

## **Conservation Easements: Structuring Effective Documents and Enforcing Terms and Conditions**

Due Diligence and Development Rights, Challenges in Amending and Enforcing Easements

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TUESDAY, APRIL 10, 2018

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

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Today's faculty features:

J. Jeffrey Holland, Partner, **Holland & Muirden**, Sharon Center, Ohio

William F. (Fritz) Paulus, Attorney at Law, Portland, Ore.

Brad Raffle, Esq., Founder and President, **Conservation Capital**, Eugene, Ore.

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# Conservation Easement Basics

STRAFFORD WEBINAR

April 10, 2018



A scenic landscape featuring a river, a fence, purple flowers, and mountains in the background. The text "What is a conservation easement?" is overlaid in white on the image.

# What is a conservation easement?

# Under the Uniform CE Act a CE is:

- A nonpossessory interest of a holder in real property imposing limitations or affirmative obligations for the purpose of:
  - retaining or protecting natural, scenic, or open space values
  - assuring its availability for agricultural, forest, recreational, or open space use
  - protecting natural resources, maintaining or enhancing air or water quality;
  - preserving the historical, architectural, archaeological, or cultural aspects of real property

# What is the Effect of a Conservation Easement?

- Both a deeded interest and contract
- Restricts future uses of the land, consistent with the Donor's wishes
- Reserves uses desired by Donor
- Runs with the land
- Usually perpetual
- Usually strict limitations on amending its terms



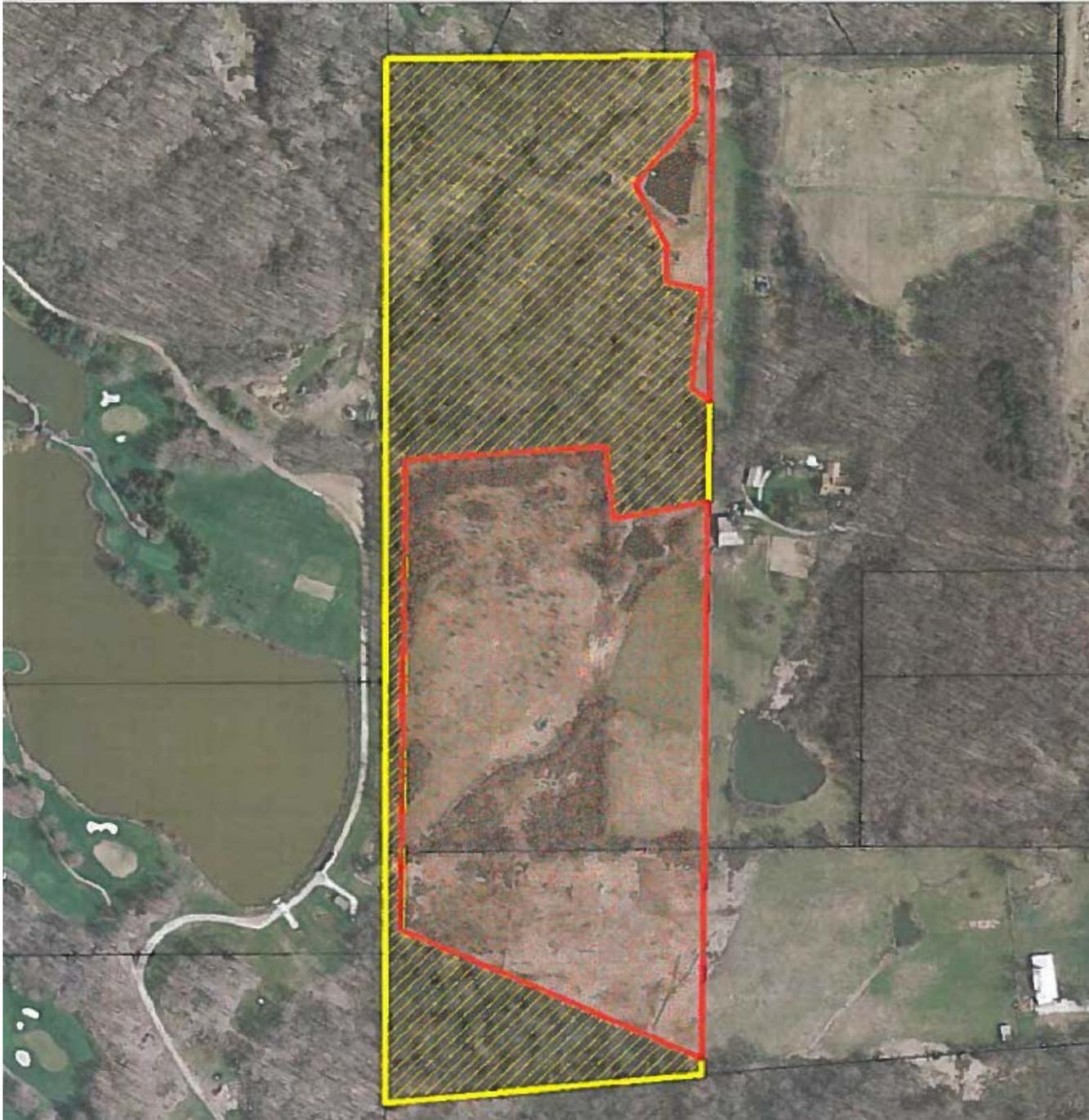
# What is A Land Trust?

**A land trust, or land conservancy, is a nonprofit organization that works to conserve land for its natural, agricultural, recreational, historical, and scenic values.**



# A CE is valid even though ...

- Not appurtenant to an interest in real property
- Can be assigned to another holder
- May impose a negative burden
- May impose affirmative obligations
- The benefit does not need to touch or concern real property
- There is no privity of estate or contract



A scenic landscape featuring a river, a fence, purple flowers, and mountains in the background. The river flows from the bottom right towards the center. A wooden fence with wire runs across the middle ground. In the foreground, there are tall purple flowers and green grass. The background shows a vast green field with a herd of cattle, and distant mountains under a clear blue sky.

# Drafting Considerations

- Tailor-made document in most instances
- Typically document is broken down into:
  - 1) recitals
  - 2) conservation purposes, matching enabling statute
  - 3) grantor's reserved rights
    - Explain why they are consistent with the conservation purposes
  - 4) prohibited uses,
  - 5) grantee's rights
    - Access to the property for inspections
    - Enforcement, including injunctive relief
  - 6) standard contract terms

# When Working with a Land Trust

- Become familiar with the land trust
  - Acquisition policies
  - Donor contribution policy
  - Long-term viability and capacity to enforce
- Land Trust Alliance Standards and Practices
  - Standard 8 (Evaluating/Selecting Conservation Projects),
  - 9 (Ensuring Sound Transactions)
  - 10 (Tax Benefits)

- If IRS charitable deduction is sought, review and incorporate relevant provisions of § 170(h) and corresponding Treasury Rules into the document
  - E.g. conservation purposes, mortgage sub, extinguishment, donee's vested rights etc.
  - Strict compliance is required or deduction will be jeopardized

# Baseline Documentation

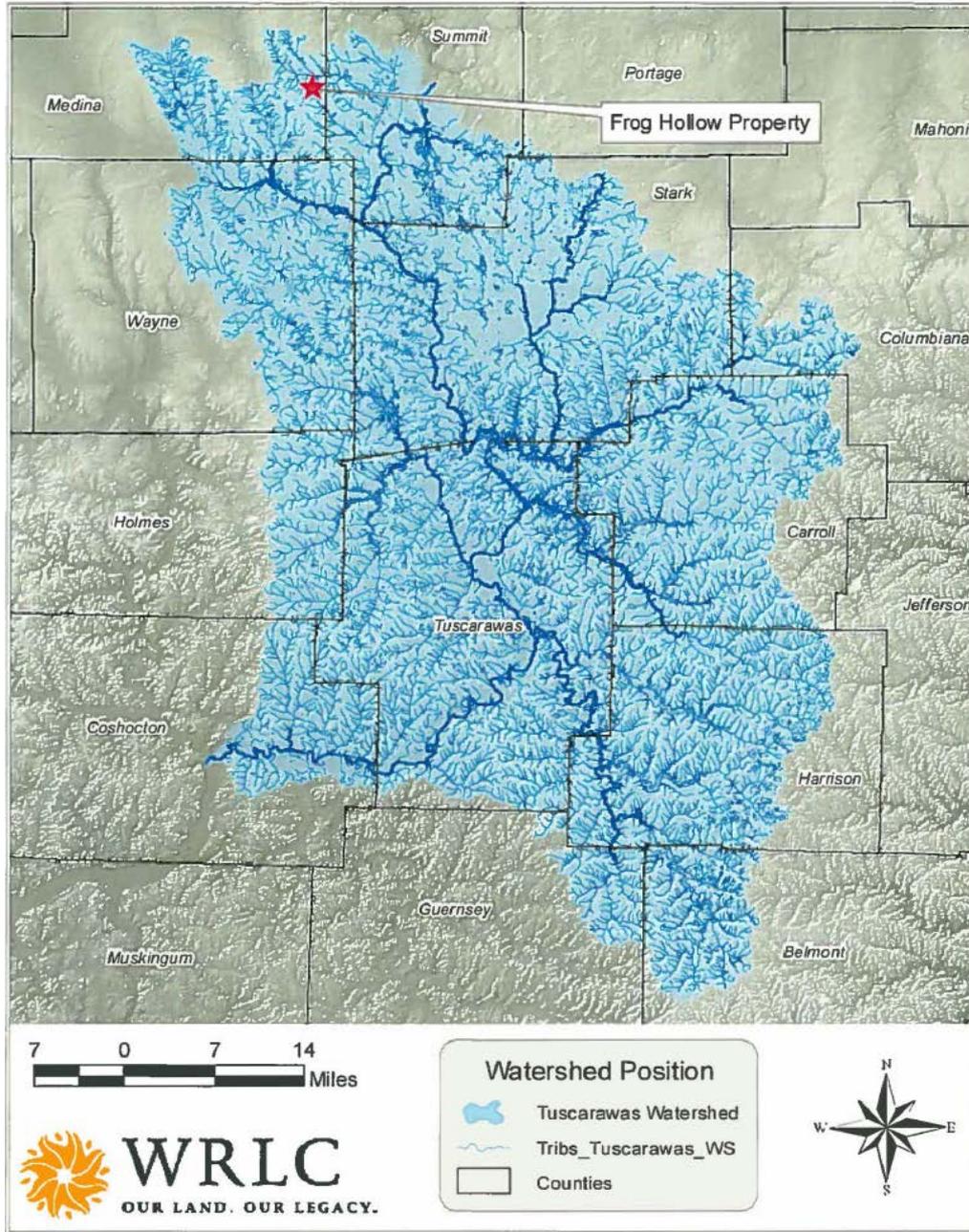
- Describes the condition of the property when the CE is granted
- Helps with future monitoring and enforcement
- Minimizes disputes about accepted uses
- Referenced in CE; may or may not be recorded
- IRS requires baseline if reserved rights may impair conservation values of the property

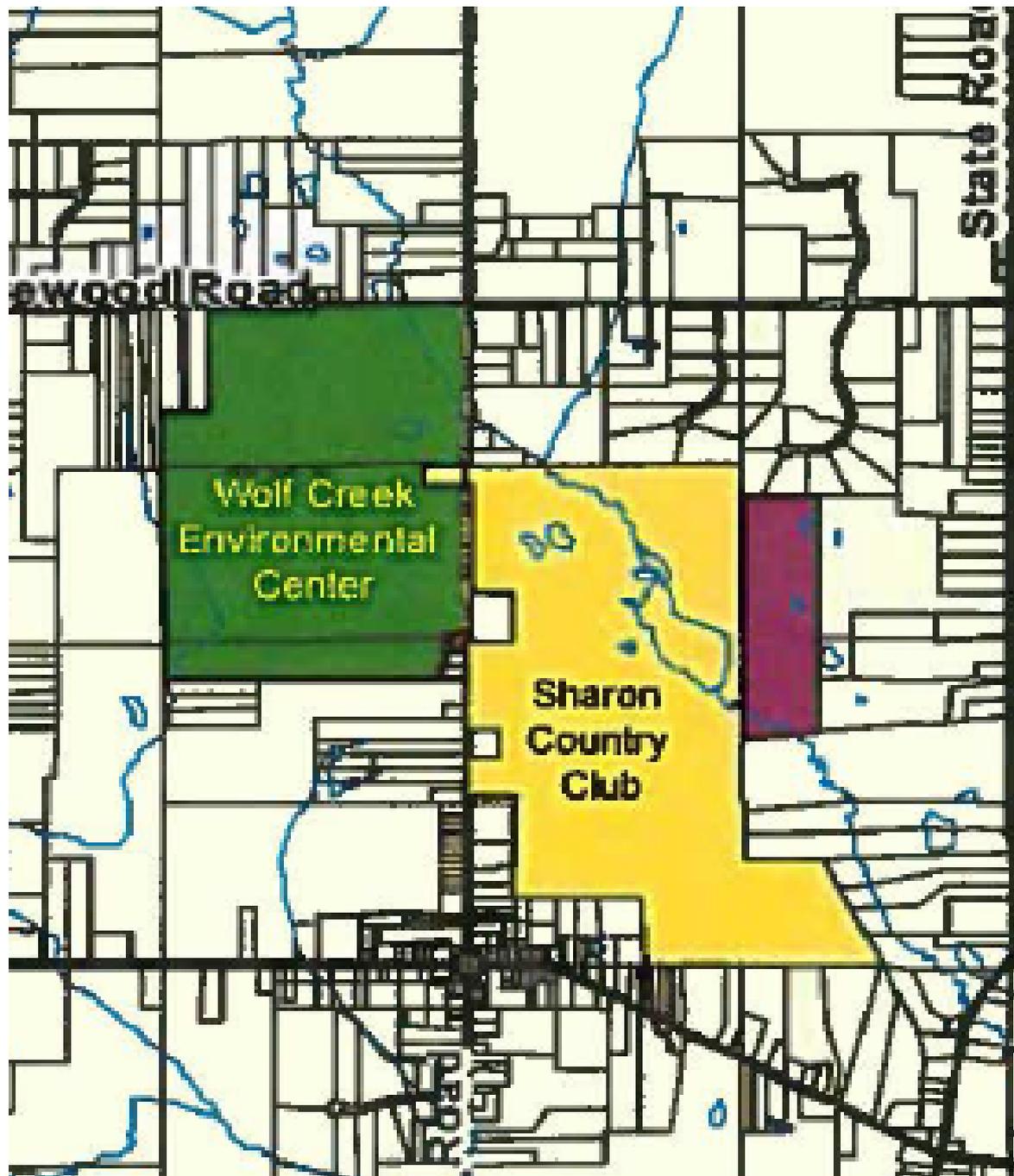
# Baseline Contents

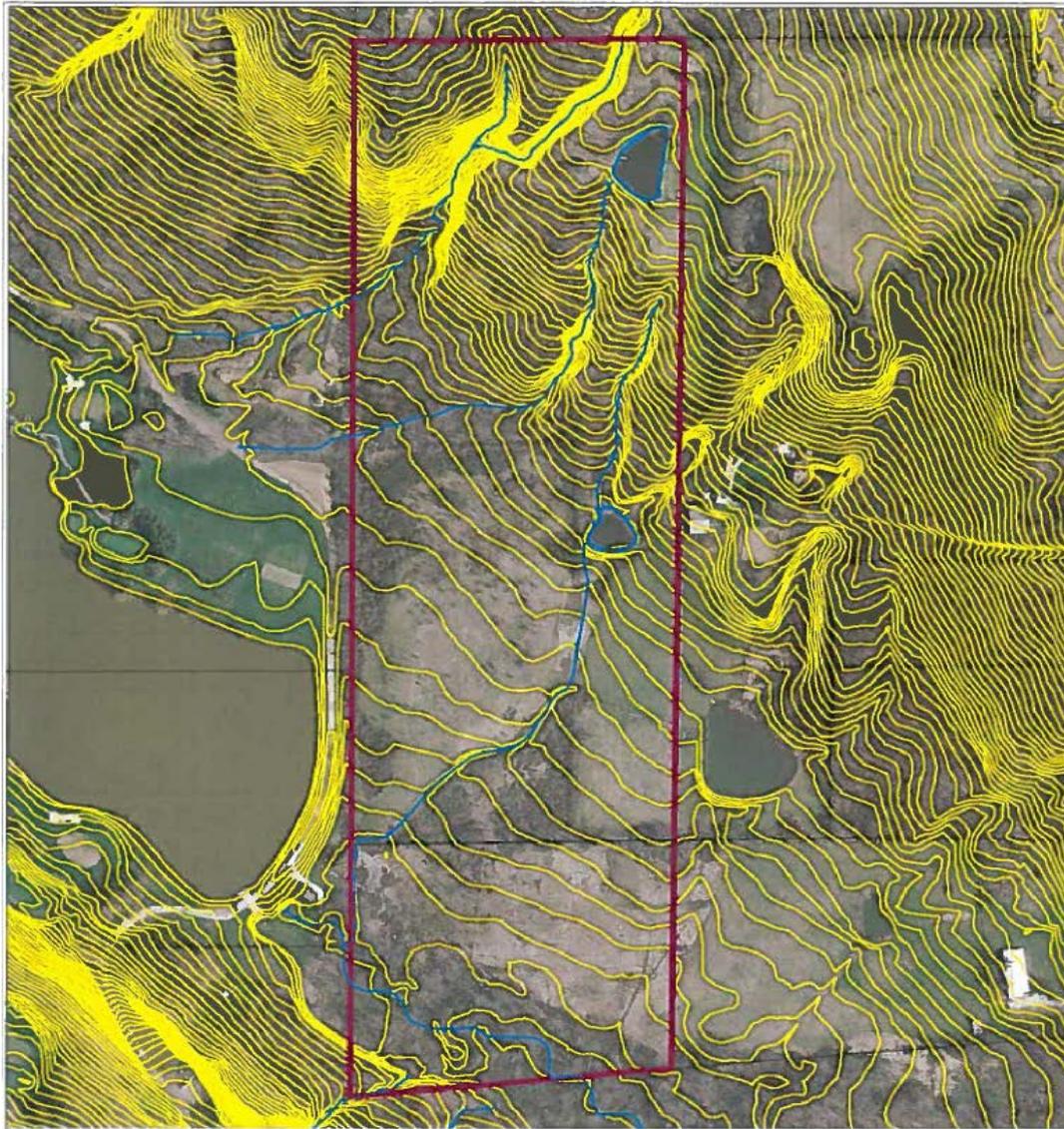
- Owner information
- Property location
- Inventory
  - Existing structures, improvements
  - Land cover (forest, field, wetlands, rock, etc.)
  - Flora
  - Fauna
- Maps

# Maps included in Baseline

- Aerial View
- Topography
- Existing Building Areas
- Natural, Farm and Limited Management Areas
- Habitats
- Soils
- Photo Points





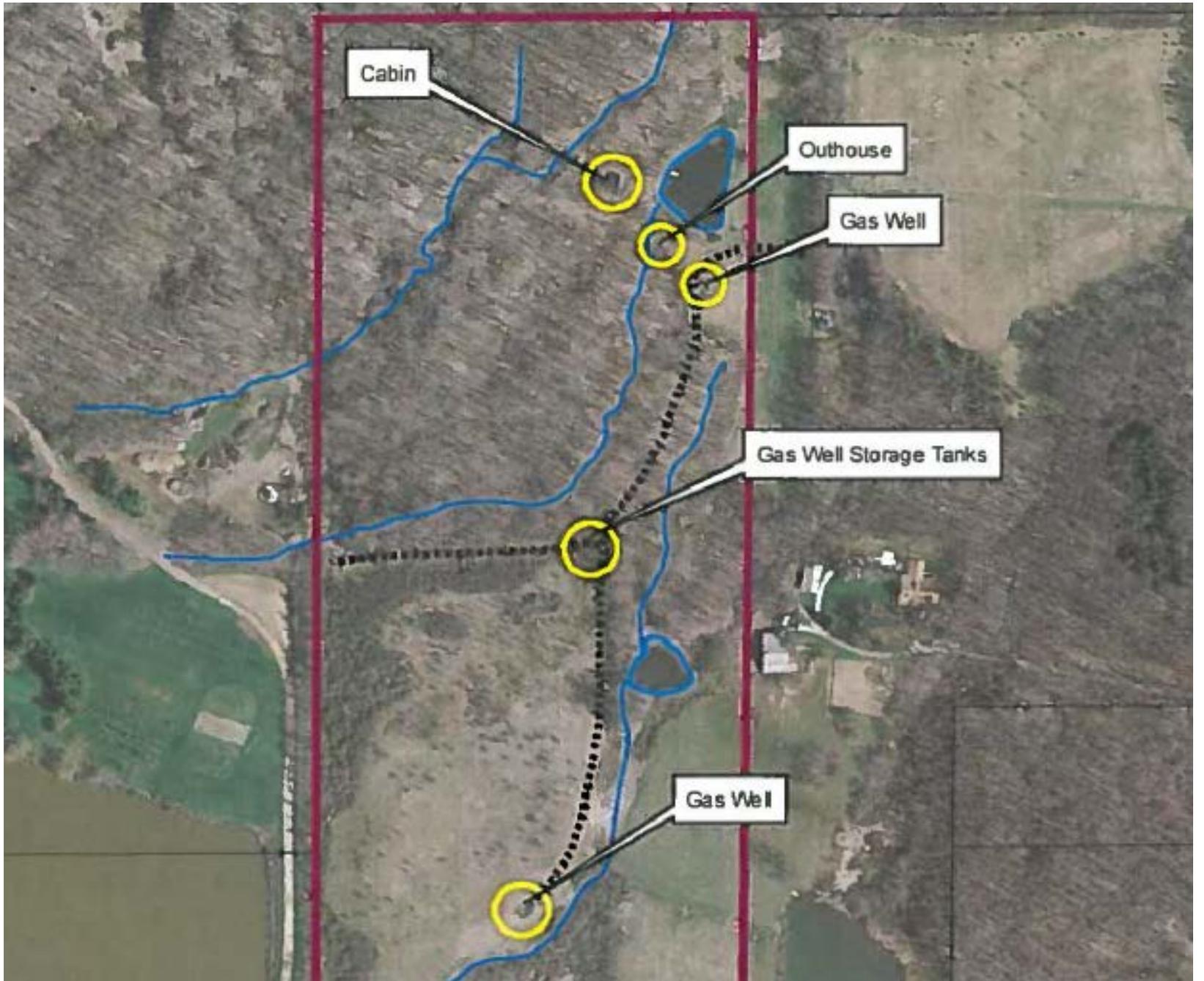


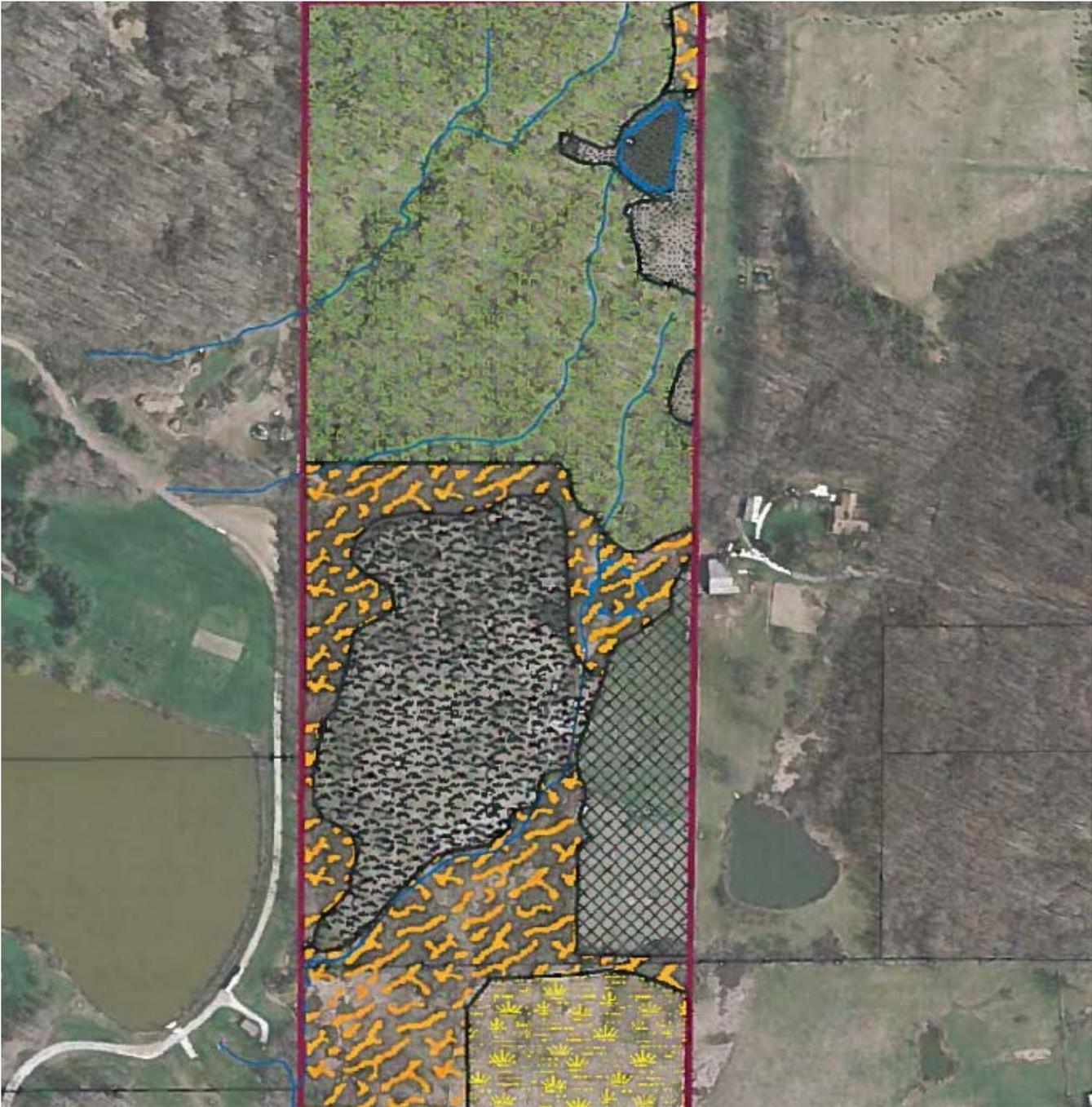
**Topography**

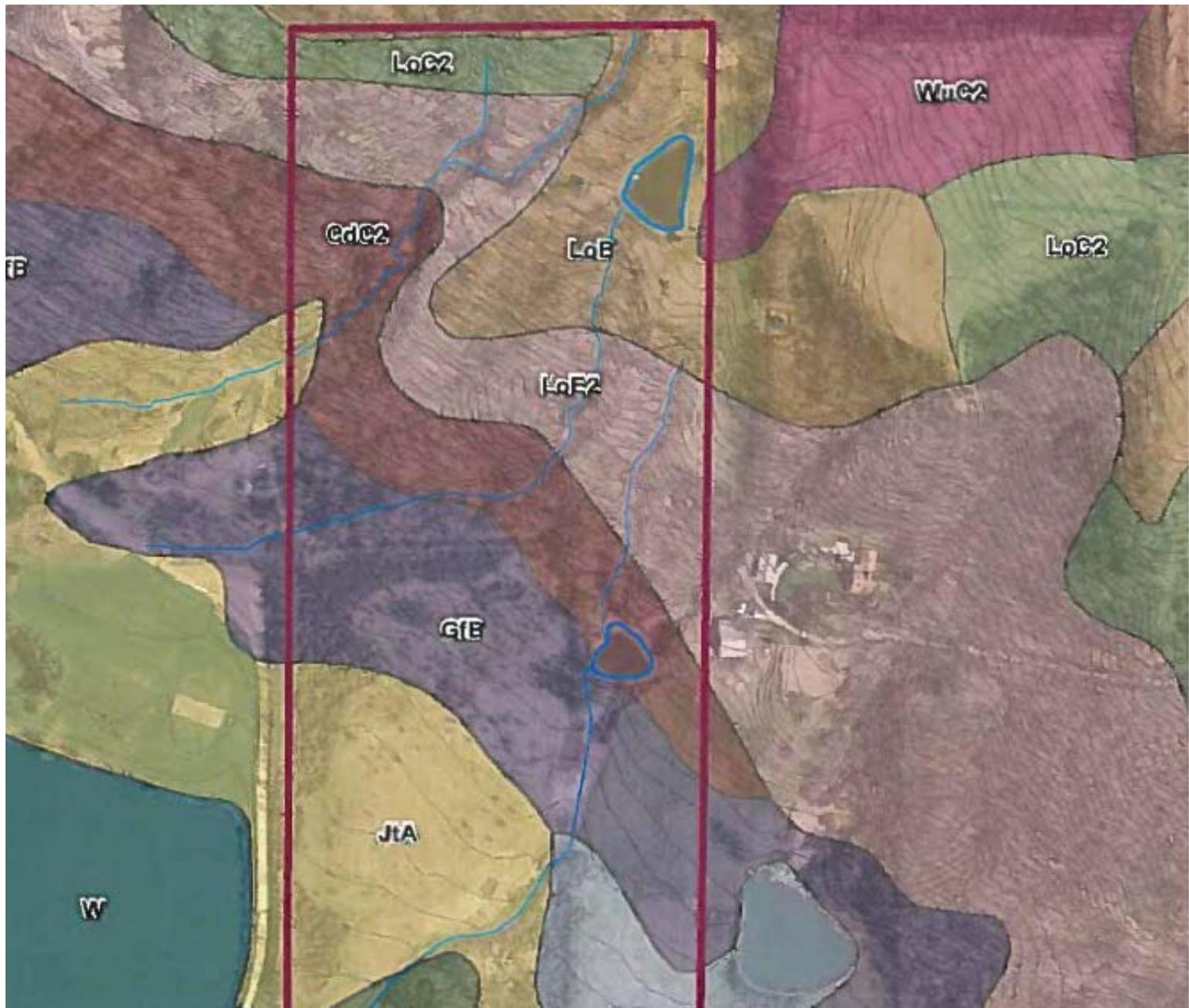
-  Frog Hollow Conservation Easement
-  Ponds
-  Streams
-  2' Contours

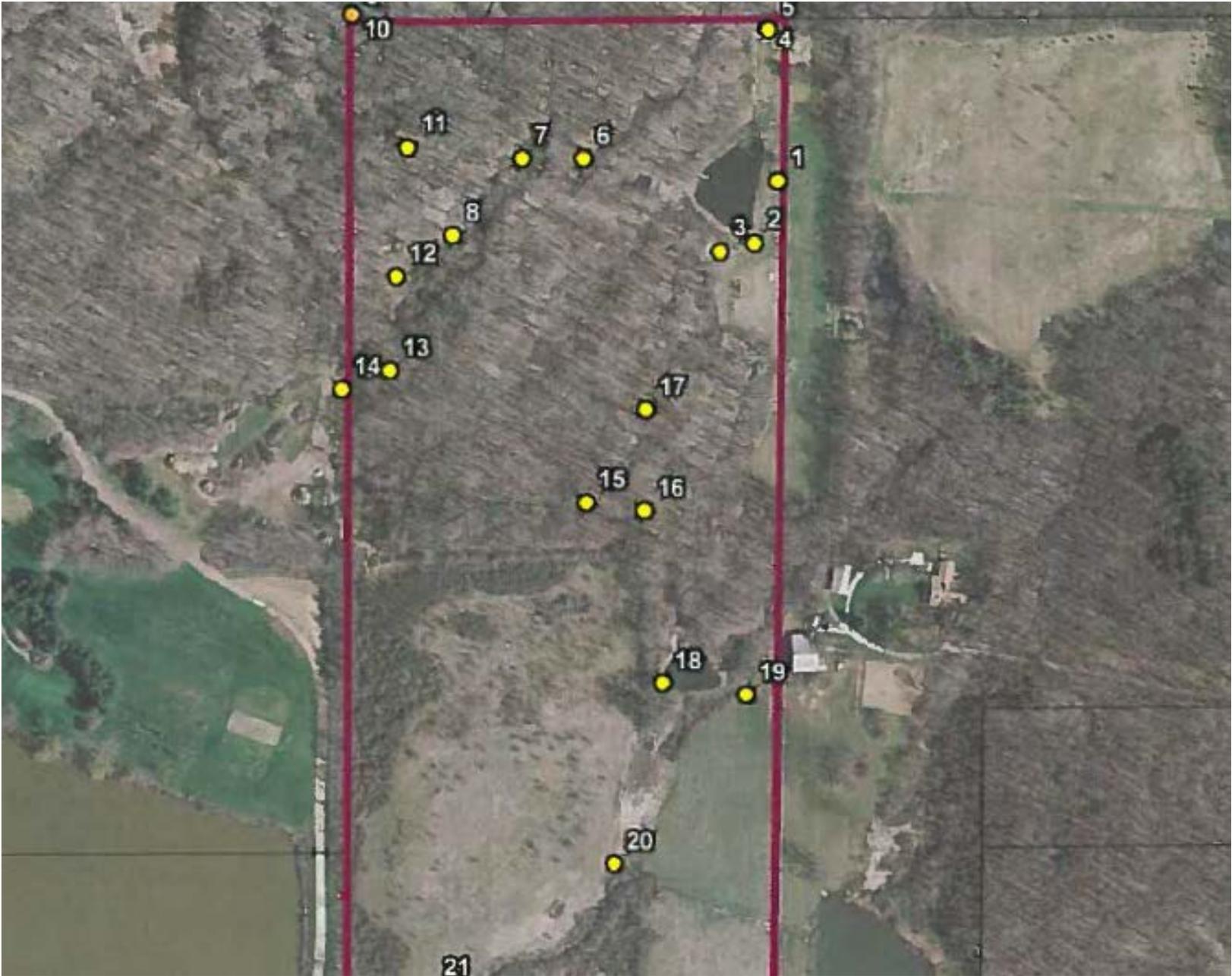


2006 Aerial Photo









# Questions/Discussion

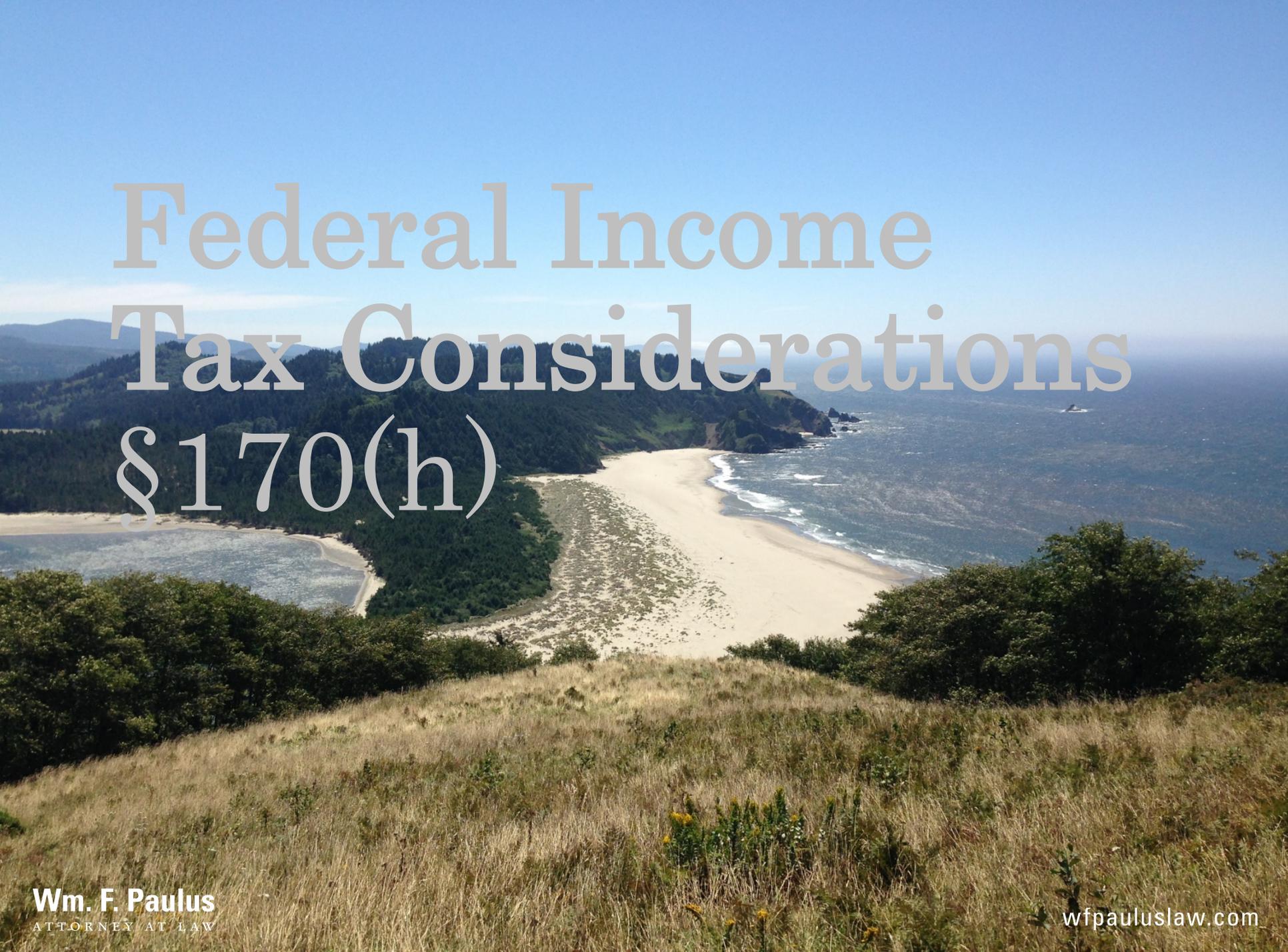


Thank you

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A scenic view of a coastline with a sandy beach, green hills, and a blue sky. The text is overlaid on the image.

# Federal Income Tax Considerations §170(h)

# Federal Income Tax Basics

- Under the Internal Revenue Code §170(h) a donation of a conservation easement to a qualified organization may be considered a deductible charitable contribution for federal income tax purposes
  - read Treasury Regulations in §1.170A-14
- A donation of a “qualified conservation contribution” is a narrow exception to the prohibition against allowing federal income tax deductions for partial interests in real estate
  - see IRC §170(f)(3)B(iii)

# Tax Basics, cont'd

- A qualified conservation contribution is a contribution
  - (a) of a qualified real property interest
  - (b) to a qualified organization, and
  - (c) exclusively for conservation purposes
- IRC §170(h)(1)

# Tax Basics, cont'd

- The term *qualified real property interest* means any of the following:
  - the entire interest of the donor other than a qualified mineral interest
  - a remainder interest, and
  - a restriction (granted in perpetuity) on the use which may be made of the real property
    - i.e. conservation easement
- IRC §170(h)(2)

# Conservation Purposes under §170(h)(4)

The preservation or protection of ...

- Land areas for outdoor recreation by, or the education of, the general public
- Relatively natural habitat of fish, wildlife, or plants, or similar ecosystem
- Open space (including farmland and forest land) where such preservation is
  - for the scenic enjoyment of the general public
  - or*

## Conservation Purposes, cont'd

- pursuant to clearly delineated Federal, State, or local government conservation policy, and will yield a significant public benefit, or
- The preservation of a historically important land area or a certified historic structure
- IRS will scrutinize claimed deductions where conservation purposes are lacking or invalid, e.g. reserved rights conflict with stated conservation values or conservation values are potentially questionable such as with a golf course

# IRS Scrutiny of CEs

## THE WALL STREET JOURNAL

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<http://www.wsj.com/articles/irs-tees-off-on-golf-courses-green-tax-claims-1451250008>

A-HED

## IRS Tees Off on Golf Courses' Green Tax Claims

Clubs' use of environmental tax breaks is full of holes, government says



The golf courses at St. James Plantation, photographed during Curtis Richardson's visit in 2013. PHOTO: CURTIS RICHARDSON

By RICHARD RUBIN

Jan. 4, 2016 8:56 p.m. ET

Curtis Richardson doesn't play much golf these days. But there he was, tramping through the rough and scrutinizing each hole at courses along the North Carolina coast.

*Atkinson v. Commissioner*  
Tax Court Memo 2015-236

# Audit Guidelines for CEs

The IRS has a set of Audit Technique Guides (ATGs) for examiners explaining issues and accounting methods for specific industries

- A good tool for the practitioner to review when preparing a donated easement where a charitable deduction is sought
- However, not a substitute for legal advice

[https://www.irs.gov/pub/irs-utl/conservation\\_easement.pdf](https://www.irs.gov/pub/irs-utl/conservation_easement.pdf)

# Perpetuity is a Cornerstone of §170(h)

- Contribution will not be “exclusively for conservation purposes” unless it is protected in perpetuity
- Reserved rights cannot be inconsistent with conservation easement purpose
- Mortgage or deed of trust must be subordinated
- Extinguishment only by a judicial proceeding
  - change in surrounding property makes conservation purposes impossible or impractical
  - proceeds from subsequent sale must be used in a manner consistent with conservation purposes

# Perpetuity in §170(h), cont'd

- Reserved surface rights to mining generally invalidate perpetual nature of easement
  - unless probability is “so remote as to be negligible”
- However, subsurface mineral extraction is permitted
  - so long as removal is not inconsistent with the conservation purposes of the donation
- Must immediately vest a property right in donee
  - at least equal to the proportionate share of the value of the CE as to the whole
  - if extinguishment occurs, donee is entitled to its proportionate share of any sale proceeds unless state law says donor gets 100%

# What is the Enhanced Federal Conservation Tax Incentive?

- Raises the deduction a donor can take for donating a conservation easement from 30% of their adjusted gross income in any year to 50% IRC §170(b)(1)(E)(i)
- Allows qualifying farmers and ranchers to deduct up to 100% of their income IRC §170(b)(1)(E)(iv)
- Extends the carry-forward for a conservation easement donor to take tax deductions from 5 years to 15 years IRC §170(b)(1)(E)(ii)
- See Consolidated Appropriations Act, 2016

# Who Is a Qualified Farmer or Rancher?

- The term “qualified farmer or rancher” means a taxpayer whose *gross income* from the *trade or business of farming* (within the meaning of Section 2032A(e)(5)) is greater than *50 percent* of the taxpayer’s gross income for the taxable year
- See *Rutkoske v. Commissioner*, 149 T.C. No. 6 (U.S.T.C. Aug 7, 2017): donors were farmers but not “qualified farmers” because income from bargain and sale of CE and sale of fee interest in farm exceeded 50% of AGI

A scenic view of a coastline from an elevated perspective. In the foreground, there is a field of tall, dry grass with some green plants. The middle ground features a wide, sandy beach curving along the coast, bordered by dense green forest. The ocean is visible to the right, with waves breaking on the shore. The sky is clear and blue. The word "Appraisals" is overlaid in large, white, serif font across the center of the image.

# Appraisals

# Some IRS Appraisal Considerations

- USPAP standards typically suffice, but federal “yellow book” might be required for federally funded projects
- IRS has additional rules for donated easements
  - see IRS Chief Counsel Memorandum 201334039, *Valuing Conservation Easements under §1.170A-14(h)(3) of Income Tax Regulations* (released August 23, 2013)
  - e.g. definition of Fair Market Value (FMV) is slightly different
    - §1.170A-1(c)

# Appraisal Considerations, cont'd

- Comparable sales of similar CEs are preferred but might be unlikely
  - see Treas. Reg. 1.170A-14(h)(3)(i)
- Thus, typically the “before and after” method is used
  - FMV of property “before” granting CE minus FMV of property subject to the terms of the CE (the “after” value) equals the CE value

# Appraisal Considerations, cont'd

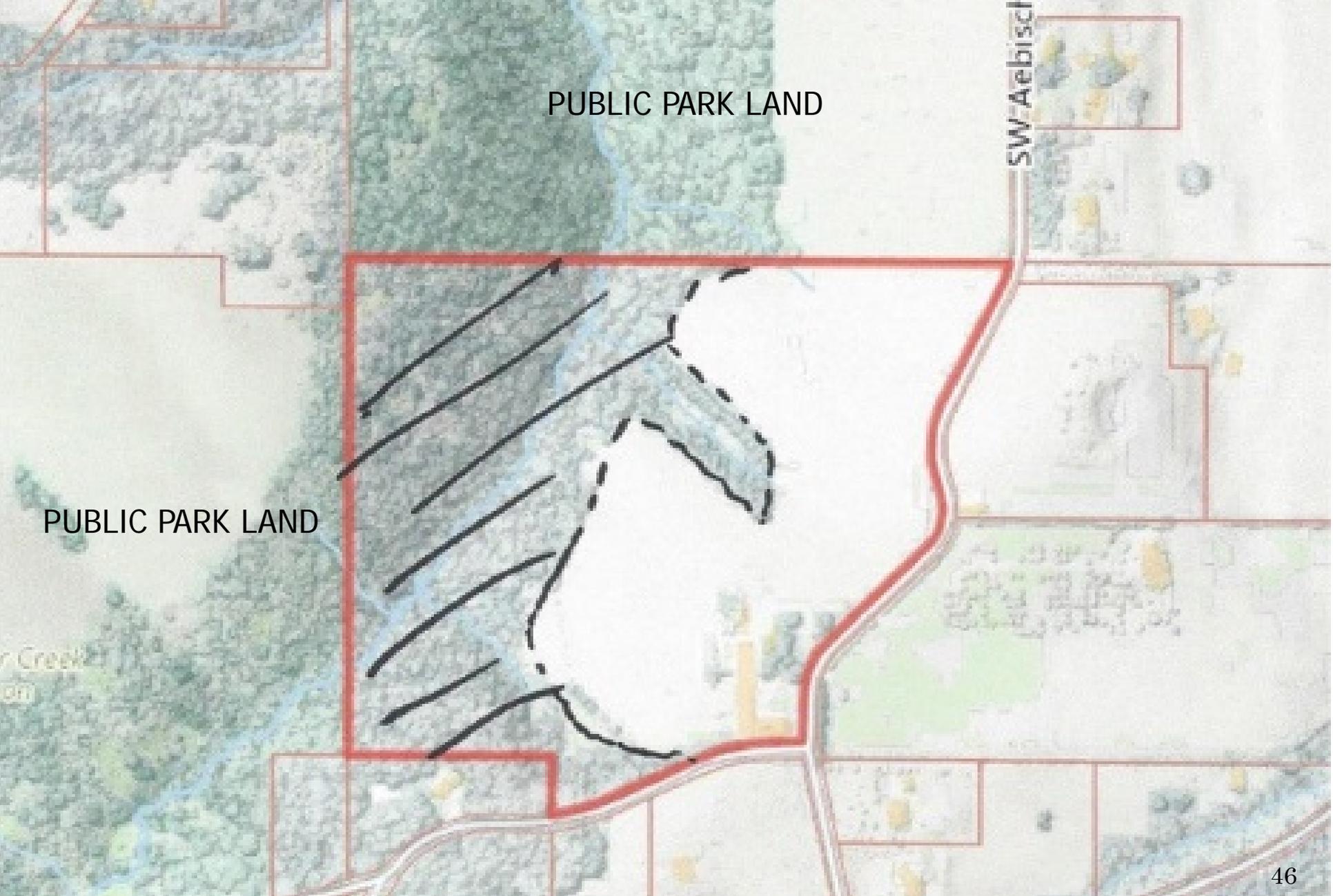
- Need “qualified appraisal” by “qualified appraiser” if FMV greater than \$5,000
  - IRC §170(f)(11); Treas. Reg. §1.170A-13(c)(3)(i)(B)
  - Treas. Reg. §1.170A-13(c)(3)(ii) outlines specific items needed
- Can not be completed earlier than 60 days before donation date and no later than the due date of the tax return on which the deduction is claimed
  - Treas. Reg. §1.170A-13(c)(3)(i)(A) and §1.170A-13(c)(3)(iv)(B)

# Appraisal Considerations, cont'd

- §1.170A-14(h)(3)(ii)
  - if before and after method is used, appraisal must take into account in the “before” valuation not only the current use of the property, but also an
  - objective assessment of how immediate or likely the property will in fact be developed if the conservation easement were not in place
  - there may be instances where an easement may have no material effect on value or may in fact enhance rather than reduce value

# Appraisal Considerations, cont'd

- Contiguous Parcel Rule
  - for contiguous property of donor or “family”
  - need to value all contiguous properties using before and after method
  - §1.170A-14(h)(3)(i)(fourth sentence)
- Enhancement Rule
  - need to factor in increase in value of donor’s other property or of a “related person,” whether contiguous or not
  - §1.170A-14(h)(3)(i)(fifth sentence)

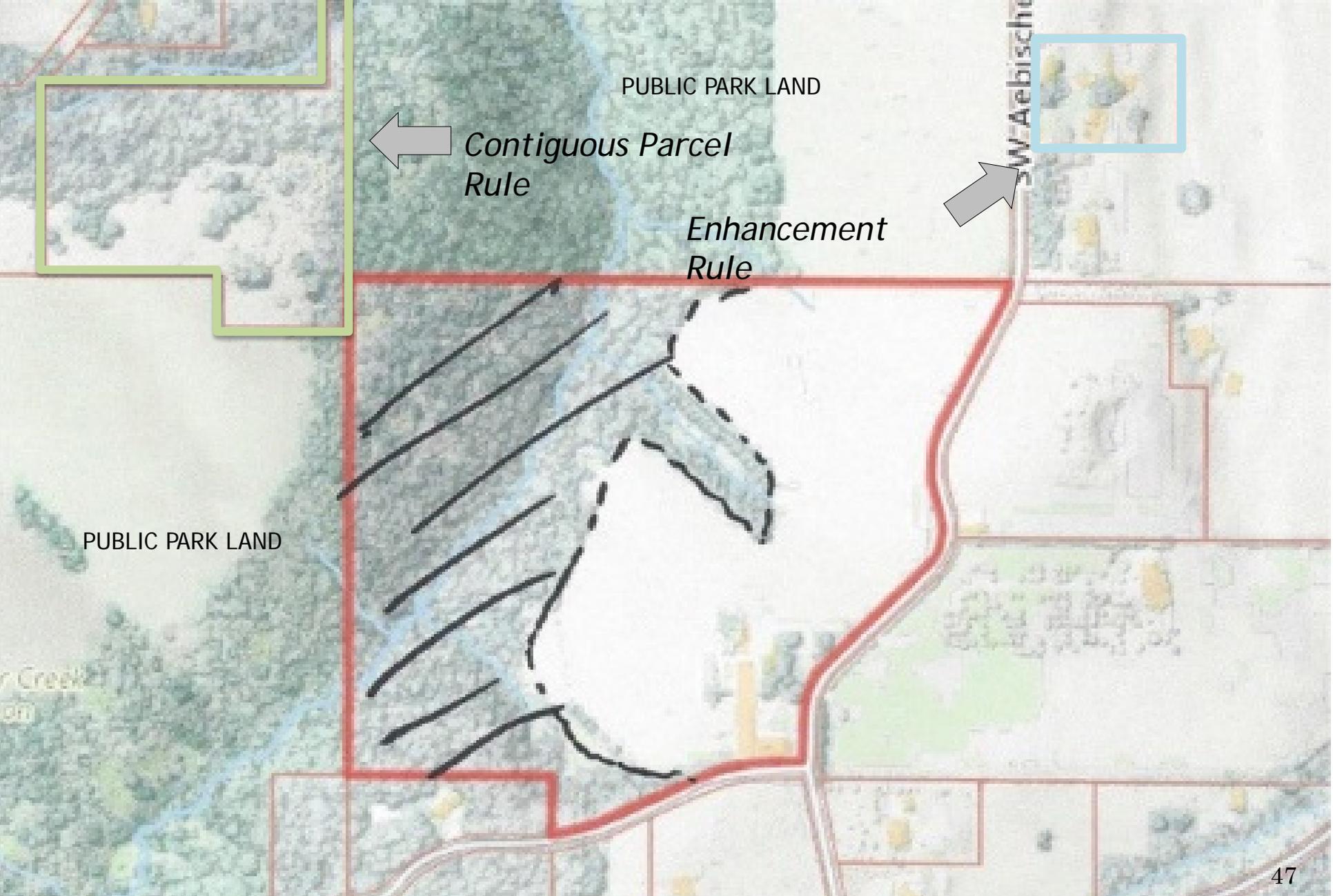


PUBLIC PARK LAND

PUBLIC PARK LAND

SW Aebisch

Creek  
on



# Other Required Forms

- Appraisal summary = IRS Form 8283
- Need to attach entire appraisal to Form 8283 if FMV > \$500,000
  - IRC §170(f)(11)(D)
- Contemporaneous written acknowledgement is required in order to qualify for a deduction
  - see §170(f)(8)

# Syndicated CE Transactions

The Treasury Department and the IRS “are aware that some promoters are syndicating conservation easement transactions that purport to give investors the opportunity to obtain charitable contribution deductions in amounts that significantly exceed the amount invested.”

- IRS Notice 2017-10 and
- As updated by IRS Notice 2017-29  
<https://www.irs.gov/pub/irs-drop/n-17-29.pdf>

# Syndicated Transactions, cont'd

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POLITICS

## Thousands of Investors Got Big Tax Breaks for Land-Rights Donations, IRS Finds

Lawmakers scrutinize syndicated conservation easements that let people profit quickly



The Bonneville Power Administration signed a conservation easement with a landowner in 2015 regarding 5,000 acres near Leadore, Idaho. Under U.S. law, land owners can donate the development rights to their property to land trusts, other charities or governments. PHOTO: ILONA MCCARTY/ASSOCIATED PRESS

By [Richard Rubin](#)

March 14, 2018 2:56 p.m. ET

 23 COMMENTS

WASHINGTON—More than 15,000 investors have participated in certain tax deals involving charitable contributions of land rights, according to new [IRS data](#) that was given to lawmakers who are scrutinizing the practice, which is estimated to cost the government more than \$1 billion in revenue annually.

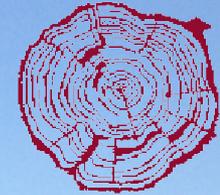
# Syndicated Transactions, cont'd

The Land Trust Alliance has done significant work on this front and you can find more information on their website



<https://www.landtrustalliance.org/topics/taxes/tax-shelters>

<https://www.landtrustalliance.org/blog/new-clarity-irs-tax-shelter-notice>



**Wm. F. Paulus**  
ATTORNEY AT LAW

# Questions

**THANK YOU**

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# **Emerging Markets for Ecosystem Services and Green Infrastructure**

"Relevance for Land Trust Conservation  
Easements"

Stafford Webinar on

Recent Developments in Conservation Easements

Presented April 10, 2018

**Brad Raffle, Esq., President, Conservation Capital LLC**

<http://conservationcap.com> 832-331-1802



Historically, land conservation has been a public or philanthropic activity, often providing private tax benefits. It is now becoming also a commercial activity, in recognition of the many private benefits provided by ecosystems.

Public-Private Partnerships are becoming a standard model for protecting nature and its services. Conservation easements are a key part of this business model.



## **Conservation Easements Not Driven by Tax Considerations**

They are a standard tool for assuring that mitigation or ecological service protections will occur

Required mitigation for past, present or future actions

Compliance with conservation commitments

Ecological Services/Green Infrastructure Transactions

## **Case Histories**

Endangered Beetle Preserve to Authorize the Keystone Pipeline

Restoration of juniper-infested rangeland

Protecting NYC Drinking Water Reservoirs

TNC and Lyme Timber protect a working forest

# Services of Nature

Physical Goods

Services Otherwise Paid For/Green Infrastructure

Genetic Information and Biodiversity

Aesthetics and Existence Value

Services That Cannot be Paid For

## **Important differentiators Between Tax-driven and Environmental Conservation Easements**

- 1. No need to satisfy IRS rules**
2. Third party enforcement is particularly important
3. Neither the beneficiaries nor the grantor benefit from the easement and usually don't want to be in the chain of title
4. The easement often must provide for on-site restoration and/or cleanup activity
5. A clear nexus is required between the protected land and either a) an adverse impact elsewhere, or b) a benefitting parcel
6. An adequate stewardship endowment is essential
7. Initial Site selection is critical

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## **Post-easement Sale of Ecological Assets**

A. Determine exactly what is being "mitigated" and/or what specific ecosystem services or conservation values are being protected. Care must be taken to avoid "double dipping"

B. Stacking

1. Same Site Stacking
2. Same Acre Stacking



## Post-easement Sale of Ecological Assets (cont'd)

### C. Special CE Drafting Considerations

- Tax Issues
- Revenue Sharing
- Accommodation of Responsible Party Obligations
- Liability Considerations



## **Evolving Enviro--Economic Markets**

Carbon (Four creditability criteria)

- Baseline and measurement approach must be specified
- Additionality must be demonstrated
- Permanence must be enforceable and assured
- Leakage must be avoided



## **Evolving Enviro--Economic Markets (cont'd)**

- Water Rights and Supply
- Water Quality
- Habitat and Biodiversity
- Limited Development



## Recommendations for Land Trusts

Legal sophistication

New business and financial considerations

Policy advocacy to encourage carefully regulated ecosystem markets

Relationships, don't try to *become* a for-profit, but *use* for-profits

# Thank You

**Brad Raffle, Esq.**

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832-331-1802

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# Q&A

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