat perpetual protection.
 - b. Enforceable under state law - Regs. §1.170A-14(g)(1)
 - States without conservation easement statutes present special challenges.
 - Must meet all requirements of state law (acceptance and recording often required).
 - Recording required to insure enforceability against future owners.
 - c. Rights of third parties must not be able to defeat the conservation purposes for the easement to qualify for deductibility.
 - Mortgages. Mortgage recorded before a conservation easement, if foreclosure, could terminate the conservation restrictions. Therefore, no deduction is permitted for a conservation contribution land that is subject to a mortgage unless the mortgage is subordinated to the right of the qualified organization to enforce the conservation purpose in perpetuity. Regs. §1.170A(g)(2).
 - Mineral rights. IRC 170(h)(5)(B). No deduction will be allowed

- if there is a retention of a qualified mineral interest and there may be extraction or removal of minerals by any surface mining method or
 - if the mineral rights were previously severed unless the probability of surface mining occurring on the property is so remote as to be negligible.
- Note: Regs. §1.170A-14(g)(4)(ii) predates amendment of statute that liberalized treatment of previously severed minerals.

d. Remote future events. A deduction will not be denied because a conservation contribution may be defeated by an event if the event is a remote possibility (e.g., failure to preserve the right by re-recording the easement). Regs. §1.170A-14(g)(3).

e. Easement documentation. If the donor reserves rights which may, if exercised, impair the conservation purposes of the easement, no deduction will be allowed unless the donor makes available to the donee, prior to the time the donation is made, documentation sufficient to establish the condition of the property at the time of the gift. Regs. §1.170A-14(g)(5)(i).

- Purpose: Maintain protection in perpetuity by providing baseline against which to monitor compliance with the use restrictions.
- Signature/acknowledgment: Donor and donee must sign statement accompanying documentation: "This natural resources inventory is an accurate representation of [the protected property] at the time of the transfer."

f. Required provisions in easement (to insure perpetual protection). Regs. §1.170A-14(g)(5)(ii):

- Donor must agree to notify donee in writing before exercising any reserved right which may have an adverse impact on the conservation purpose.
- Donee must have a right to enter the property at reasonable times to monitor compliance.
- Donee must have a right to enforce the conservation restrictions by appropriate legal proceedings, including the right to require the restoration of the property to its

condition at the time of the donation.

- g. Change of conditions/extinguishment. Regs. §1.170A-14(g)(6).
- Circumstances allowing easement to be extinguished. “Unexpected change in conditions surrounding the property” that makes the continued use for conservation purposes “impossible or impractical.”
 - Changed conditions must be reviewed in judicial proceedings.
 - Reapplication of proceeds to the conservation purpose of the original contribution is required.
 - Easement must contain donor’s agreement that donation creates a property right in the donee with FMV at least equal to the proportionate value that the easement bears to the value of the property unrestricted at the time of the gift. On sale of property, donee must receive proportionate share of sale proceeds (subject to any contrary state law).
- h. Amendment. An amendment should be allowed only if consistent with the conservation purpose of the easement and if it does not affect the perpetual duration of the easement.

G. Public Access. Whether donor must permit public access to protected property depends on conservation purpose:

- Protection of natural areas - no. Regs. §1.170A-14(d)(3)(iii)
- Public outdoor recreation or education - yes
- Open space - visual access is sufficient. Regs. §1.170A-14(d)(4)(ii)(B)
- Historic preservation - visual access is sufficient. Regs. §1.170A-14(d)(5)(iv)

H. Value of Donated Easement Rights. Regs. §1.170A-14(h)(3). Method also applies to purchased easements.

1. Method of valuation

- a. Based on sales of comparable easements, if available (rarely).
- b. “Before and after” test: Value of easement is difference between:

- FMV of the property before the easement
 - FMV of the property subject to the easement (modified highest and best use)
- c. Enhancement value - If the granting of the easement has the effect of increasing the value of other property owned by the donor, the value of the easement must be decreased by the amount of that increase. (Regs. §1.170A-14(h)(3)(i))
- I. Donee disclosure and acknowledgment requirements; donor substantiation requirements
1. Donee's disclosure requirement - "quid pro quo" contributions - A charitable organization that receives a payment in excess of \$75 that is partly a contribution and partly in consideration for goods and services provided to the payor must provide to the donor, upon solicitation or receipt of the contribution, a written statement that:
- Informs the donor that the amount of the contribution deductible for federal income tax purposes is limited to the value of the donation in excess of the value of the goods or services provided by the organization
 - Provides the donor with a good faith estimate of the value of such goods or services. IRC 6714.
2. Donor's substantiation requirement; donee acknowledgment
- a. No deduction is allowed for a gift of \$250 or more in value unless the taxpayer substantiates the gift with a contemporaneous written acknowledgment from the donee organization. IRC 170(f)(8)(A), Reg. 1.170A-13-(f)(1). The acknowledgment must contain:
- The amount of any cash donated and a description, but not the value of any non-cash property contributed.
 - A statement of whether the charity provided any goods or services in consideration, in whole or in part, for the donation.
 - A description and a good faith estimate of the value of any goods or services given to the donor. IRC 170(f)(8)(B), Reg. 1.170A-13(f)(2).
- b. Donor's responsibility for appraisal

- Taxpayer/donor must maintain written records of value of the FMV of the property before and after donation. Regs. §1.170A-14(i).
- IRS Form 8283 - Taxpayer/donor must attach to income tax return to claim deduction for non-cash gift in excess of \$500.
 - Taxpayer must obtain appraisal to substantiate deduction that exceeds \$5,000 (subject to certain exceptions for marketable securities) claimed on form 8283.
 - Appraisal must be made no earlier than 60 days before the date of contribution and no later than the due date for the return for the tax year in which contribution made.
 - Appraisal must be done by a “qualified appraiser” (cannot be the donor, donor’s employee, etc.).

Gift Tax charitable deduction

- A. Gifts in excess of \$13,000 per donee per year must be declared on gift tax return and count toward unified credit amount for gift and estate tax. Once unified credit amount is exceeded, tax is payable.
- B. IRC 2522(d) – gift tax charitable deduction if conservation easement meets tests under Section 170(h).
1. Transfers of a qualified real property interest (as defined in IRC 170(h)(2)(c) – perpetual easements) to a qualified organization exclusively for conservation purposes.
 2. Treas. Reg. 25.2522(c) – 3(c)(2)(iv) incorporates Treas. Reg. 1.170A-14.
 3. Issue: if the easement does not meet the “conservation purposes” test, will gift tax be due?

Estate Tax Consequences and Requirements

- A. Easement granted by decedent BEFORE death. Property is included in gross estate (subject to tax) and is valued as restricted.
- B. Easement granted by will or post death - Estate Tax Charitable Deduction
1. Full fair market value of property is included in gross estate, but
 2. IRC 2055(f) – deduction from gross estate for qualified real property

interest as defined in IRC Section 170(h) (i.e., conservation easement) donated by the estate (under terms of will OR via IRC 2031(c)(9) post mortem grant of conservation easement).

- C. Estate tax EXCLUSION for portion of value of underlying land with a qualified conservation easement. IRC §2031(c).
1. Added by Taxpayer Relief Act of 1997. Applies to estates of decedents dying after 1997.
 2. The benefit. An estate that includes land subject to a qualified conservation easement may exclude up to 40% of the value of the land (determined subject to restrictions). The exact percent reduction depends on the extent to which the conservation easement reduces the value of the property (the greater the restriction the greater the percentage exclusion).
 3. Requirements:
 - Election by the executor to take the exclusion.
 - Land located anywhere in the US or a possession of the US
 - Land must have been owned by the decedent or member of the decedent's family for 3 years ending on decedent's death.
 - A qualified conservation easement was granted by the decedent or a member of his/her family:
 - which satisfies requirements for income tax deduction AND
 - includes a prohibition on more than a de minimis use for a commercial recreational activity. IRC §2031(c)(8)(B).
 4. Effect – Estate can exclude from estate tax up to maximum of \$500,000 of value of the underlying land for decedents dying after 2001.
 5. Exclusion under 2031(c) does not apply to any development rights retained by the donor of a qualified conservation easement – IRC 2031(c)(5)(A).
 6. The cost: If estate tax exclusion is claimed, underlying property gets carry over basis (not stepped-up) and therefore, potential exposure to greater capital gains when property sold.