Anthony P. Curatola, Editor

Conservation Easements: Earning Green for Conserving Green Spaces

BY DIANE RIORDAN AND MICHAEL RIORDAN

Since 1980, Congress has provided a charitable contribution deduction to taxpayers who grant interests in real property to qualified organizations for conservation purposes. The contribution may consist of a restriction on real property that must control in perpetuity the way in which the property is used. Such a restriction is known as a "conservation easement." Private property owners can satisfy their desire to conserve the environment and also reduce taxes by donating conservation easements on their property to qualified organizations. Because the fair market value of the property is decreased by the value of the easement, it may provide estate and property tax benefits as well.

In general, easements protect both private and public interests. A private easement, for example, may be created under the principles of common law for a landowner to secure the right of way over a neighbor's property. Conservation easements don't conform to the traditional common law categories of easements and have been enabled by individual state statutes. The term "conservation purpose," defined by IRC §170(h)(4), refers to the preservation of land areas for outdoor recreation, education, or scenic enjoyment; protection of the habitat of fish, wildlife, plants, or similar ecosystems; or preservation pursuant to a clearly delineated federal, state, or local governmental policy to protect historical land or structures.

The value of the deduction for a conservation easement is much less than the cash necessary for a buyer to purchase the property outright. Federal tax incentives augment government and other funding for land conservation purchases, and state tax credits in approximately a dozen states provide further incentives.

The Land Trust Alliance, which represents the interests of more than 1,600 land conservation nonprofit groups, estimates that "the pace of private-land conservation by local and state land trusts more than tripled between successive five-year periods from 2000 to 2005." According to the organization's website, an estimated 37 million acres have been conserved by private contributions—16.5 times the size of Yellowstone National Park. Because taxpayers increasingly are using easements in their tax planning and generating millions of dollars in write-offs, the IRS is examining returns to verify deductions and "crack down on easement donation abuses" (Joe Stephens, "Fairfax Case Draws Line on Easements," *Washington Post*, June 4, 2006). Recipients now must provide information with their Form 990s.

Assuming the property has been held for one year before the contribution, the value of the deduction for the easement is generally determined by comparing the value of the property with and without the conservation restrictions. The process requires a "qualified appraiser," which the Pension Protection Act of 2006 (P.L. 109-280) (PPA) defines by statute for this purpose. Taxpayers must file IRS Form 8283 with their tax returns and attach certain docu-

ments at the time of filing, including declarations by the appraiser. IRC §6662 imposes income tax penalties for misstatements of valuation. The penalties are 20% of a tax underpayment due to a substantial valuation misstatement and 40% of the tax underpayment due to a gross valuation misstatement. Under provisions in the PPA, a contribution's valuation misstatement is "substantial" if it is 150% of the correct valuation (a change from 200%) and "gross" if it is 200% (a change from 400%). Appraisers also can be penalized.

Exchanging deductions for easements raises interesting questions, and the increase in grants has resulted in a corresponding increase in attention by the courts, Congress, and the IRS. For example, should a taxpayer receive a federal tax deduction for a conservation easement when there is no benefit to the general public beyond preexisting local restrictions?

Recent Court Activity

In *Turner* (126 TC 16), the Tax Court disallowed a $342,781 deduction for a conservation easement because the taxpayers planned to develop the property to its maximum yield within the property's existing zoning classification and wouldn't protect an historically important land area or certified historical structure. The realty was situated in an historical district in the general area of Mount Vernon, the former home of George Washington, and adjacent to President Washington's Grist Mill property. Approximately 30 acres were conglomerated for development. As they were zoned as "R-2" property, an owner would have been permitted to build two single-family dwellings per acre, but slightly more than half of this property was situated in a 100-year flood plain and was not available for residential development. The Tax Court ruled that providing an easement restricting the development in 15 of the acres didn't provide any public benefit beyond the local restrictions and denied the tax benefit.

In *Glass* (98 AFTR2d 2006-8309, December 21, 2006), the Sixth Circuit Court of Appeals affirmed the 1998 Tax Court decision in favor of the taxpayers. Their property consisted of 10 acres on the shoreline of Lake Michigan. The IRS questioned whether the property was a "significant" habitat and whether the easement met the "exclusively for conservation purposes" requirement. Specifically, it argued that the property was too small, the taxpayers retained too many rights, and neighboring property owners' building rights weren't restricted, thus precluding the easement serving the stated conservation purposes. The appellate court agreed with the Tax Court that the habitat was significant in that it provided a habitat for threatened animals—including bald eagles—and certain plants.

Congressional Action

The topic of qualified conservation easements has been discussed frequently by Congress and was addressed in the PPA. In the "Report on Options to Improve Tax Compliance and Reform Expenditures" issued January 27, 2005, the Joint Committee on Taxation advocated eliminating certain deductions with respect to façade and personal residences, substantially reducing the deduction for all other qualified conservation contributions, and imposing new standards on appraisals and appraisers regarding the valuation of such contributions. It estimated that its recommendations would raise $1 billion in taxes.

The PPA achieves some of these goals. New provisions expand the Treasury's authority to penalize appraisers and taxpayers for overvaluation and make it more difficult for easements in registered historical districts to qualify for a deduction. Taxpayers claiming a deduction for a qualified conservation contribution in excess of $10,000 made after February 13, 2007, with respect to the exterior of a building located in a registered historic district must pay a $500 fee to the IRS and reduce the charitable deduction by a fraction of rehabilitative credits previously taken. Interests must preserve the entire exterior of the building—not just the façade—and must prohibit changes to the exterior of the building inconsistent with its historical character. The donor and qualified organization must execute a written agreement stating that the organization has an appropriate conservation purpose and adequate resources to manage and enforce the restriction. Additional paperwork must be filed with the return.

Effective for tax years beginning after December 31, 2005, and before January 1, 2008, however, the annual limit for deductibility of the value of conservation easements was raised from 30% of an individual's contribution base to 50%, and rules have been added favoring conservation activities by farmers and ranchers.

IRS

The IRS issued Notice 2006-96 to provide guidance on the new definitions of "qualified appraisals" and "qualified appraisers" in IRC §170(f)(11) and valuation misstatements under the new IRC §6695A. It

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also issued Notice 2007-50 to provide guidance on the addition of §170(b)(1)(E), which relaxes the annual percentage limitation rules from 30% to 50% of the contribution base for donations of qualified conservation easements by individuals and extends the carryforward of unused contribution deductions from five to 15 years.

In general, the amount of charitable donations that an individual may deduct in a taxable year is limited to the applicable percentage of that individual's contribution base pursuant to IRC §170(b)(1). The term "contribution base" refers to the adjusted gross income computed without regard to any net operating loss carrybacks. The applicable percentage of an individual's contribution base varies depending on the donee organization and the property contributed. The current deduction for cash donations made to organizations described in IRC §170(b)(1)(A) is limited to 50% of AGI; the current deduction for donations of capital gain property to such organizations is limited to 30% of AGI. Total value of all donations may not exceed 50% of AGI, and deductions must be ordered in priority as set forth in §170(b)(1) and §170(d)(1).

In the first example provided in Notice 2007-50, the taxpayer (who isn't a rancher or farmer) contributes both a conservation easement eligible for the temporary 50% annual limitation and the 15-year carryforward as provided in the PPA and a cash charitable donation subject to the 50% annual limitation and the five-year carryforward. The cash donation is applied to the contribution base limit first. The Notice also answers questions relating to increased benefits for farmers and ranchers granting qualified conservation easements (which are beyond the scope of this article) and announces future regulations supporting the changes introduced by the PPA. Given the increase in incentives and the public's interest in conservation, we can expect increased activity by taxpayers and regulators. ■

Diane Riordan is the Journal of Accounting Education Professor at James Madison University, Harrisonburg, Va. You can reach her at riordada@jmu.edu.

Michael Riordan is a professor of accounting at James Madison University, Harrisonburg, Va. You can reach him at riordamp@jmu.edu.

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