Conservation Easements

A Lexis Practice Advisor® Practice Note by
William F. Paulus, Attorney at Law; and Nancy E. Duhnkrack, Coalition of Oregon Land Trusts

William F. Paulus
Attorney At Law

Nancy Duhnkrack
Coalition of Oregon Land Trusts

This practice note provides an overview of conservation easements and guidance on preparing them. Additionally, it outlines tax incentives for these transactions, and includes recommendations for counseling clients considering granting or accepting such agreements.

Laws governing conservation easements, like most areas of real estate law, vary by jurisdiction. This note is based on the Uniform Conservation Easement Act (UCEA), as modified by the Oregon enabling statute, ORS 271.715 through ORS 271.795. At times, references are made to other states for comparison, but in no way should this note be considered a comparative analysis of conservation easement statutes across the country. For a detailed discussion of easements, see Easement Agreement Basics and 7 Thompson on Real Property, Thomas Editions § 60.02. For discussion of a purchase option in a conservation easement, see 1 Federal Taxes Affecting Real Estate § 6.05.

What Is a Conservation Easement?

A conservation easement is a legal agreement between a landowner and an eligible entity that imposes restrictions and/or affirmative obligations on the landowner's property to retain or protect natural or historic resources for the public good. Like a traditional common law easement, a conservation easement is a grant of less than the landowner's entire interest in the property and its terms are binding upon the successors and assigns of the original parties. Conservation easements are generally voluntary agreements negotiated between the landowner (also known as the grantor) and the holder of the easement (also known as the grantee), either for financial consideration, to obtain a government permit, or through donation.

The grantee typically must be a nonprofit conservation organization, such as a land trust, or a government entity. Some states, such as Oregon, permit Indian Tribes to hold conservation easements.

A Very Brief History

The use of conservation easements as a voluntary tool for resource protection arose as part of the environmental movement in the early 1970s. In the late 1970s and early 1980s, the federal government allowed the donation of a conservation restriction to be treated as a tax-deductible charitable gift. See 26 U.S.C. § 170(f)(3)(B)(iii) and 170(h). Because of this significant incentive, donated and non-donated conservation easements proliferated across the country, with over 167,721 easements protecting more than 27 million acres on private and public lands recorded by 2019. See National Conservation Easement Database, NCED at a Glance.

The Uniform Conservation Easement Act (UCEA)

Because conservation easements do not exist under common law, a state statutory framework is necessary for their existence. To further uniformity among the state statutes, the UCEA was approved and recommended for enactment in all 50 states by the National Conference of Commissioners on Uniform State Laws (NCCUSL) in 1981. Under the UCEA, as in many states, the definition of a conservation easement is quite broad:

> "Conservation easement" means a nonpossessory interest of a holder in real property imposing limitations or affirmative obligations the purposes of which include retaining or protecting natural, scenic, or open-space values of real property, assuring its availability for agricultural, forest, recreational, or open-space use, protecting natural resources, maintaining or enhancing air or water quality, or preserving the historical, architectural, archaeological, or cultural aspects of real property.

Unif. Conservation Easement Act § 1(1).

Counsel looking for further guidance on the interpretation of a particular state's conservation easement statute should rely on case law from the state's appellate courts, if available. However, if that is lacking, such as in Oregon, the prefatory notes and commentary to the UCEA are a useful surrogate, especially if the state's statute is based in whole or in part on the UCEA. The commentary to the UCEA was revised and amended in 2007 to provide more clarity about how conservation easements dovetail with the law of charitable trusts and the doctrine of *cy pres*, which provides for interpretation of charitable trust documents as close as possible to the grantor's intent.

Under the UCEA, the restrictions and obligations of conservation easements are immunized from "certain common law impediments which might otherwise be raised." Unif. Conservation Easement Act Commissioners' Prefatory Note. Thus, the UCEA permits a landowner to transfer a restriction upon the use of property to a holder, which will be enforceable by the holder and its successors whether or not the holder has an interest in land benefited by the restriction. Furthermore, the holder's interest in the property may be assigned to another qualified conservation entity. Thus, it is not necessary to have the "traditional conditions of privy of estate and 'touch and concern,'" that are normally applicable to real property covenants that run with the land. See Unif. Conservation Easement Act Commissioners' Prefatory Note.

Using the terminology of easements is not without debate. The easement terminology was favored because lawyers and courts are familiar with this nomenclature and less so with restrictive covenants and equitable servitudes. It was thought that sticking with a known concept would reduce the confusion that could arise if a separate hybrid interest were instead described. Moreover, the non-possessory interests that satisfy the requirements of real covenant or equitable servitude doctrine will invariably meet the UCEA's less demanding requirements for easements. See Unif. Conservation Easement Act Commissioners' Prefatory Note.

Types of Conservation Easements

Conservation easements may be categorized by means of acquisition, conservation purposes, and duration.

Acquisition

Generally, a conservation easement may be acquired through purchase, donation, or exaction.

- **Purchased.** An easement may be purchased from the landowner by the holder for an agreed-upon price. Because of public policy considerations, most government and land trust easement holders typically cannot purchase an easement for more than fair market value. Fair market value can be determined through an appraisal.
- **Donated.** A landowner may donate an easement to the holder or sell the easement for less than fair market value. The donation or bargain sale may qualify as a charitable contribution for federal income tax purposes. See I.R.C. § 170(h) and discussion below under Tax Benefits Available for Donated Conservation Easements.
- **Exacted.** An easement may be "exacted" as part of a federal or state land use permitting process, most often, as mitigation for environmental impacts of a development. Mitigation banks are frequently used to provide conservation easements to offset adverse effects of development.

Conservation Purposes

State law determines the eligible purposes for a conservation easement. The purposes of a particular easement will frequently determine its eligibility for funding from various local, state, and federal programs. In addition, the Internal Revenue Code, Section 170(h), defines those conservation purposes that qualify the easement for a federal tax deduction, which are:

- **Public recreation or education.** "The preservation of land areas for outdoor recreation by, or the education of, the general public." I.R.C. § 170(h)(4)(A)(i). Public access is required and use by the public must be substantial and regular.

- **Significant, relatively natural habitat for fish, wildlife, or plants.** "The protection of a relatively natural habitat or fish, wildlife, or plants, or similar ecosystem." I.R.C. § 170(h)(4)(A)(ii). Significant habitat includes habitat for rare, endangered, or threatened plants, natural areas representing high quality examples of a terrestrial or aquatic community and natural areas included in, or contributing to, the ecological viability of public parks or preserves.
- **Open space, including farmland and forestland.** "The preservation of open space (including farmland and forestland) where such preservation is (I) for the scenic enjoyment of the general public, or (II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy, and will yield a significant public benefit." I.R.C. § 170(h)(4)(A)(iii). The regulations list eight factors that, among others, may be used in determining whether a view qualifies as scenic. See Treas. Reg. § 1.170A-14(d)(4)(ii)(A). A qualifying governmental conservation policy would include preferential tax assessment.
- **Historic preservation.** "The preservation of an historically important land area or a certified historic structure." I.R.C. § 170(h)(4)(A)(iv). Historically important land areas include independently significant land areas and land areas adjacent to properties listed on 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.

Duration

Conservation easements are usually designed to last forever, and most easement holders accept only perpetual conservation easements. North Dakota's state statute, however, limits a conservation easement's term to 99 years and certain government programs allow for 10–30 years easement contracts. Tax benefits, however, are only available for permanent easements.

Creation, Acceptance, and Recording

Under the UCEA, a conservation easement may be created, conveyed, recorded, assigned, released, modified, terminated, or otherwise altered or affected in the same manner as other easements. No right or duty in favor of or against a holder and no right in favor of a person having a third-party right of enforcement (as mentioned below) arises under a conservation easement before its acceptance by the holder and a recordation of the acceptance. Unless terminated by a court, a conservation easement is typically unlimited in duration except if the instrument creating it otherwise provides. An interest in real property in existence at the time a conservation easement is created is not impaired by it unless the owner of the interest is a party to the conservation easement or consents to it.

Third-Party Right of Enforcement

A conservation easement may also have a third-party right of enforcement provision, which grants a right to a party that is not the easement holder to enforce any of its terms. Typically, the possessor of the third-party right of enforcement must be itself eligible to be a holder of the easement. Often funders of conservation easements, such as government entities, who will not be the holder, request to have third-party rights of enforcement to protect the public interest in defending the conservation easement if the holder is unable to do so or no longer in existence. Some states require that assumption of third-party enforcement rights and duties must be accepted in writing by the holder and that this acceptance must be recorded.

Drafting Considerations

In most instances, each conservation easement is tailor-made based on the characteristics of the property, including the conservation purposes of the project, whether a donation is being sought, funder requirements if it is a purchased easement, and which rights the landowner is willing to give up and retain. These provisions are key components to drafting any such instrument. Accordingly, documents are generally divided, at a minimum, into the following sections:

- Recitals or "whereas clauses"
- The grant of the easement by whom to who, with stated consideration (whether monetary or a donation)
- The specific conservation purposes and public benefit served
- The grantor's reserved rights
- Prohibited uses, also referred to restrictions
- The grantee's rights, which include the right of inspection, enforcement, and in certain instances, other affirmative rights, such as the ability to restore the property to achieve certain habitat goals
- Standard contract terms applicable to most easements that are consistent with state real estate law
- Signature pages for all landowners, the holders, any third-party with a right of enforcement, and the corresponding notary blocks for acknowledging the signatures for recording –and–

- Referenced exhibits in the body of the agreement that are attached at the end of the document (e.g., property legal description, easement legal description, easement area maps)

Moreover, as mentioned above, the text of the document must be consistent with the state conservation easement enabling statute and the relevant state law providing requirements for real property instruments. If general public access is not an intended use of the easement area, it is customary to clearly state so in the easement.

Land Trust Considerations

If you are representing a landowner in a transaction with a land trust, it is advisable to review that entity's acquisition policies, as well as the applicable Land Trust Standards and Practices, particularly Standard 8 (Evaluating and Selecting Conservation Projects), Standard 9 (Ensuring Sound Transactions), and Standard 10 (Tax Benefits), as these are the ethical and technical guidelines that all Land Trust Alliance-member land trusts must adopt and follow. See Land Trust Standards and Practices, Land Trust Alliance (Revised 2017).

Federal Tax Deduction Considerations

If your client is seeking a federal tax deduction, it is imperative that you incorporate the key provisions of I.R.C. § 170(h) and the interpreting administrative rules under Treasury Regulation § 1.170A-14 into the document. The absence of such will jeopardize the claimed deduction. These provisions include but are not limited to:

- The applicable federal conservation purposes
- The mortgage subordination requirements
- The requirement that extinguishment may occur only through a judicial proceeding
- The need for baseline documentation
- The restriction on sale proceeds
- The requirement that the donation immediately vests a property right in the donee
- The limitation on transfers by the donee to other qualified holders –and–
- The requirement that the donee is a qualified holder committed to protect the conservation values and enforce the easement in perpetuity

Thoroughly read the current Treasury Department regulations, Internal Revenue Service (IRS) guidance documents, and relevant case law, prior to drafting a conservation easement in these circumstances.

Since the federal income deduction has been a powerful incentive for creating conservation easements across the country, it is a customary drafting technique to include the relevant I.R.C. § 170(h) conservation purposes, in addition to those mentioned in your state statute (e.g., ORS 271.715(1) in the case of Oregon), even if an income tax deduction is not sought.

Conservation easements where the conservation purposes are apparently lacking will likely invite IRS scrutiny, such as where:

- The protected area is proportionally small in size to the entire property. However, in Glass v. Commissioner, 471 F.3d 698 (6th Cir. 2006), the taxpayer survived such scrutiny when the Tax Court upheld the conservation purposes of a donated easement to protect a small portion of a 10-acre property that had possible places to create relatively natural habitat.
- The public benefit of the conservation values is marginal or ill-defined. For example, merely limiting the subdivision and development of lots on a property subject to a conservation easement is not by itself enough to the satisfy the open space requirement of the conservation purposes test under I.R.C. § 170(h). Turner v. Commissioner, 126 T.C. 299 (2006).
- The reserved rights conflict with the stated conservation values. For example, in Atkinson v. Commissioner, Nos. 2683-11, 2693-11, 2694-11, 2695-11, 2700-11, 18938-12, 2015 Tax Ct. Memo LEXIS 243 (T.C. Dec. 9, 2015), the Tax Court held that a relatively natural habitat was not being protected by an easement on a golf course because the use of pesticides in a manner allowed in the easement could destroy the ecosystem of the encumbered property.

Quid Pro Quo Contribution Considerations

Another issue of concern is quid pro quo conservation easement donations. A quid pro quo contribution is where a conservation easement is donated to a qualified organization or government entity in return for goods or services, such as a land use planning approval. These donations are not deductible, unless the amount transferred exceeds the fair market value of the quid pro quo and is with charitable intent. United States v. American Bar Endowment, 477 U.S. 105, 117 (1986).

Reserving Landowner Rights

Drafting an easement to protect the conservation values while simultaneously reserving some rights for the landowner to use the property can be a delicate balance. The seven

practice tips below, adapted from Land Trust Alliance, "Federal Judge Crushes Fracking Plans" (Nov. 13, 2013), are applicable to landowners and holders alike seeking to prepare conservation easements that can stand the test of time and cover unforeseen circumstances that were not specifically addressed in the text of the conservation easement:

- Craft a clear, unambiguous, and sufficiently detailed conservation purposes clause that is supported by the baseline documentation report
- Identify conservation attributes and values and clearly articulate what makes those attributes important
- Elaborate on the purposes, attributes, and values in the baseline documentation report
- Ensure that every reserved right does not impair the property's conservation values
- Articulate how the reserved rights are not inconsistent with the stated conservation purposes
- Consider defining critical terms but use caution and balance the use of definitions against the risk of them becoming obsolete
- Include language that gives the holder discretion to determine if any activity, use, or structure is inconsistent with the purposes of the easement

Restrictions on Transferability and Termination of Conservation Easements

Restrictions on Transferability

A conservation easement will limit future organizations or agencies that might someday hold the easement. Generally, a holder can transfer its easement interests if the integrity of the easement is not affected by the transfer and if the new holder meets the state statutory requirements (and federal requirements if the easement was a deductible gift). For tax-deductible gifts, the easement document must state that the holder will never transfer the easement unless the transferee meets two requirements: (1) the transferee is qualified at the time of transfer to hold the easement under state and federal laws, and (2) the transferee will continue to enforce the easement restrictions. See Treas. Reg. § 1.170A-14(c)(2).

Additionally, easement transfer provisions may require the approval of third-party beneficiaries. Although landowner consent to the transfer should not be required, the holder should encourage the landowner to participate in the transfer process. The actual transfer is accomplished through a signed and recorded assignment. There may be an accompanying agreement covering matters such as transfer of stewardship funds and any required reporting.

Termination of Conservation Easements

In certain limited circumstances, perpetual conservation easements can be terminated. Several state statutes, as well as the UCEA, provide that conservation easements may be terminated "in the same manner as other easements." See, e.g., ORS 271.725(2). While other state statutes are silent on the matter, a few are arguably permissive, and some provide restrictions, such as the need for court approval, the following methods of termination are relevant in all states.

- **Eminent domain.** When land restricted by a conservation easement is taken by a government or government-empowered private entity for a public purpose, the conservation easement may also be terminated by condemnation. The nature and extent of compensation to the easement holder upon termination is a matter of some complexity. The IRS has specific regulations governing easement extinguishment provisions, that require a judicial proceeding and a division of proceeds that provides the holder with a portion of the proceeds that is at least equal to the proportionate value of the easement to the value of the property at the time of the gift. See Treas. Reg. § 1.170A-14(g)(6)(ii).
- **Foreclosure.** A conservation easement may be terminated through the foreclosure of a preexisting lien on the property such as a mortgage. This can be avoided if, at the time the easement is created, the holder of the mortgage agrees to subordinate its interest to the easement. IRS regulations require a subordination agreement if the grantor plans to take a tax deduction. See Treas. Reg. § 1.170A-14(g)(2).
- **Merger.** Under the common law doctrine of merger, an easement will be extinguished when the holder becomes the fee title owner of the property. The applicability of this doctrine to conservation easements is a matter of state law and will generally be determined by one of the following approaches: (1) common law merger, (2) a statutory provision requiring merger, or (3) a statutory provision prohibiting merger. The holder may be able to prevent a merger by including an anti-merger provision in the easement or assigning the easement or an interest in the easement to a third party prior to the acquisition of fee title.
- **Changed conditions.** Under a legal doctrine similar to cy pres, a court may terminate a conservation easement if a subsequent unexpected change in circumstances in conditions makes the continued use of the property for conservation purposes impossible. Economic changes

are generally not considered sufficient justification for termination. Under these circumstances, the court will try to ensure that the property or money from the sale of the property will be used for conservation purposes.

Judicial Actions

For UCEA based conservation easements, an action affecting a conservation easement may be brought by:

- An owner of an interest in real property burdened by the easement
- A holder of the easement
- A person having a third-party right of enforcement –or–
- A person authorized by other law

However, the UCEA does not affect the power of a court to modify or terminate a conservation easement in accordance with the principles of law and equity.

Validity

One of the main goals of the UCEA was to identify and negate common law defenses that could be used to impede the use of easements for conservation purposes. Specifically, under the UCEA, a conservation easement is valid even though:

- It is not appurtenant to an interest in real property
- It can be or has been assigned to another holder
- It is not of a character that has been recognized traditionally at common law
- It imposes a negative burden
- It imposes affirmative obligations upon the owner of an interest in the burdened property or upon the holder
- The benefit does not touch or concern real property –or–
- There is no privity of estate or of contract

Tax Benefits Available for Donated Conservation Easements

Under I.R.C. § 170(h), donations of conservation easements to qualified organizations are deductible charitable contributions for federal income tax purposes if particular criteria are met. Federal tax law is very complex and continues to evolve. This discussion is just a brief overview of I.R.C. § 170(h) and some of the more relevant corresponding Treasury Regulations pertaining to donated conservation easements. If your client intends to seek a federal tax deduction for a donated conservation easement, you must familiarize yourself with the rules and regulations, in addition to applicable tax court decisions, IRS rulings, letters, and notices, prior to drafting the agreement. A good resource is the IRS's "Conservation Easement Audit Techniques Guide" (rev. Jan. 24, 2018), which provides guidance to tax examiners for reviewing charitable contributions of conservation easements and the valuation thereof.

Typically, donations of partial interests in real property are not deductible, but the donation of a conservation easement is one of the narrow exceptions to this rule. I.R.C. § 170(f)(3)(B)(iii). The term "conservation easement" is not used in I.R.C. § 170(h). Instead, it falls under the nomenclature of qualified conservation contributions. A conservation easement is considered a qualified conservation contribution if it is a contribution (1) of a qualified real property interest, (2) to a qualified organization, (3) exclusively for conservation purposes. I.R.C. § 170(h)(1). Despite the IRS nomenclature, we will continue to refer to qualified conservation contributions as conservation easement donations in this section of the article.

The term "qualified real property interest" includes "a restriction (granted in perpetuity) on the use which may be made of the real property." I.R.C. § 170(h)(2). This is where the definition of a conservation easement falls under the federal tax code. The requirement that a donated easement be perpetual to be tax-deductible is a cornerstone of the federal rules and regulations. A qualified organization generally means public charitable organizations and any unit of government. See I.R.C. § 170(h)(3). As outlined above under Types of Conservation Easements the eligible conservation purposes are defined in I.R.C. § 170(h)(4)(A).

Special rules with respect to buildings in registered historic districts are addressed in I.R.C. § 170(h)(4)(B) and certified historic structures are defined in I.R.C. § 170(h)(4)(C).

A contribution will not be treated as exclusively for conservation purposes unless the conservation purposes are protected in perpetuity. I.R.C. § 170(h)(5)(A). Moreover, for a donation to be considered exclusively for conservation purposes, the donor must not reserve rights that are inconsistent with the conservation purpose of the easement. See Treas. Reg. § 1.170A-14(e)(2).

Reserved rights to surface mining generally invalidate the perpetual nature of an easement for federal tax purposes. I.R.C. § 170(h)(5)(B). To address a frequent problem in Western states where the ownership of surface mineral rights was separated from the estate, Congress provided an exception to the no-surface-mining rule "if the probability of surface mining occurring on such property is so remote as

to be negligible." I.R.C. § 170(h)(5)(B)(ii). Nonetheless, the extraction of minerals from the subsurface is permitted on an easement so long as such removal is not inconsistent with the conservation purposes of the donation. See I.R.C. § 170(h)(5)(B)(ii); Treas. Reg. § 1.170A-14(g)(4)(i).

As another component of the perpetuity requirement, a donated easement claimed as a tax deduction can only be extinguished by judicial proceedings upon a finding that a subsequent unexpected change in the conditions surrounding the property makes the continued use of the property for conservation purposes impossible or impractical. Treas. Reg. § 1.170A-14(g)(6)(i). At the time of the gift, the donor must agree that the donation of the conservation easement gives rise to a property right immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation easement bears to the value of the property as a whole at the time of the gift. Treas. Reg. § 1.170A-14(g)(6)(ii). Consequently, a donee is entitled to their proportionate share of sale proceeds if the easement is extinguished under Treas. Reg. § 1.170A-14(g)(6)(i) or through eminent domain. Treas. Reg. § 1.170A-14(g)(6)(ii). All of the donee's proceeds in this instance must be used in a manner consistent with the conservation purposes at the time the easement was donated. Treas. Reg. § 1.170A-14(g)(6)(i). Any mortgage or deed of trust must be subordinated to the rights of the easement holder to enforce the conservation purposes of the gift in perpetuity, if a charitable deduction is to be obtained by the donor. Treas. Reg. § 1.170A-14(g)(2).

Syndicated Conservation Easement Transactions

Transactions involving the donation of conservation easements that are explicitly promoted to third-party investors seeking an income tax deduction are being closely scrutinized by the IRS. Often these transactions involve very high tax deductions in the aggregate, where the investors have little or no interest in the subject property that is typically owned by a pass-through entity, such as a limited liability company, and are provided as an opportunity to obtain a charitable contribution deduction in an amount that significantly exceeds the amount invested. The rise in the use of these unusual transactions caused the IRS to issue Notice 2017-10—Syndicated Conservation Easement Transactions (Dec. 23, 2016) (the "Notice"), to identify and classify when these kind of transactions are "listed transactions" and thus require "material advisors" (e.g., attorneys) to file a report identifying the transactions to the IRS. The Notice does not provide additional regulation on the matter. However, you should be aware that if a transaction meets the criteria in the Notice, then the IRS will greatly scrutinize the public benefit of the donation and its valuation. The Land Trust Alliance website is also a good resource on the subject for landowners and land trusts alike.

Valuation

A charitable contribution is not deductible unless it is substantiated in accordance with the Internal Revenue Code and applicable regulations. The Treasury Regulations authorized under I.R.C. § 170(f)(11)(H) set forth strict conservation easement appraisal requirements for federal charitable tax deduction purposes.

The value of a charitable contribution of a conservation easement under I.R.C. § 170(h) is the fair market value of the perpetual conservation restriction at the time of the contribution. Treas. Reg. § 1.170A-14(h)(3)(i); see also Treas. Reg. § 1.170A-1(c). Conservation easements having a fair market value greater than $5,000 must be substantiated by a qualified appraisal prepared by a qualified appraiser. I.R.C. § 170(f)(11)(C)–(E). These terms are further defined in I.R.C. § 70(f)(11)(E) and Treas. Reg. § 1.170A-13(c)(3), (5). Note that, in order to be a qualified appraisal, the appraisal cannot be completed more than 60 days before the date of the donation. Treas. Reg. § 1.170A-13(c)(3)(i). In addition to obtaining a qualified appraisal, a taxpayer seeking a charitable deduction for a donated conservation easement must attach a fully completed appraisal summary to his or her tax return for the year in which the donation is made. Treas. Reg. § 1.170A-13(c)(2)(i); I.R.C. § 170(f)(11)(C). The appraisal summary is made on an IRS Form 8283 (Noncash Charitable Contributions). See Treas. Reg. § 1.170A-13(c)(4) for additional appraisal summary requirements. For easements valued more than $500,000, the taxpayer must attach the entire appraisal to the return. I.R.C. § 170(f)(11)(D).

The IRS requires strict compliance with the appraisal requirements. If the requirements are not met, the deduction will be disallowed. In determining the fair market value of an easement, appraisers must first rely on sales prices of comparable easements if a substantial record of such sales exists. Treas. Reg. § 1.170A-14(h)(3)(i). In most cases, due to the unique nature of conservation easements, this type of marketplace sales data will not exist. Consequently, the fair market value is typically determined by calculating the difference between the fair market value of the property as a whole before it is encumbered with the easement and the fair market value of the property after the granting of the easement (i.e., the before-and-after test). Treas. Reg. § 1.170A-14(h)(3)(i).

If the easement covers a portion of contiguous property owned by a donor or the donor's "family," as defined in 26 U.S.C. § 267(c)(4), the amount of the deduction is the difference between the fair market value of the entire contiguous parcel before and after the granting of the easement (i.e., the contiguous-parcel rule). Treas. Reg. § 1.170A-14(h)(3)(i). A similar rule applies to other property owned, whether or not such property is contiguous, by

the donor or a "related person," as defined in either I.R.C. § 267(b) or I.R.C. § 707(b), that is increased in value by the grant of a conservation easement by the donor (i.e., the enhancement rule). Treas. Reg. § 1.170A-14(h)(3)(i). For further details about the application of the contiguous-parcel rule or the enhancement rule, refer to IRS Associate Chief Counsel Memorandum Number 201334039 (rel. Aug. 23, 2013).

Note that a before-and-after valuation must consider not only the current use of the property, but an objective assessment of how immediate or remote the likelihood is that the property, absent the easement, would in fact be developed. Treas. Reg. § 1.170A-14(h)(3)(ii). Furthermore, there may be instances where the grant of a conservation easement may have no material effect on the value of the property or may enhance, rather than reduce, the value of the property. In those instances, no deduction will be allowed. Treas. Reg. § 1.170A-14(h)(3)(ii).

Baseline Documentation

The conservation values and condition of the property at the date of execution of the easement are further described in documentation commonly referred to as baseline documentation report, which is typically required by holders of conservation easements whether or not a donation is sought. The baseline documentation generally is a written report with narrative, maps, and photographs that the parties agree provide an accurate representation of the property on the effective date of the easement. See Treas. Reg. § 1.170A-14(g)(5)(i). It is also intended to help the holder monitor the conservation values of the property and assist the landowner in minimizing disputes in the future about what are accepted uses.

If the donor of a conservation easement reserves rights that may impair the conservation values of the property, for a federal tax deduction to be allowed, the donor must provide the donee with the baseline documentation prior to the time the donation of the easement is made. Treas. Reg. § 1.170A-14(g)(5)(i).

While this regulation states that the "donor must make available" the baseline documentation, donee organizations, such as land trusts or government entities, typically complete this task on behalf of the landowner. Nonetheless, the donor and representative of the donee must sign an accompanying statement that the natural resources inventory in the baseline documentation is an accurate representation of the protected property at the time of the transfer. Treas. Reg. § 1.170A-14(g)(5)(i).

Conclusion

Conservation easements are a popular legal mechanism to protect conservation values on private property because they are flexible, relatively low cost, keep land in private ownership, and may provide valuable tax benefits. However, because conservation easements are generally designed to be perpetual and provide public benefits, drafting such agreements requires careful scrutiny of state law and the federal tax code and regulations, and in-depth, frequent, consultations with your client.

William F. Paulus, William F. Paulus Attorney At Law
William F. (Fritz) Paulus is a real estate attorney in Portland, Oregon who represents public and private clients with all facets of real property transactions for land protection throughout the state. Conservation easements are one of his practice areas. He authored a chapter about conservation easements in the Oregon Real Estate Deskbook and is a frequent speaker on the topic.

Previously, Mr. Paulus was a Real Estate Negotiator with the Natural Areas Program at Metro, served as the Executive Director of the Oregon Water Trust, and is a former Assistant Attorney General at the Oregon Department of Justice. Mr. Paulus graduated from Whitman College with a degree in mathematics, earned his law degree from the University of Oregon, and has been a member of the Oregon State Bar since 1991.

Nancy E. Duhnkrack, Pro Bono Program Manager, Coalition of Oregon Land Trusts
Nancy Duhnkrack coordinates the pro bono program for the Coalition of Oregon Land Trusts (COLT) and provides pro bono legal advice to COLT for its members.

Nancy is a graduate of Northwestern School of Law, Lewis and Clark College. She retired in 2014 as Staff Attorney/Law Clerk for the U.S. Court of Appeals for the Ninth Circuit after 20 years at the Court. She was an Adjunct Professor at the law school from 1990-2010 and is a frequent speaker on conservation easement design and enforcement.