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## Introduction to Conservation Easements

### 1. Definition

A conservation easement is a legally enforceable agreement between a landowner (“grantor”) and a conservation group or government body (“grantee”), in which the grantor gives up certain development rights. Conservation easements are contracts that can be tailored to suit the property and the landowner’s needs. The restrictions are spelled out in a conservation easement deed, a legal document recorded at the Registry of Deeds. This creates an encumbrance on the title, which legally binds present and future owners. The restrictions against development, once set in place, “run with the land” and are binding in perpetuity on all future owners. The land remains on the county tax rolls.

The purpose of a conservation easement is to protect significant conservation values of a property from being degraded. Examples of conservation values that can be protected through a conservation easement include: open space, plant and wildlife habitat, water quality, soil quality, forest and timber resources, scenic enjoyment by the general public, traditional agriculture, and historically important structures and land.

The grantee, which receives and holds the conservation easement, cannot exercise the development rights given up by the grantor. The grantee in essence becomes a guardian. It holds a long-term responsibility to monitor the land to ensure that its use complies with the terms of the conservation easement. It has the legal right – and obligation – to enforce those restrictions if a violation occurs.

### 2. Potential tax benefits of a conservation easement

***Federal income tax deduction*** – The donor of a conservation easement is entitled to an income tax deduction for the value he or she has given up. The amount of the deduction is equal to the fair market value of the land before the easement minus the value of the land after it is restricted with the easement. The donor can deduct up to 50% of his or her adjusted gross income for the year in which the gift occurs, and can “carry forward” the unused amount of the deduction and apply that to his or her income for 15 more years. The tax rules require the easement to be in perpetuity, donated to a government agency or tax-exempt conservation organization, and fulfill one of several conservation purposes. These include the protection of: land for the enjoyment or education of the public; relatively natural habitat for fish, wildlife or plants; scenic open space or open space that has been identified by a government agency as worthy of protection; or historically important property. (IRC Section 170(h). US Treas. Reg. 1.170A-14(a)).

***Estate and gift tax valuation*** – When a landowner donates a conservation easement on property, he or she lowers the value of that property, and the potential estate tax that may be due if he or she owns that property at death.

**Estate tax exclusion** – If a landowner donates a conservation easement on property and all the requirements of Internal Revenue Code Section 2031(c) are met, an additional 40% of the value of the land with the easement in place (disregarding value of structures on the property) can be excluded from the gross estate of the decedent. Coupled with the reduction in value mentioned above, this is a double estate planning incentive.

**Post-mortem donation** – Under IRC Section 2031(c), an estate can donate a conservation easement after the death of the landowner and thereby lower the landowner's estate tax bill. The easement must be recorded by the due date, including extensions for the estate tax return. The deadline is nine months after the death of the decedent, with a possible six-month extension within the discretion of the IRS.

**Dealer Status** – If the donor is a dealer in real estate, the easement donation may be considered a donation of inventory, in which case the amount of the deduction could be limited to the donor's cost or basis in the property. This issue is pending review by the Tax Court.

**Quid Pro Quo Rule** – If the "donation" is really a bargained-for exchange, proceeding from the incentive of anticipated benefit to the donor, there is no gift and accordingly no deduction. Reg. Sec. 14(h)(3)(i).

**NOTE:** *The above discussion has been simplified for the purpose of introducing the topic of potential tax benefits. We encourage landowners to obtain professional advice from their attorney, accountant or tax specialist to determine their specific tax benefits, and to act only after deliberate consideration and thorough review of the tax implications by their attorney, accountant, or tax specialist*

### **3. Summary of steps in a conservation easement transaction**

**Initial Steps** – SAHC provides the landowner with information about conservation easements and the transaction process, including a Landowner Questionnaire. The landowner completes the Questionnaire and provides basic information about the property, including its address, location, size and general description, landowner contact information, maps, title reports, existing appraisals or other pertinent information. SAHC staff visits the property with the landowner, and begins discussing the proposed transaction. The landowner is encouraged to consult with a tax and legal advisor to be fully informed of the tax and legal issues his or her family needs to address.

**Approval by the SAHC Board** – SAHC staff evaluates proposed conservation easement under SAHC Project Selection Criteria. SAHC staff presents the proposed project to the SAHC Land Protection Committee, which will formulate a recommendation to the Board regarding the appropriateness of the project within the scope of SAHC's mission. The SAHC Board then votes whether to approve the project, considering factors such as: Would the proposed conservation easement protect significant conservation values such as open space, plant and wildlife habitat, water quality, forest and timber resources, or scenic enjoyment by the general public? Can the proposed land-use restrictions in the easement be sufficiently monitored? How likely are violations? Are adequate stewardship funds available to monitor and enforce the easement restrictions?

**Baseline documentation report** – SAHC staff gathers data about the property and prepares this report, which documents the current condition of the property and the conservation values to be protected. The report includes text, photographs and maps to depict the condition of the property at the time the easement is granted, so changes that occur in the future can be detected through monitoring, documented, and responded to appropriately.

**Survey** – If there is not an adequate survey or legal description, the property should be surveyed.

**Appraisal** – If the landowner plans to seek an income tax deduction, the IRS requires a qualified appraisal of the fair market value of the property before and after the easement is in effect, to determine the value of the donation. Fair market value is defined by the IRS as “the price at which a property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of all the facts” (Reg. Sec. 1.170A-1(c)). The value before the easement includes the development potential of the property – reflecting for example the number of house lots that could go on it, their potential sale price, the cost and timeline of installing development infrastructure such as roads and utilities, legal and engineering fees, the length of time it would take to sell lots, and the cost of borrowing to support developing the property.

The appraisal must be completed before the donor files the tax return for the year in which the gift is made, and not more than sixty days prior to the date of the gift (Reg. Section 1.170A-13(c)(3)(i)(A)). SAHC must receive the appraisal for review before the conservation easement is executed. A thorough, honest, and comprehensive appraisal by a qualified appraiser with experience in the particular real estate market is important. Engaging an appraiser early in the process can help inform the landowner of the potential value of the easement.

**Clear Title** – Title work to ensure clear title free of encumbrances. If the property is mortgaged, a subordination letter should be obtained from the lender, in which the lender agrees that if the mortgage is ever foreclosed and the property is subsequently sold, it will be sold subject to the conservation easement. Provided there is still enough equity after the conservation easement to protect the bank’s interest, the bank will generally agree to subordinate.

**Preparation of the Conservation Easement** – The conservation easement is drafted either by SAHC staff, reviewed by SAHC’s attorney and the landowner and his or her family. It is recommended that the landowner obtain an independent legal review of the easement. The goal is clear and enforceable language that sets forth clearly established rights and restrictions, which helps prevent violations and helps SAHC monitor the easement. After the easement document is finalized, it is signed by both parties, notarized, and recorded in the county in which the land is located.

#### **4. Stewardship of conservation easements**

When SAHC accepts a conservation easement, we promise to monitor and enforce the terms of the agreement *in perpetuity*. These promises are required for SAHC to fulfill its legal obligations, and to maintain the tax deductibility of the easement donation. This means that we become permanently responsible for the following items and their financial costs:

**Baseline Document** – As mentioned above, SAHC prepares a baseline documentation report that includes maps, photographs, and text describing the property’s conservation values at the time the conservation easement is executed.

**Monitoring and documentation** – SAHC will visit the property annually to compare its condition to the information contained in the baseline document. SAHC will record our findings so that we can determine if any activity happens to degrade the conservation values of the property. Consistent monitoring helps strengthen the relationship between the landowner and SAHC, foster better understanding of the role of each, remind the landowner of the easement terms, and inform the land trust of the condition of the property. Easements with greater potential for violations may need more frequent inspections. For example: (a) unusually restrictive easements, (b) easements that allow construction –

during construction, (c) easements in heavily used areas – where surrounding development may impact the number of potential violations, (d) small easements with many abutting landowners, and (e) easements with public access provisions – where vandalism or improper usage may occur.

***Steps in monitoring*** – SAHC staff or a contracting consultant will (a) contact the landowner to schedule a visit and invite him or her to accompany the inspector, (b) review the easement, baseline documentation, aerial photos, topographic maps, and previous monitoring reports to be aware of potential problems and information to be gathered, (c) visit the property, covering as much of the easement as possible, (d) examine boundaries for trespass, areas of landowner reserved rights, and areas of special restrictions, and (e) document condition of property using camera and easement monitoring form to document photo location.

***Documenting and archiving monitoring results*** – SAHC staff or a contracting consultant will (a) fill out an inspection form that includes the inspector's name, affiliation, address and signature, date, property owner and location, presence or absence of the landowner during the inspection, and a comment area to note the condition of the property, (b) label each photo with the property name and location on the property map, sign and date each photo page to attest to its accuracy, (c) notify the landowner in writing that the land trust inspected the easement and if anything was not in compliance, (d) store accurate records of the inspection in a safe place, which could stand up in court if the easement or a violation are legally challenged.

***Negotiating*** – If an activity occurs that degrades the conservation values of the property in violation of the easement, SAHC will negotiate with the responsible party to solve the problem.

***Legal Enforcement*** – If necessary, SAHC will enforce the conservation easement in a court of law.

These responsibilities will be SAHC's forever. In order for us to accept a new conservation easement, we must have adequate funds on hand to cover these long-term costs, separate from our general operating budget. Accordingly, we ask the landowner to make a ***stewardship contribution*** to SAHC to help cover these costs. This contribution is tax deductible, and if necessary can be staged over several years. In cases where the grantor is unable to make a donation, we may turn to the community to raise necessary funds, perhaps with help from the landowner. Neighboring property owners, local supporters, or government entities may be potential sources of stewardship funds.

***The Southern Appalachian Highlands Conservancy encourages the understanding and use of land conservation tools such as conservation easements to insure the future of our region's unique land and other natural resources. Our staff is trained and experienced in land protection, and can assist landowners throughout the easement process. However, we do not act as the landowner's legal representative, advisor, accountant, or tax specialist. Before a landowner makes significant decisions about the conservation of property, he or she should seek tax and or legal advice from an attorney, accountant or tax specialist.***