

## INTRODUCTION

### **D**o you want to keep your land, and protect it?

You may be entitled to an income tax deduction for *protecting your property from development*. That protection takes the form of a recorded restriction on your property, known as a “conservation easement” or a “conservation restriction.” *When you create a conservation easement* and donate it to a charitable organization, *you still own your land*; the size of the income tax deduction is based on the *value of the development rights you give up*. In addition, since you are reducing the value of your property, the value of your taxable estate drops, your estate tax drops, and your property tax should be lowered.

With a conservation easement, you have restricted your right (and the right of any future owner) to develop the land, but you can continue to live on it or farm it, invite guests over or keep trespassers off, or, subject to the restrictions, sell the property, give the property away, or leave the property to your children.

### **W**hat is a “Conservation Easement”?

Put very simply, a *conservation easement* is a restriction on the use of your property. It is a *recorded deed restriction*, and the *right to enforce the restriction* is given to a tax-exempt charitable organization (generally in the conservation field) or a government agency.

In its most basic form, a conservation easement *will protect* land against future real estate development, industrial use, and many potential commercial uses. A conservation easement generally allows you to *continue current uses*, including, for example, residential and recreational use, agriculture, forestry, or ranching. A conservation easement protects *some important conservation quality* of your land, such as habitat, open space, or scenic views.

### **T**he “Conservation Purposes” Test

It is important to emphasize that not every easement restricting the future development of property will meet the tax law

requirements. The tax law requires that the gift be “for conservation purposes.” As a rule, the following generalization works: the more significant the land is, the more it adds to the public good, the more likely it is that you will qualify for the deduction. If you are protecting a large tract of primarily undeveloped property or ranchland or farmland, or a smaller parcel of land with scenic or open space qualities, if you are protecting habitat for an important or threatened animal or plant species, if you are preserving a scenic view on a long stretch of roadside that is threatened with subdivision, if you are contributing to a greenbelt around a city or preserving a watershed by a scenic brook or river or lake, your donation is more likely to qualify for a deduction. In addition, you can meet the “conservation purposes” test if you protect important historic property.

You will probably *not* qualify for a deduction if there is nothing special or unusual about the land that you are protecting except that it does not currently have more houses on it. Think of it this way. *If you are truly contributing something to the general environmental well-being of the area, then that's a good (and deductible) gift.* If you are truly trying to get away with something (“maybe I can get a deduction for not permitting any more development on my suburban house lot”), and there is nothing particularly unusual about your property or its setting, you are probably not entitled to an income tax deduction. (As a practical matter, in this latter case, it may be difficult to find a donee organization to accept your easement gift.)

## **H**ow the Gift is Valued

For the purposes of the tax rules, the “value” of a property is equal to what it would sell for if it were put to the most valuable economic use that is possible under the circumstances. In many cases (though not all), with land that is generally underdeveloped or only partially developed, the “value” for estate tax purposes is equal to the highest amount someone would pay for it if it were sold for development.

Let's say that Riverview is worth \$2,500,000 to a developer (who would then subdivide the property, build homes on it, and sell homes and/or house lots).

If Riverview were subject to a conservation easement, however,

and *could not be subdivided*, the development potential would be non-existent and the value of the property would be considerably lower (although Riverview would still retain some significant value). For example (and remember, this is just an example), let's say the value of Riverview as a 200-acre "estate" that could never be further developed is \$1,000,000. For the Landowners' property, then, the value before the easement or restriction would be \$2,500,000, and the value after the restriction would be \$1,000,000. [Ed.Note: In practice, particularly where wetlands are involved, the value of a conservation easement is frequently less than the example used here.]

Now, here is the rule. In the case of a gift of a conservation easement, *the value of the gift is equal to the difference between the value of the property before the easement and the value of the property after the easement.*

Stephen J. Small, *Preserving Family Lands: Essential Tax Strategies for the Landowner.* (Rev. 2nd Ed.)

## **I. GENERAL**

A taxpayer is generally not entitled to take a charitable deduction for a contribution (not made in trust) of a partial interest in property. Internal Revenue Code Section 170(f) provides three exceptions: (1) a contribution of a remainder interest in a personal interest in a personal residence or farm; (2) a contribution of an undivided portion of the taxpayer's entire interest in property; and (3) a qualified conservation contribution. This pamphlet deals with exception three, "qualified conservation contributions," more commonly known as conservation easements.

## **II. TAX ADVANTAGES OF GIVING A CONSERVATION EASEMENT**

### **A. General**

The gift of a conservation easement may generate substantial federal and state income, estate, gift and ad valorem (property) tax savings.

### **B. Income Tax Savings**

As detailed below, the gift of a conservation easement can generate a substantial federal and state income tax deduction.

In addition, S.C. Code §49-29-100 (Cum. Supp. 1996) states that "[f]or land-owners donating perpetual easements to the State under the Scenic Rivers Program, a deduction from state income tax may be taken equal to the fair market value of the easement granted."

Although the rules regarding the amount of the federal income tax deduction to which a taxpayer is entitled are complex, generally gifts by an individual to a public charity (i.e. a §501(c)(3) organization that is not a private foundation) are deductible in the amount of the fair market value of the gift up to 50% of the taxpayer's adjusted gross income. This 50% limit applies to the total of all charitable contributions the taxpayer makes during the year. In other words, the deduction for charitable contributions cannot exceed more than 50% of the taxpayer's adjusted gross income for the year (Line 32, Form 1040).

There is one major exception to the above rule: a special 30% of

adjusted gross income limit applies where the taxpayer gives long term capital gain property - which will include many gifts of appreciated land or conservation easements - and computes the deduction using fair market value without reduction for appreciation. (The 30% limitation does not apply where the taxpayer elects to reduce the fair market value of the property by the amount that would have been long-term capital gain if the taxpayer had sold the property. For more information see IRS Publication 526 (Rev. Nov.1996).) "In most cases where property is highly appreciated in value, it is more advantageous for the taxpayer to choose the 30% option. However, a seriously ill person, a person who is expecting a large drop in income, or a person donating property that has appreciated very little might want to make the 50% election." *Conservation Options: A Landowner's Guide* at pg 47.) Accordingly, the 30% limitation will apply as a general rule to most gifts of conservation easements.

Charitable contributions by corporations are deductible up to 10% of the corporation's taxable income. Taxable income for this purpose is computed without regard to the charitable deduction itself, loss carrybacks, and the special corporate deductions contained in Internal Revenue Code Sections 241-47 and 249-50. IRC Section 170(b)(2) states that the 10% limit on corporate contributions applies without regard to whether the contribution is made in cash or appreciated property.

A taxpayer can carry over contributions which are not deductible in the current year because they exceed the adjusted gross income limit. The excess may be carried over and deducted in each of the next five years until it is used up. Any portion not deducted during the five year period cannot be used. An individual taxpayer's total contributions deduction in a carry forward year cannot exceed 50% of his adjusted gross income for that year.

One additional limitation is likely to apply. In 1991, Congress enacted an overall limitation on the deductibility of certain itemized deductions, including charitable contributions. In 1997, the limitation applies if the taxpayer's adjusted gross income (line 32 of Form 1040) is more than \$117,950 (\$58,975 for married-filing-separately.) Where the limitation applies, the itemized deductions are reduced by the smaller of: (1) 3% of the amount by which the taxpayer's adjusted gross income exceeds \$117,950 (\$58,975 for married-filing- separately), or (2) 80% of the itemized deductions which are affected by the limit. See the *Itemized Deductions Worksheet* in the *Instructions for Form 1040*, and use

the worksheet on page A-5 of the Form 1040 instructions to figure out the limitation.

Recent PLR 9537018 discusses the pass-through treatment to the shareholders of SubChapter S Corporations of a charitable deduction made by the Corporation through the granting of a qualifying conservation easement. Similarly, PLR 9318017 discusses the pass-through treatment to partners of the granting of a conservation easement made by a partnership.

### **C. Estate and Gift Taxes**

Internal Revenue Code Sections 2055 and 2522 permit a gift or estate tax charitable deduction for a gift or devise of a perpetual conservation easement, even for one (made after 1986) that does not meet the *specific* qualification for "conservation purpose" set forth in the statute for income tax purposes, but meets the other remaining requirements set forth in Section 170(h). (The rules regarding the deductibility of charitable contributions for gift and estate tax purposes are far less complicated than those for income tax purposes. The rules for income tax purposes are accordingly discussed in great detail in the remainder of this publication.)

By way of background, Section 2501 of the IRC imposes a tax on the transfer of property by gift. Section 2511 of the Code provides that the gift tax applies to all transfers by way of a gift whether the transfer is in trust or otherwise, and whether the gift is direct or indirect. Section 2522(a), however, provides a gift tax charitable deduction for the amount of all gifts made to or for the use of charitable organizations. While Section 2522(c)(2) generally precludes a deduction where a donor transfers an interest in property to a charitable beneficiary and retains an interest in the same property, it contains an exception for certain split interests described in Section 170(f)(3)(B) of the Code. Section 25.2522(c)-3(c)(2)(iv) of the regulations provides that a deduction will be allowed where the charitable interest is a qualified conservation contribution, as defined in Section 1.170A-14 of the Regulations. The deduction is not subject to either percentage limitations or the reduction rules which apply for income tax purposes.

The granting of a conservation easement can substantially reduce the value of property so as to reduce the gift tax consequences of an *inter vivos* transfer of property, for example a gift of a farm or plantation to children.

For estate tax purposes, a deduction is allowed, for the use of qualified charitable organizations, which are almost identical to those qualifying for income tax purposes. See IRC Sections 2055(a)(2) and 170(c)(2) and Regulation §20.2055-1(a). The deduction is unlimited in amount and is not subject either to the percentage limitation or reduction which apply for income tax purposes. Section 2055(d) does provide that the amount of the deduction for any transfer shall not exceed the value of the transferred property required to be included in the gross estate.

## **D. Property Taxes**

### **1. General**

The calculation of real property taxes in South Carolina involves the following three elements: the Assessment Ratio; Millage; and Valuation.

#### **a. Assessment Ratio**

The South Carolina Constitution provides in Article X, Section 1, that the assessment of all property shall be equal and uniform in the following classifications:

**i.** All real and personal property *owned by or leased to manufacturers, utilities and mining operations* shall be taxed on an assessment equal to ten and one-half (10 ½%) percent of the fair market value of such property.

**ii.** All real and personal property owned by or leased to companies primarily engaged in *transportation for hire* of persons or property shall be taxed on an assessment equal to nine and one-half (9½%) percent of the fair market value of such property.

**iii.** The *legal residence* and not more than five acres contiguous thereto shall be taxed on an assessment equal to four (4%) percent of the fair market value of such property.

**iv.** *Agricultural real property* which is actually used for such purposes shall be taxed on an assessment equal to four percent (4%) of its value for such purposes when owned or leased to individuals or partnerships and certain small business corporations. Agricultural real property, owned by all other corporations, is taxed at six (6%) percent. (As stated below, land subject to a conservation easement is classified as agricultural real property.)

**v.** All other real property shall be taxed on an assessment equal to six (6%) percent of the fair market value of such property.

**vi.** *All farm machinery and equipment* shall be

taxed on an assessment equal to five (5%) percent of the fair market value. (Under S.C. Code §12-37-220(B)(14)(Supp.1996) most farm machinery and equipment is exempt from property taxation.)

**vii.** *All other personal property* shall be taxed on an assessment equal to ten and one half (10 ½%) percent of the fair market value of such property.

Section 12-43-232(3)(d) provides that "Unimproved real property subject to a perpetual conservation easement as provided in Chapter 8 of Title 27 must be classified as agricultural real property." This provision may be important because normally property is used for agricultural purposes only when it "is used by the producer to raise, harvest, or store crops, to feed, breed or manage livestock, or to produce plants, trees, fowl or animals useful to man. Real property on which only products grown or raised thereon are prepared for man's use by the owner or lessee of the tract, who disposes of them by marketing or other means, is used for agricultural purposes." DOR Regulation 117-114, *Definition of Agricultural Real Property*.

The Regulation further notes that the following uses of real property do not qualify as agricultural: "Recreation" and "Vacant Land" (land lying dormant).

The valuation is multiplied by this assessment ratio to produce the "assessed value" of a particular piece of property. Taxes are levied based upon this assessed value.

### **b. Millage**

Each taxing jurisdiction determines on an annual basis the number of mills required to apply to the total assessed value of property subject to taxation within its jurisdiction in order to raise the money it needs to operate for the next year.

For example, if a landowner owned a piece of property with a value of \$100 and an assessment ratio of 4% (the ratio for agricultural property), the assessed value of that property equals \$4.00 (\$100 x 4%). If the taxing jurisdiction decided in a particular year to levy a tax of 200 mills, then the property tax liability of the owner would be \$.80 (\$4.00 x .200).

## **2. Valuation**

### **a. General**

Article III §29 of the South Carolina Constitution states that "All

taxes upon property, real and personal, shall be laid upon the actual value of property taxed..." Article X §1 of the S.C. Constitution provides that ad valorem taxation of real property in this state must be based on the classifications stated above, and that "fair market value" is to be used within each classification. More specifically, §12-37-930 provides:

*All property must be valued for taxation at its true value in money which in all cases is the price which the property would bring following reasonable exposure to the market, where both the seller and the buyer are willing, are not acting under compulsion, and are reasonably well informed of the uses and purposes for which it is adapted and for which it is capable of being used...*

Obviously, the granting of a conservation easement may affect a property's fair market value. S.C. Code § 27-8-70 (Cum. Supp. 1996) of the Conservation Easement Act of 1991 recognizes this fact by providing: "For ad valorem tax purposes real property that is burdened by a conservation easement must be assessed and taxed on a basis that reflects the existence of the easement." (In fact, Uniform Standards of Professional Appraisal Practice (1994 ed.) Rule 1-2C specifically requires an appraiser, when developing a real property appraisal to consider easements, restrictions, or other items of a similar nature.)

### **b. Methods for Determining Fair Market Value**

In *South Carolina Tax Commission v. South Carolina Tax Board of Review*, 287 S.C. 415, 339 S.E. 2d 131 (Ct. App. 1985), the Court of Appeals indicated its approval of the three methods customarily used to determine fair market value in property tax matters: "the income or capitalization approach, the replacement value approach, and the market data or comparable sales approach."

### **c. Agricultural Property Valuation**

As stated above, unimproved real property subject to a conservation easement is classified as agricultural real property. Fair market value for agricultural purposes is statutorily defined in S.C. Code § 12-43-220(d)(2)A (Supp. 1996). This Section provides two valuation rules, one for "land used for the growth of timber" and one for "the growth of other agricultural products." "Fair market value" for the latter is defined as "the productive earning power based on soil capability to be determined by capitalization of typical cash rents or the capitalization of typical net annual income of similar soil in the region...." Department of

Revenue regulations provide values depending on the soil capacity of the region in question. See Regulation 117-114, *Definition of Agricultural Real Property* and Regulation 117-126, *Use Value Procedure for Cropland and Timberland*.

### **3. Scenic Rivers Act**

Land subject to a perpetual easement donated to the state of South Carolina pursuant to the South Carolina Scenic Rivers Act is *exempt* from real property taxes. See S.C. Code §§ 12-37-220(36) and 49-29-100.

### **E. Federal Tax Conformity**

The lengthy discussion below deals primarily with the federal law governing both conservation easements as well as the deductibility of qualified donations. South Carolina annually conforms its income tax laws with the federal tax laws. Therefore, any gift to a charity or governmental entity which qualifies for a charitable deduction for federal income tax purposes would also be deductible for South Carolina income tax purposes. See Chapter 6, Article 1 of Title 12 of the S.C. Code.

### **F. Special State Tax Rules Applicable to the Scenic Rivers Act**

In July 1974, Governor John West signed the original South Carolina Scenic Rivers Act into law. The Act authorized the establishment of a state Scenic Rivers Program and specified procedures for the designation, acquisition and use of river segments deemed worthy of protection. The primary vehicle for protecting river corridors under the 1974 law was the acquisition of conservation easements from riparian landowners. On June 1, 1989, Governor Carroll A. Campbell, Jr. signed into law the Scenic Rivers Act of 1989. The new law maintains the voluntary aspects of the previous law, relying primarily on voluntary donations of land and conservation easements, while at the same time creating the Scenic Rivers Trust Fund. The new law also provided more options for landowners participation. See *generally* South Carolina Scenic Rivers Program Administrative Handbook (Water Resources Commission 1991). (The Water Resources Commission is now a Division of the Department of Natural Resources.)

The new Act contains a tax incentive provision found in S.C. Code Ann. §49-29-100 (Supp. 1996). This Section states in part:

*For landowners donating perpetual easements to the State under the Scenic Rivers Program, a deduction from*

*state income tax may be taken equal to the fair market value of the easement granted. The value of a perpetual easement is determined as the difference between the fair market value of the total property before the land is burdened with the easement and the fair market value of the property after the easement is granted. After the grant of a perpetual easement, land subject to a permanent easement is exempt from all property taxes. Donors of land in fee simple may elect to take a deduction from state income tax equal to the value of the fee donated. For both donations in fee simple or easement, the donor may elect to take the deduction during a five-year period following the donation. The total deduction may be taken during any one year of the five-year period or the deduction may be taken in proportionate amounts during the five-year period. The value of the fee or easement must be assessed at the time of the donation.*

### **III. DEFINITION OF A "QUALIFIED CONSERVATION CONTRIBUTION"**

#### **A. Basic Elements of a Deductible Charitable Contribution**

"A charitable contribution for which an income tax deduction is allowable under §170 generally consists of five elements: (1) a transfer of (2) money or property (3) to a permissible donee (4) that is both voluntary and without receipt of economic consideration or benefit and (5) that is in the proper form." 521 TMP, *Charitable Contributions: Income Tax Aspects* at pg. A-2.

A charitable contribution deduction for a gift of a conservation easement has been allowed by the IRS in revenue rulings since 1964 and by the Internal Revenue Code since 1976.

By way of background, Section 170(a)(1) of the IRC permits a deduction for any "charitable contribution," as defined in subsection (c). Section 170(c) of the Code defines a "charitable contribution" as a contribution or gift to or for the use of certain donees. Under Section 170(f)(3)(A), a taxpayer who makes a contribution (not made by a transfer in trust) of an interest in property less than the taxpayer's entire interest in property generally is not allowed a deduction; however, Section 170(f)(3)(B)(iii) provides an exception to this rule for a "qualified conservation contribution."

### **B. "Qualified Conservation Contribution"**

Internal Revenue Code Section 170 generally controls the deductibility of charitable contributions. The Section was amended to specifically provide a charitable deduction for a qualified conservation contribution. Internal Revenue Code Section 170(h)(1) defines a qualified conservation contribution as a contribution of (1) a qualified real property interest; (2) to a qualified organization; (3) exclusively for conservation purposes.

As may be expected, all three of these elements are terms of art which are defined in both the statute and regulations, as discussed below.

## **IV. QUALIFIED REAL PROPERTY INTEREST**

As indicated above, I.R.C. 170(h) defines a qualified conservation contribution, in part, as the contribution of a "qualified real property interest." Section 170(h)(2)(c) of the Code defines "qualified real property interest" to include a restriction granted in perpetuity on the use of real property. A qualified real property interest includes any of the following interests in real property: (1) the entire interest of the donor other than a qualified mineral interest, (2) a remainder interest, and (3) a restriction (granted in perpetuity) on the use which may be made of the real property. Clause (3) covers qualifying conservation easements. Section 1.170A-14(b)(2) of the Regulations defines a "perpetual conservation restriction" as a restriction granted in perpetuity on the use that may be made of real property--including an easement.

### **A. Entire Interest**

Regulation 1.170A-14 provides that a real property interest shall not be treated as an entire interest if the property in which the donor's interest exists was divided prior to the contribution in order to enable the donor to retain control of more than a qualified mineral interest or to reduce the real property interest donated. An entire interest in real property may consist of an undivided interest in the property. Minor interests, such as rights-of-way, that will not interfere with the conservation purposes of the donation, may be transferred prior to the conservation contribution without affecting the treatment of a property interest as a qualified real property interest.

### **B. In Perpetuity**

The Regulation further provides that a perpetual conservation

restriction is a qualified real property interest. A "perpetual conservation restriction" is a restriction granted in perpetuity on the use which may be made of real property--including, an easement or other interest in real property that under state law has attributes similar to an easement (e.g., a restrictive covenant or equitable servitude). See S.C. Code §27-8-30(c)(Supp.1996) of the Conservation Easement Act of 1991 (subject to certain exception, "a conservation easement is unlimited in duration unless the instrument creating it provides otherwise.") For purposes of this Section, the terms "easement," "conservation restriction," and "perpetual conservation restriction" have the same meaning. The definition of "perpetual conservation restriction" is not intended to preclude the deductibility of a donation of affirmative rights to use a land or water area under 1.170A -13(d)(2). Any rights reserved by the donor in the donation of a perpetual conservation restriction must conform to the requirements of this Section. See paragraph (d)(4)(ii), (d)(5)(I), (e)(3), and (g)(4) of this Section.

Regulation 1.170A-14 further provides a deduction shall be allowed for a contribution under this Section only if in the instrument of conveyance the donor prohibits the donee from subsequently transferring the easement (or, in the case of a remainder interest or the reservation of a qualified mineral interest, the property), whether or not for consideration, unless the donee organization, as a condition of the subsequent transfer, requires that the conservation purposes which the contribution was originally intended to advance continue to be carried out. Moreover, subsequent transfers must be restricted to organizations qualifying, at the time of the subsequent transfer, as an eligible donee under this Section. When a later unexpected change in the conditions surrounding the property that is the subject of a donation makes impossible or impractical the continued use of the property for conservation purposes, the requirement of this paragraph will be met if the property is sold or exchanged and any proceeds are used by the donee organization in a manner consistent with the conservation purposes of the original contribution. The "in perpetuity" requirement is also discussed, *supra*, in the subsection dealing with extinguishment.

## V. **Q**UALIFIED ORGANIZATION

As stated above, I.R.C. 170(h) defines in part "qualified conservation contribution" as requiring the contribution to be

made to a “qualified organization.” Internal Revenue Code Section 170 defines a “qualified organization” to mean an organization which “(A) is described in clause (v) or (vi) of subsection (b)(1)(A), or (B) is described in Section 501(c)(3) and (I) meets the requirements of Section 509(a)(2), or (ii) meets the requirements of Section 509(a)(3) and is controlled by an organization described in subparagraph (A) or in clause (I) of this subparagraph.”

The Regulations state (in equally cryptic terms) that for purposes of Section 170, the term “qualified organization” means: (I) A governmental unit described in Section 170(b)(1)(A)(v); (ii) An organization described in Section 170(b)(1)(A)(vi); (iii) A charitable organization described in Section 501(c)(3) that meets the public support test of Section 509(a)(2); or (iv) A charitable organization described in Section 501(c)(3) that meets the requirements of Section 509(a)(3) and is controlled by an organization described in paragraphs (c)(1) (I), (ii), or (iii) of that Section.

As stated above, Section 170(h)(3) provides in general that a “qualified organization” includes an organization described in Section 170(b)(1)(A)(vi). Section 170(b)(1)(A)(vi) of the Internal Revenue Code refers to organizations which meet all of the following characteristics: are organized within the United States; are organized and operated exclusively for charitable purposes; have no part of their net earnings inuring to the benefit of any private shareholder or individual; are not disqualified for tax exemption under Section 501(c)(3) by reason of attempting to influence legislation; do not participate or intervene in (including the publishing or distributing of statements) any political campaign on behalf of (or in opposition to) any candidate for public office; and normally receive a substantial part of their support (exclusive of income received in the exercise or performance by such organization of their charitable or other purposes constituting their basis for exemption under Section 501(a)) from a governmental unit referred to in Section 170(c)(1) or from direct or indirect contributions from the general public. *See also* S.C. Code §27-8-20(2)(Supp.1996) of the South Carolina Conservation Easement Act of 1991.

PLR 9407005 discusses at length the eligibility of conservation organizations to qualify under section 501(c)(3).

Regulation 1.170A-14 provides that to be considered an eligible

donee under this Section, an organization must be a qualified organization, have a "commitment" to protect the conservation purposes of the donation, and have the resources to enforce the restrictions. The necessary "commitment" will be deemed to be present where the conservation group is organized or operated primarily or substantially for one of the conservation purposes specified in Section 170(h)(4)(A). While the regulations also require that the conservation group have the resources to enforce the restrictions contained in the easement, the organization need not set aside funds to enforce the restrictions. See also S.C. Code §§27-8-20(4) & -40 (Supp.1996) dealing with the right of holders and third parties to enforce the terms of conservation easements.

Under Section 1.170A-14(c)(2) of the regulations, the donor must prohibit transfers of the easement by the donee, unless, in the subsequent transfer, that donee requires that the conservation purpose continues to be carried out, and the subsequent transferee qualifies as an eligible donee under Section 1.170A-14(c)(1) of the regulations.

Summarizing the above rules, as a practical matter, a deduction is restricted to the grant of an easement to a governmental body or a publicly supported charity (and not a private foundation.) The donor will generally want some documentary evidence that the organization is a qualified one. The donor may want to check IRS Publication 78, Cumulative List of Organizations, which lists most qualified organizations. This publication, which is annually updated, is available in the reference section of many local libraries.

The donor will also want a copy of the donee's "Letter of Determination." This is the IRS letter to the charity, generally two pages in length, that notifies the charity of its tax exempt status. (Note: the letter is generally a very poor looking photostat.) Other documents of possible interest to donees include IRS Form 1023 (Application form filed by the charity to obtain its tax exempt status) and IRS Form 990 (includes information on the charity's income, expenses, assets, liabilities, and net assets for the past fiscal year.)

The more recent Private Letter Rulings on conservation easements have noted in their discussion of "qualified organization" that the donee is qualified to do business and is in good standing in the state. Consequently, donors may want to obtain certified copies of a domestic donee's "Certificate of Existence NonProfit Corporation"

and, if the donee is incorporated in another state, a “Certificate of Qualification to do Business,” from the Public Charities Division of the S.C. Attorney General’s Office.

IRS Rev. Proc. 82-39 summarizes several general rules of interest to donors. Section 2.01 of this Revenue Procedure provides that Section 170 of the Code, with certain limitations, allows deductions for federal income tax purposes of contributions or gifts made to or for the use of an organization that qualifies as an organization described in Section 170(c). In order for contributions by donors to be deductible, the organization must qualify *at the time of the contribution*. Section 2.03 of the Rev. Proc. provides in general that contributions to organizations listed in Publication No. 78, Cumulative List of Organizations, will be deductible. Section 3.03 of the Rev. Proc. states that where an organization listed or covered by Publication No. 78 ceases to qualify as an organization to which contributions are deductible under Section 170 of the Code and the IRS subsequently revokes a ruling or a determination letter previously issued to it, contributions made to the organization by persons unaware of the change in the status of the organization generally will be considered allowable if made on or before the date of an appropriate public announcement, such as publication in the Internal Revenue Bulletin, stating that contributions are no longer deductible. However, the IRS is not precluded from disallowing a deduction for any contribution made after an organization ceases to qualify under Section 170, where the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for, or was aware of, the activities or deficiencies on the part of the organization that gave rise to the loss of qualification.

## **VI. DEFINITION OF “EXCLUSIVELY FOR CONSERVATION PURPOSES”**

### **A. Conservation Purpose**

As previously indicated, I.R.C. §170(h)(1)(C) requires that the contribution be given exclusively for conservation purposes. Section 170 defines “conservation purpose” to include:

- (i) the preservation of land areas for outdoor recreation by, or the education of, the general public,
- (ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,

- (iii) the preservation of open space (including farmland and forest land) 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, or
- (iv) the preservation of an historically important land area or a certified historic structure.

The two most common forms of conservation easements fall under (1) protection of a relatively natural habitat or (2) preservation of open space. (In many cases the easement will be drafted in an effort to qualify under both provisions.) Accordingly, these two provisions are discussed at length below.

### **1. Recreation or Education**

Regulation 1.170A-14 provides that the donation of a qualified real property interest to preserve land areas for the outdoor recreation of the general public or for the education of the general public will meet the conservation purposes test. Thus, conservation purposes would include, for example, the preservation of a water area for the use of the public for boating or fishing, or a nature or hiking trail for the use of the public. The preservation of land areas for recreation or education will not meet the test of this Section unless the recreation or education is for the substantial and regular use of the general public. Thus, this type of conservation easement is not used frequently.

### **2. Protection of Relatively Natural Habitat**

#### **a. General**

Under Section 170(h)(4)(A)(ii) of the Code, the term “conservation purposes” includes the protection of a relatively natural habitat or ecosystem. As outlined below, section 1.170A-14 (d)(3) of the Regulations describes the protection of a relatively natural habitat or ecosystem.

#### **b. Alteration by Human Activity**

Section 1.170A-14 (d)(3)(I) of the Regulations states that the fact that the habitat or environment has been altered to some extent by human activity will not result in a deduction being denied if the fish, wildlife, or plants continue to exist there in a relatively natural state. For example, the preservation of a lake formed by a man-made dam or a salt pond formed by a man-made dike would meet the conservation purposes test if the lake or pond were a nature feeding area for a wildlife community that included rare, endangered, or

threatened native species. Very recent PLR 9537018 dealt with alteration by human activity. (The facts of this PLR are discussed at length in the Donative Intent Section of this publication.) The taxpayer in that case was engaged in the business of growing and harvesting timber. It proposed granting an easement on certain property which was contiguous to a national forest. The property was home to a variety of animals, including the endangered bald eagle, and two species of special interest to the U.S. Fish & Wildlife Service.

The PLR noted that “most of the timber stands on the range have been logged at some time within the last \*\*\* years. Wildlife flourishes where there has been selective logging because the logging has opened the tree canopy, allowed light to penetrate, and encouraged the growth of brush and grass on the forest floor that is necessary for wildlife. Much of the timber on the property is reproduction timber resulting from logging during the last 10-25 years and is presently about five to ten feet high.”

In addition to the prior alteration, the taxpayer reserved the right to selectively cut timber under certain guidelines. The PLR described these activities as follows:

*Although Taxpayer's activities will alter the habitat in which the wildlife live, that habitat will continue to be a relatively natural one in that it will continue to be timberland, with no addition of artificial manmade areas for the wildlife.*

*The selective timber activities will temporarily destroy wildlife habitat. However, timber levels will be maintained so that the property will contain areas for the wildlife to relocate. Moreover, the easement gives special protection to wetland areas and to bird of prey nesting sites. With the exception of small animals with homes in the trees logged or in old logs that are not specially protected, wildlife will not be permanently displaced by timber activities. Taxpayer is aware of no rare, endangered, or threatened species that would be permanently displaced by Taxpayer's activities.*

The PLR ruled that under these facts the contribution qualified, and stated:

*The property proposed to be subject to the*

*conservation easement provides a relatively natural habitat for numerous species of wildlife, especially, elk, deer, moose, and wild turkey, and to a lesser extent, cougar, coyote, black bear, grouse, badger, lynx, bobcat, wolverine, goose, duck, heron, osprey, hawk, pileated woodpecker, Northern goshawk, and the bald eagle. The property is home to the potentially threatened wolverine and Northern goshawk, and one lake on the property contains the potentially threatened Westslope cutthroat trout. The property is within a management zone of the National Forest designated as essential yearlong game habitat. Although the habitat has been altered by timber activities, the wildlife continues to exist in a relatively natural state. Consequently, we conclude that the contribution is made for the conservation purpose of protecting a relatively natural habitat under Section 170(h)(4)(A)(ii) of the Code.*

### **c. Significant Habitats**

Significant habitats and ecosystems include, but are not limited to:

- (1) habitats for rare, endangered, or threatened species of animal, fish, or plants;
- (2) natural areas that represent high quality examples of a terrestrial community or aquatic community, such as islands that are undeveloped or not intensely developed where the coastal ecosystem is relatively intact; and
- (3) natural areas which are included in, or which contribute to, the ecological viability of a local, state, or national park, nature preserve, wildlife refuge, wilderness area, or other similar conservation area.

### **d. Examples of Significant Habitats**

The IRS has discussed in several recent Private Letter Rulings examples of qualifying natural habitats. In PLR 9218071 the facts were stated as follows:

*The taxpayer owns an approximately 500 acre tract of coastal land. The property contains brackish marshes and fresh-to-brackish water ponds, a mixed hardwood forest, some limited acreage under cultivation, two residences, a veterinary hospital, and extensive coastal wetlands containing a wide variety of plant and animal life, including wood storks. Wood storks are a federally recognized endangered species. See 50 CFR 17.11, 12.*

*The areas surrounding the property have been subject*

*to increasing development, primarily of a resort/residential nature. Adjacent land has recently been developed with condominiums and townhouse complexes. Uncontrolled development of the taxpayer's property could result in noise pollution that would discourage the wood storks from using the brackish marshes and ponds for feeding. A similar effect could occur if dredging operations caused increased erosion and loss of the wetlands that attract the wood storks.*

In PLR 9318017 the IRS stated:

*The Partnership is a limited partnership organized under the laws of the State. For more than three years, the Partnership has owned 535 acres of land in the State that adjoins the State Park. The partnership proposes to grant by deed, a conservation easement over 485 acres of the property to X....*

*Two State officials with jurisdiction over the adjacent State Park have indicated how the proposed transaction will contribute to the ecological viability of the park. These officials describe how the proposed protected areas serve as a habitat for various types of fish, wildlife, and plants, including brook trout, a fish rarely found in the State and the State's only native trout species, and Indian Paintbrush, a plant of "special concern" to the State. In effect, the proposed transaction will enhance the continuation and expansion of the habitat.*

PLR 9420008 states:

*A State Division of Wildlife official states that the proposed transaction will contribute to the ecological viability of the National Forest. The official describes the property as a relatively undisturbed natural habitat. The official states that most of the other privately held neighboring properties have been developed to an extent that has destroyed their significant wildlife value.*

Lastly, PLR 9632003 states:

*Taxpayers have represented that the Property and Ranch provide extensive habitat for raptors, elk, game*

*birds, song birds, waterfowl, small mammals, and a variety of other plant and animal species. Taxpayers represent that Ranch provides significant open space and natural habitat, which provide prey for various birds, some of them endangered. Donee has identified two globally rare plant species on the Property, and taxpayers have represented that Ranch contains two creeks, both of which nurture pristine plant communities, a large variety of trees and many species of shrubby plants, all of which provide excellent habitat, as well as shelter, nesting and roosting areas, and feeding habitat for upland gamebirds and songbirds. In addition, the water impoundments and adjacent wetlands located on Ranch provide nesting, feeding, and shelter for waterfowl. Taxpayers represent that these areas and adjacent meadows and fields provide habitat for small mammals, bobcat, cougar, bear, elk, white-tail and mule deer, and moose.*

**e. Examples of Permissible Easement Terms and Conditions**

As previously stated, Section 170(h)(2)(C) of the Code defines the term “qualified real property interest” to include a “restriction” granted in perpetuity on the use of real property. Both the donor and the donee have a critical interest in making the easement restrictive enough to satisfy the donee’s conservation objectives and the IRS’s requirements for a charitable deduction while at the same time reserving within the donee acceptable remaining use of the property. Indeed, inadequate restrictions might also affect the amount of the deduction, since minimal restrictions might not result in any diminution in the value of the property. See *generally, Conservation Easements: Guide to the Legal Document*, Vermont Land Trust, Technical Bulletin. This Bulletin notes that each Easement should generally contain a section dealing with Restricted Uses of the Property (rights of way and easements, signs, trash, excavation, subdivision, as well as a general clause prohibiting uses inconsistent with the purposes of the conservation easement); as well as Permitted Uses of the Property (agriculture, forest management, farm buildings, water resources, trails, existing homestead, as well as additional housesites.) Quoted below are restrictions--and reservations of rights--found in easements which the IRS found acceptable in several Private Letter Rulings. (Note that only select portions of the Rulings are quoted below.)

In November of 1996, the IRS issued PLR 9632003 which stated in part:

*The proposed deed of easement will be recorded. The purpose of the easement is to assure that the Property will be retained forever predominantly in its natural, scenic, and open space condition for conservation purposes and to prevent any use of the Property that will significantly impair or interfere with the conservation value of the Property, the wildlife habitat on the Property, or its natural resources and associated ecosystems. The deed of easement prohibits mining, surface mining, excavating, dredging, or removing from the Property of soil, loam, gravel, peat, sand, hydrocarbons, rock or other mineral resource or natural deposit. It also prohibits commercial or industrial uses of the Property, construction of any building, structure or facility (except as expressly reserved by taxpayers or approved by Donee), destruction of trees, grasses or other vegetation, installation of underground storage tanks or dumping of trash, and other uses of Property that would impair its conservation values, unless necessary for protection of those values. Taxpayers have reserved in the deed of easement the right to conduct ranching and agricultural activities for domestic or commercial purposes and may, upon notice to Donee, construct only those structures reasonably necessary in connection with those activities. Taxpayers also have reserved the right to repair, remodel, replace, or expand existing buildings, but such activities may not increase the size of the structures to more than 150 percent of--and must use an architectural style consistent with--structures existing on the effective date of the easement. Taxpayers are permitted to construct no more than one additional residence and associated improvements on the Property. One potential area of construction is in a Building Envelope within Area III, which is identified on a map attached to the deed of easement as located at the northern end of the Property. The deed also reserves to taxpayers the right to subdivide the Property and to convey separately Area III and to create new unpaved roads only for residential access to Area III. Donee approval is not required for the residential construction on, or subdivision and conveyance of, Area III, but the deed of easement provides that these activities may not adversely impact*

*important habitat and may not interfere with the essential scenic quality of the Property or with the governmental policies being furthered by the easement. The deed of easement reserves to taxpayers the alternative right to construct a residence and associated improvements outside the Building Envelope and to subdivide the Property, both of which require Donee approval. The deed of easement provides that Donee approval shall be withheld if the use of the site for the proposed activity would interfere with the essential scenic quality of the Property. Other factors to be considered by Donee in granting approval for construction or subdivision include the protection of habitat and water quality, the need for additional road construction, and the extent to which the proposed activity would otherwise impair conservation values of the Property. Taxpayers reserve in the deed of easement the right to construct additional associated improvements within the Ranch Compound and to conduct commercial and educational activities that are not incompatible with the protection of the conservation values of the Property. These activities must occur within structures existing on the Ranch Compound on the date of the donation, and may include maintenance of professional corporate offices, provision of meals and lodging for paying guests, or running of a school or summer camp, but the deed of easement provides that these activities must be compatible with the protection of the conservation values of the Property, have a low level of impact and intrusion on the Property, be environmentally sound, and not be inconsistent with the purpose of the easement. Donee has indicated that its interpretation of the easement is that "any activities within the Ranch Compound, like any other activities on the Ranch, absolutely cannot be harmful to the wildlife on the Ranch, which is extensive and which we are committed to protecting, and cannot impair the scenic view." Taxpayers also are permitted to subdivide and convey no more than two additional lots to an organization that is a qualified donee under Section 170(h) and that agrees to carry out the purpose of the easement, although taxpayers must first offer these lots to Donee.*

In 1994, the IRS, in PLR 9420008, approved the following easement language:

*The chairman of the open space conservation program for County and the State Division of Wildlife official have separately written that the rights retained by the taxpayers (described below) are consistent with the property's natural habitat attributes.*

*Under the terms of the easement, Taxpayers agree to the following restrictions:*

- 1. Except as described below, natural, ecological, wildlife, open space, scenic, and aesthetic features will not be changed, disturbed, altered, or impaired,*
- 2. There will be no construction of any residential dwelling units, or any commercial or industrial structures,*
- 3. There will be no establishment of any residential, commercial, or industrial uses,*
- 4. There will be no construction, placing, or erection of any commercial signs or billboards,*
- 5. There will be no subdivision of the property, except that all or any portion of the property may be sold, exchanged, devised, or granted, if such transfer is effected with an express provision that the property is subject to the terms and conditions of the easement,*
- 6. Except as described below, there will be no use of motorized vehicles,*
- 7. There will be no establishment or maintenance of any commercial feed lot,*
- 8. There will be no commercial harvesting of timber,*
- 9. There will be no storage, dumping, or any other deposit of abandoned vehicles, trash, ashes, garbage, or other unsightly material,*
- 10. There will be no surface, subsurface, or strip mining of loam, peat, coal, geothermal, soil, sand, gravel, rock, oil and gas fuel, or other mineral resources,*
- 11. There will be no activities conducted that are detrimental to water purity,*
- 12. There will be no cattle or large mammal predators brought on the property, and*
- 13. There will be no non-native species of vegetation planted.*

*Under the terms of the easement, the taxpayers retain the following rights:*

- 1. To control access to the property by all persons, except*

- for the right of the donee to inspect the property to ensure compliance with the terms of the easement,*
- 2. To grow and harvest hay, and other such agricultural farm products, and to maintain horses,*
  - 3. To maintain, repair, and replace existing structures, fences, and other improvements,*
  - 4. To conduct limited forestry activities, including tree planting, tree thinning, pest control, and vegetation control for protection against fire or disease or for road maintenance,*
  - 5. To develop and maintain such water resources and facilities as are necessary or convenient for the uses of the property or adjacent property,*
  - 6. To control soil erosion, conserve soil and existing vegetation, and control parasitic plants,*
  - 7. To install and maintain utilities, erect agricultural structures, construct, widen, and maintain roadways that provide access to the adjacent property and are approved by the local jurisdiction, and*
  - 8. To use motorized vehicles, including snowmobiles, for recreational purposes and to exercise the rights described above; however, no motorized vehicles will be used on certain interior roads at certain times corresponding to elk calving periods.*

In PLR 9218071, the easement was described as follows:

*The taxpayer has transferred a restrictive covenant to X in perpetuity that largely restricts future development, but permits the taxpayer and his successors to make residential use of several small tracts that are excluded from the covenant. The taxpayer and his successors have also retained the right to:*

- 1. Hunt and fish to a limited extent,*
- 2. Cut and gather firewood for personal use,*
- 3. Cut timber in accordance with a written forest management plan prepared jointly with X,*
- 4. Maintain and replace the existing structures and roads,*
- 5. Farm the existing farm,*
- 6. Drill water wells, and*
- 7. Possess any minerals found in, on, or under the property, except that no surface mining methods are allowed and no other methods are allowed if they would be destructive of the conservation purposes of the*

easement.

*Under the terms of the covenant, except with respect to the retained rights, the taxpayer and his successors are restricted from:*

- 1. Conducting of commercial or industrial activities,*
- 2. Constructing of any structures,*
- 3. Building of new roads or widening of existing roads,*
- 4. Clearcutting of timber,*
- 5. Artificial regenerating of timber with "genetically improved" seedlings,*
- 6. Timber harvesting equipment operating in any forested wetland area,*
- 7. Removing, destroying, cutting, trimming, mowing, altering, or spraying with biocides of any vegetation, with the exception of reducing a natural threat of infestation,*
- 8. Planting of any non-native species of vegetation,*
- 9. Filling, excavating, dredging, mining, or drilling,*
- 10. Removing of topsoil, sand, gravel, rock, minerals, or other materials,*
- 11. Dumping of ashes, trash, or any other material,*
- 12. Changing the topography in any manner,*
- 13. Constructing of ponds, groins, or dikes,*
- 14. Manipulating, disrupting, or altering of the natural water courses,*
- 15. Conducting of activities detrimental to water purity,*
- 16. Trapping or interfering with the animal population,*
- 17. Off-road operating of any motor vehicles, except to the extent necessary to conduct permitted farming and forestry operations, and*
- 18. Subdividing the property.*

*The effect of the covenant is to perpetually bar the taxpayer and his successors from developing or exploiting the property in any way other than the way it is currently developed or exploited. The property's current state will be preserved.*

Lastly, PLR 9318017 summarized the easement language in the following terms:

*Under the terms of the easement, any use of the property that would be inconsistent with the protection of the habitat will be prohibited. Specifically, the easement will prohibit:*

1. *Cutting or removing any vegetation, except as necessary for protection against fire or disease, for road maintenance, or in connection with the rights reserved by the Partnership as described below,*
2. *Engaging in any agricultural, commercial, or industrial activity,*
3. *Introducing non-native plants or animals,*
4. *Altering the topography, including dumping, excavating, mining, or drilling,*
5. *Constructing any buildings or other structures, except in connection with the rights reserved by the Partnership as described below,*
6. *Constructing new roads or widening existing roads,*
7. *Disrupting any tidal or other waters or conducting any activity detrimental to water purity, and*
8. *Operating motorized vehicles, except in connection with the security and management of the property. Under the terms of the easement, the Partnership reserves the right to create hiking trails, including footbridges and toilet facilities. The Partnership also reserves the right to install and maintain water systems (wells, pumps, tanks, and water lines) and utility lines. The easement provides that the exercise of these reserved rights would require the advance approval of X and may not impact or threaten any rare plant populations on the property.*

#### **f. Limitations on Public Access**

Section 1.170A-14(d)(3)(iii) allows limitations on public access to property held for the conservation purpose of protecting a relatively natural habitat. For example, a restriction on all public access to the habitat of a threatened native animal species would not cause the donation to be nondeductible.

#### **3. Preservation of Open Space**

Regulation 1.170A-14 deals at great length with an easement granted for the purpose of protecting open space. The regulation (and associated Code Section 170(h)(4)(A)(iii)) state the donation of a qualified real property interest to preserve open space (including farmland and forest land) will meet the conservation purposes test of this Section if such preservation is either (A) pursuant to a clearly delineated Federal, state, or local governmental conservation policy and will yield a significant

public benefit, or (B) for the scenic enjoyment of the general public. In both cases the preservation must yield a significant public benefit.

**a. Scenic Enjoyment**

The Regulation provides that a contribution made for the preservation of open space may be for the scenic enjoyment of the general public. Preservation of land may be for the scenic enjoyment of the general public if development of the property would impair the scenic character of the local rural or urban landscape or would interfere with a scenic panorama that can be enjoyed from a park, nature preserve, road, waterbody, trail, or historic structure or land area, and such area or transportation way is open to, or utilized by, the public. "Scenic enjoyment" will be evaluated by considering all pertinent facts and circumstances germane to the contribution. Regional variations in topography, geology, biology, and cultural and economic conditions require flexibility in the application of this test, but do not lessen the burden on the taxpayer to demonstrate the scenic characteristics of a donation under this paragraph. The application of a particular objective factor to help define a view as "scenic" in one setting may in fact be entirely inappropriate in another setting.

Among the factors to be considered are the:

- (1) Compatibility of the land use with other land in the vicinity;
- (2) Degree of contrast and variety provided by the visual scene;
- (3) Openness of the land (which would be a more significant factor in an urban or densely populated setting or in a heavily wooded area);
- (4) Relief from urban closeness;
- (5) Harmonious variety of shapes and textures;
- (6) Degree to which the land use maintains the scale and character of the urban landscape to preserve open space, visual enjoyment, and sunlight for the surrounding area;
- (7) Consistency of the proposed scenic view with a methodical state scenic identification program, such as a state landscape inventory; and
- (8) Consistency of the proposed scenic view with a regional or local landscape inventory made pursuant to a sufficiently rigorous review process, especially if the donation is endorsed by an appropriate state or local governmental agency.

Stephen Small notes that this list of factors "is *not* an all-inclusive list, *not* a checklist, and *not* a weighted list of the only factors the Service considers to be important. Rather, it is the Service's

attempt to *suggest* certain criteria that may or *may not* be relevant to the evaluation of a particular donation.” *Tax Law of Easements* at pg. 7-3 (emphasis in original.)

To satisfy the requirement of scenic enjoyment by the general public, visual access to or across the property by the general public is sufficient. Regs. §1.170A - 14(d)(4)(ii)(B) states that physical access to the property by the public is not required. Further, under the terms of an open space easement on scenic property, the entire property need not be visible to the public for a donation to qualify, although the public benefit from the donation may be insufficient to qualify for a deduction if only a small portion of the property is visible to the public.

## **b. Governmental Conservation Policy**

### **(i) General**

Section 170(h)(4)(A)(iii)(II) of the Code provides that preservation of open space must be done pursuant to a clearly delineated governmental policy. Section 1.170A-14 (d)(4)(iii) of the Regulations states that this requirement is intended to protect the types of property identified by public representatives as worthy of preservation or conservation. A general declaration of conservation goals by a single official or legislative body is not sufficient. However, a governmental conservation policy need not be a certification program that identifies particular lots or small parcels of individually owned property. This requirement will be met by donations that further a specific, identified conservation project, such as the preservation of land within a state or local landmark district that is locally recognized as being significant to that district; the preservation of a wild or scenic river, the preservation of farmland pursuant to a state program for flood prevention and control; or the protection of the scenic, ecological, or historic character of land that is contiguous to, or an integral part of, the surroundings of existing recreation or conservation sites. Section 1.170A-14 (d)(4)(iii)(A) of the Regulations states for example that the donation of a perpetual conservation restriction to a qualified organization pursuant to a formal resolution or certification by a local governmental agency established under state law specifically identifying the subject property as worthy of protection for conservation purposes will meet the requirement of this paragraph. A program need not be funded to satisfy this requirement, but the program must involve a significant commitment by the government with respect to the conservation project. For example, a *governmental program according preferential tax assessment* or preferential zoning for certain

property deemed worthy of protection for conservation purposes would constitute a significant commitment by the government.

Acceptance of an easement by an agency of the Federal Government or by an agency of a state or local government (or by a commission, authority, or similar body duly constituted by the state or local government and acting on behalf of the state or local government) tends to establish the requisite clearly delineated governmental policy, although such acceptance, without more, is not sufficient. The more rigorous the review process by the governmental agency, the more the acceptance of the easement tends to establish the requisite clearly delineated governmental policy. For example, in a state where the legislature has established an Environmental Trust to accept gifts to the state which meet certain conservation purposes and to submit the gifts to a review that requires the approval of the state's highest officials, acceptance of a gift by the Trust tends to establish the requisite clearly delineated governmental policy. However, if the Trust merely accepts such gifts without a review process, the requisite clearly delineated governmental policy is not established.

A limitation on public access to property subject to a donation under this paragraph will not render the deduction nondeductible unless the conservation purpose of the donation would be undermined or frustrated without public access. For example, a donation pursuant to a governmental policy to protect the scenic character of land near a river requires visual access to the same extent as would a donation under this Section.

**(ii) Safe Harbor**

After noting that a broad declaration of conservation goals by a single official or legislative body is not sufficient, and that the donation must further a specific, identified conservation project, the Regulation concludes with a safe harbor. The Regulation accordingly states:

*For example, the donation by a perpetual conservation restriction to a qualified organization pursuant to a formal resolution or certification by a local governmental agency established under state law specifically identifying the subject property as worthy of protection for conservation purposes will meet the requirement of this paragraph.*

“Note that the Regulation says ‘will meet the requirement of this paragraph.’ It does not say ‘tends to establish,’ or ‘ in the absence of evidence to the contrary may be regarded as,’ or any other qualified endorsement.” Small, *Tax Law of Easements* at pgs 8-2 to 8-3.

**(iii) Examples of Governmental Conservation Policy**

As previously stated, the Regulations provide that qualifying open space easements must be established pursuant to “clearly delineated” Federal, State or Local Governmental policy and that a general declaration of conservation goals by a single official or legislative body is not sufficient. Below are quotes from various Private Letter Rulings governmental policy objectives which the IRS deemed qualifying.

Accordingly, recent PLR 9632003 stated:

*The County Comprehensive Plan (County Plan) designates the east slope of M Mountains as a Resource Conservation Area for purposes of protecting scenic views, preservation of traditional livestock-agricultural use of the area, and protection of important wildlife habitat and water sources. A primary goal of the County Plan is to discourage development of prime agricultural lands. Ranch has been identified by State as an important goose breeding area. In addition, according to State, Ranch provides buffer areas and open migration routes for elk, which use two State Elk Feeding Grounds in the vicinity of Ranch.*

\* \* \* \*

*The proposed donation is consistent with County and State policies of land preservation and with the County Plan and County Zoning Resolution. Ranch has been evaluated by the State Game and Fish Department and has been identified as a goose breeding area. Taxpayers have represented that State has indicated that Ranch provides buffer areas and open migration routes for elk. Therefore, the donation is pursuant to a clearly delineated governmental policy.*

PLR 9420008 stated:

*A State Division of Wildlife official states that the*

*proposed transaction will contribute to the ecological viability of the National Forest. The official describes the property as a relatively undisturbed natural habitat. The official states that most of the other privately held neighboring properties have been developed to an extent that has destroyed their significant wildlife value.*

*The governing body of County has passed a resolution in support of the granting of the easement. The resolution provides, in part, that the property's natural, agricultural, ecological, and aesthetic qualities are of great importance to State and County. In addition, substantial benefits would accrue to State and County, if the property were encumbered by the easement. The chairman of the open space conservation program for County and the State Division of Wildlife official have separately written that the rights retained by the taxpayers ... are consistent with the property's natural habitat attributes.*

PLR 8713016 recited:

*The farm is located in an Agricultural Area, created by ordinance, as enacted and ordained by the Township. The Agricultural Area was established under State law, by action of the Township, after receiving reports of the Township Planning Commission and Advisory Committee. The subject State law indicates that it is a desired policy of the State to encourage the development and improvement of its agricultural lands for the production of food and other agricultural products. You contend that the law is designed to protect designated areas from urban pressure from expanding metropolitan areas. 'It is the purpose of this Act to provide a means by which agricultural land may be protected and enhanced as a viable segment of the State's economy, and as an economic and environmental resource of major importance.' In addition, pursuant to the State's Clean and Green Act, the subject property receives preferential assessment privileges.*

*\* \* \* \**

*The State statutes identifying the preservation of farmland as a conservation goal, and Ordinance Number*

*12 of Township setting forth policy declarations favoring the preservation of open space and agricultural property express a delineated governmental policy. The fact that the township ordinance favors the lessening of industrial, commercial and residential development in the immediate Agricultural Area is demonstrative of a significant public benefit and establishes the relationship discussed in Section 1.170A-14(d)(4)(vi) of the regulations.*

PLR 8626075 found:

*The aesthetic qualities of the Lake shorelines have been documented in the DNR Report and by the Regional Planning Commission in its land-use report. Statistics have been provided illustrating that a substantial number of individuals utilize the Lake for recreational purposes, and have the ability to view the subject property from the lake and from the promenade strip. You represent that developmental pressures in the Lake area are increasing and it is your contention that this conservation easement will definitely preserve a unique wooded area and residence on lakeshore property for the benefit of both local residents and users of the lake.*

*Governmental agencies, such as the Department of National Resources, Regional Planning Commission, the Lake Environmental Agency and the local municipalities, have all adopted policies that recognize the importance of preserving open space and natural areas in the Lake Watershed. A program, funded through a federal grant, identified primary environmental corridors. Consistent with these objectives, the Regional Planning Commission has recommended that the Conservancy accept conservation easements to assist in preserving the environmental corridors. You contend that the preceding governmental involvement demonstrates that the proposed conservation easement is consistent with public programs to preserve and protect open space and natural areas within the Lake Watershed.*

Lastly, PLR 8638012 stated:

*You contend that the proposed conservation easement will preserve land for agricultural purposes pursuant to clearly delineated government policies of both the State and the County. Such policies are evidenced in the State Constitution, in a variety of State statutory enactments and in the General Plan of the County.*

*Article XIII, Section 8 of the State Constitution provides that: to promote the conservation, preservation and continued existence of open space lands, the Legislature may define open space land and shall provide that when this land is enforceably restricted, in a manner specified by the Legislature, . . . use or conservation of natural resources, or production of food or fiber, it shall be valued for property tax purposes only on a basis that is consistent with its restrictions and uses.*

*Pursuant to constitutional authority, the State Legislature has adopted Sections 421 to 430 of the State Revenue and Taxation Code. As special property tax statutes they provide for significantly reduced ad valorem taxation of property subject to one of a select, enumerated set of enforceable restrictions. An 'open space easement' qualifies as one of the enforceable restrictions. State statutes define an 'open space easement' as any right or interest in open space land granted for a term of years or in perpetuity to a county, city, or non-profit organization where the deed or other granting instrument imposes restrictions that through the limitation of future use, effectively preserve the natural character of open space land. State statute further declares that the acquisition of open space easement is in the public interest and constitutes a public purpose for which public funds may be expended or advanced.*

*The State Legislature has found and declared (a) 'that the preservation of open space land is necessary not only for the maintenance of the economy of the state, but also for the assurance of the continued availability of land for the production of food and fiber . . . , and (b) that discouraging premature and unnecessary conversion of open space land to urban uses is a matter of public*

*interest and will be of benefit to urban dwellers because it will discourage non-contiguous development patterns that unnecessarily increase the costs of community services to community residents.'*

*You represent that these specific, codified statements of legislative policy provide much more than a mere declaration of general conservation goals by the state legislature. Acting pursuant to state constitutional authority, the elected representatives have established specific, identified conservation goals. The accomplishment of these goals is supported by a comprehensive scheme of property tax abatement. The State Department of Conservation has estimated that by 1981 over 16 million acres of State land were under a restriction qualifying the land for property tax relief resulting in lost property tax revenues exceeding \$340 million annually.*

*The County as a local governmental entity has enacted specific policies contained in the County General Plan which indicate a strong desire by county planners to preserve open space and agricultural land through a variety of techniques. The General Plan provides that 'land owners shall be encouraged voluntarily to restrict the development potential of property through grants of conservation easements, . . . or other appropriate protections in areas designated for open space uses such as agricultural and resource conservation. ' The General Plan, in addressing general land use in the County provides that 'in order to preserve its open space and rural character the County shall encourage the voluntary restriction of development through dedication of scenic or conservation easements. . . .'*

*\* \* \* \**

*The State, in its constitution and in a variety of legislative enactments establishes specific, identified conservation goals, particularly the preservation of farmland. Specific policy declarations by the County in its General Plan manifest a local governmental policy for the preservation of agricultural open space. In addition, to determine whether property is eligible for reduced property taxation pursuant to the grant of an*

*open space easement, as per State Government Code, it must be approved by the county planning department and reported to the County Board of supervisors for acceptance.*

**(iv) South Carolina Law**

As previously stated, under Section 170(h)(4)(A)(iii)(II) of the Internal Revenue Code the term “conservation purposes” includes the preservation of open space, including farmland and forest land, if the preservation is pursuant to a clearly delineated federal, state, or local governmental policy and will yield a significant public benefit. Section 1.170A-14(d)(4)(iii) of the regulations provides that the governmental policy requirement will be met by donations that further a specific, identified conservation project. Section 1.170A-14(d)(vi) provides that the more specific the governmental policy with respect to the particular site to be protected, the more likely the governmental decision by itself will tend to establish the significant public benefit associated with the donation.

Two South Carolina state programs, the Heritage Trust Program and the South Carolina Scenic Rivers Act, have relevance in this respect.

The South Carolina Scenic Rivers Act is found at S.C. Code §§49-29-20 to -210 (Supp. 1996). The Act at Section 49-29-30 contains the following legislative statement of purpose:

*The General Assembly finds that certain selected rivers and river segments of this State possess unique or outstanding scenic, recreational, geologic, botanical, fish, wildlife, historic, or cultural values. It is the policy of the General Assembly to provide for the protection of these selected diminishing values and to preserve the state's natural heritage for the benefit and enjoyment of present and future generations.*

The South Carolina Scenic Rivers Program, administered through the Department of Natural Resources' Water Resources Division, is charged to protect unique and outstanding rivers. Through a community planning approach, the program identifies and prioritizes river management needs and strives to protect resources including plant and animal life, wildlife habitat, water quality, wetlands, scenic views, geologic formations, recreation areas, and cultural or historic treasures.

Recognizing that activities on river-bordering land can have a direct and immediate impact on river resources, the SC Scenic Rivers Program encourages riparian landowners to practice wise land and water use management through voluntary implementation of best management practices (BMPs) and participation in the Scenic Rivers Stewardship Program. The stewardship program offers landowners four land management options including land registration, a memorandum of agreement (MOA), a conservation easement, and donation of land. Land registration and the MOA are non-binding agreements as opposed to the permanent and legally-binding conservation easement.

Currently, there are five state-designated scenic rivers in South Carolina: a 15 mile segment of the Broad in Cherokee and York counties; the lower 14 miles of the Little Pee Dee in Horry and Marion counties; 10 miles of the lower Saluda below Lake Murray dam in Lexington and Richland counties; a 54 mile stretch of the Lynches through Darlington, Florence, Lee and Sumter counties; and five miles of the Middle Saluda in Greenville County. Work is under way to designate an additional 63 miles on the Little Pee Dee and Lumber rivers. Other rivers may be added to the program in the future.

The South Carolina Heritage Trust Program is found at S.C. Code Ann. §§ 51-17-10 to -150 (Supp. 1996). The program, which is run by the Heritage Trust Advisory Board in conjunction with the Department of Natural Resources, was established to inventory, preserve, use and manage unique and outstanding natural or cultural areas and features of South Carolina. Property owners may establish a heritage preserve by transferring fee simple, or granting a conservation or open space easement, to certain qualifying property to the program. Property owners are also required to enter into a Dedication Agreement with DNR which lists any conditions, restrictions, permissive and nonpermissive uses regarding the property. Upon acceptance into the program, the deed or easement along with the Dedication Agreement are filed with the real estate records in the respective county.

In PLR 9052028, the IRS favorably summarized the Heritage Trust Program as follows:

*The State by statute has adopted the Program. The Program's purposes include protecting lands "as habitats and places for maintaining plant and animal species in communities," and "as reservoirs of natural and cultural*

*materials.” The program defines “natural features” as including “natural elements of surviving undisturbed natural ecosystems,” and “cultural features” as including an “outstanding example of our historical or archeological heritage.” The Program, in part, provides for registering sites as worthy of preservation, and requiring and monitoring commitments as to continued preservation. Two separate officials of the Program have indicated in writing their opinions that the Partnership’s land should qualify as a registered site because of its natural and cultural features, and they have indicated their willingness to recommend such a registration.*

While PLRs are addressed solely to the taxpayer who requests it, and may not be cited as precedent, nevertheless the IRS’s comments in PLR 9052028 regarding the Heritage Trust Program are of interest:

*We find that the Program is a clearly delineated state governmental policy under Section 170(h)(4)(A)(iii)(II) of the Code. We find that the donation furthers specific, identified conservation projects of the Program under Section 1.170A-14(d)(4)(iii) of the regulations and that of the furtherance of other significant conservation interests.*

### **c. Significant Public Benefit**

All contributions made for the preservation of open space must yield a significant public benefit. “The public benefit requirement was designed to prevent taxpayers from generating income tax deductions by placing restrictions on their property that do not further any public purpose.” 521 TMP *Charitable Contributions: Income Tax Aspects* at pg. A-42.

Section 1.170A-14 (d)(iv)(A) of the Regulations states that all contributions made by the preservation of open space must yield a significant public benefit, to be evaluated by considering all pertinent facts and circumstances germane to the contribution. Factors germane to the evaluation of public benefit from one contribution may be irrelevant in determining public benefit from another contribution. No single factor will necessarily be determinative. Among the factors to be considered are the:

- (1) Uniqueness of the property to the area;
- (2) Intensity of land development in the vicinity of the property

(both existing development and foreseeable trends of development);

(3) Consistency of the proposed open space use with public programs (whether Federal, state or local) for conservation in the region, including programs for outdoor recreation, irrigation or water supply protection, water quality maintenance or enhancement, flood prevention and control, erosion control, shoreline protection, and protection of land areas included in, or related to, a government approved master plan or land management area;

(4) Consistency of the proposed open space use with existing private conservation programs in the area, as evidenced by other land, protected by easement or fee ownership by organizations referred to in 1.170A -14(c)(1), in close proximity to the property;

(5) Likelihood that development of the property would lead to or contribute to degradation of the scenic, natural, or historic character of the area;

(6) Opportunity for the general public to use the property or to appreciate its scenic values;

(7) Importance of the property in preserving a local or regional landscape or resource that attracts tourism or commerce to the area;

(8) Likelihood that the donee will acquire equally desirable and valuable substitute property or property rights;

(9) Cost to the donee of enforcing the terms of the conservation restriction;

(10) Population density in the area of the property; and

(11) Consistency of the proposed open space use with a legislatively mandated program identifying particular parcels of land for future protection.

The regulation notes that the preservation of an ordinary tract of land would not in and of itself yield a significant public benefit, but the preservation of ordinary land areas in conjunction with other factors that demonstrate significant public benefit or the preservation of a unique land area for public employment would yield a significant public benefit. For example, the preservation of a vacant downtown lot would not by itself yield a significant public benefit, but the preservation of the downtown lot as a public garden would, absent countervailing factors, yield a significant public benefit. The following are other examples of contributions which would, absent countervailing factors, yield a significant public benefit:

- the preservation of farmland pursuant to a state program for flood prevention and control;

- the preservation of a unique natural land formation for the enjoyment of the general public; the preservation of woodland along a public highway pursuant to a government program to preserve the appearance of the area so as to maintain the scenic view from the highway; and
- the preservation of a stretch of undeveloped property located between a public highway and the ocean in order to maintain the scenic ocean view from the highway.

**d. Limitation**

A deduction will not be allowed for the preservation of open space if the terms of the easement permit a degree of intrusion or future development that would interfere with the essential scenic quality of the land or with the governmental conservation policy that is being furthered by the donation. See Reg.1.170A -14(e)(2) for rules relating to inconsistent use.

**e. Relationship of Requirements**

Regulation 1.170A-14 provides that although the requirements of “clearly delineated governmental policy” and “significant public benefit” must be met independently, for purposes of this Section the two requirements may also be related. The more specific the governmental policy with respect to the particular site to be protected, the more likely the governmental decision, by itself, will tend to establish the significant public benefit associated with the donation. For example, while a statute in State X permitting preferential assessment for farmland is, by definition, governmental policy, it is distinguishable from a state statute, accompanied by appropriations, naming the X River as a valuable resource and articulating the legislative policy that the X River and the relatively natural quality of its surrounding be protected. On these facts, an open space easement on farmland in State X would have to demonstrate additional factors to establish “significant public benefit.” The specificity of the legislative mandate to protect the X River, however, would by itself tend to establish the significant public benefit associated with an open space easement on land fronting the X River.

In the very recent Private Letter Ruling 9603018 the IRS summarized the “sliding scale” approach of the Regulations as follows:

*Under either of the above definitions of conservation purpose, preservation of the Property must yield a significant public benefit. Section 1.170A-14 (d)(4)(iv)*

*of the regulations enumerates several factors, some of which are relevant to -- and would be met by -- the donation of the Property. However, section 1.170A-14 (d)(4)(vi) of the regulations also provides that, the more specific the governmental policy with respect to the particular site to be protected, the more likely it is that the governmental decision, by itself, will tend to establish the significant public benefit associated with the donation.*

*As discussed previously, at both the County and Township levels, there have been pronouncements of goals to preserve scenic and undeveloped farmland in County and along Road X. Most importantly, Township has indicated that it “strongly supports” taxpayers’ efforts to protect “an important property” within Township, which will result in “important public benefits.” Therefore, taxpayers have satisfied the requirement that there be a significant public benefit.*

With respect to the relationship between the requirements of “scenic enjoyment” and “significant public benefit,” the regulation states that since the degrees of scenic enjoyment offered by a variety of open space easements are subjective and not as easily delineated as are increasingly specific levels of governmental policy, the significant public benefit of preserving a scenic view must be independently established in all cases.

Donations may satisfy more than one test. In some cases, open space easements may be both for scenic enjoyment and pursuant to a clearly delineated governmental policy. For example, the preservation of a particular scenic view identified as part of a scenic landscape inventory by a rigorous governmental review process will meet the tests of both paragraphs of this Section.

#### **f. Examples of Qualifying Restrictions**

Quoted below are the restrictions contained in several Private Letter Rulings which found the contributions to qualify.<sup>1</sup> (The excerpts quoted below are brief, and readers will naturally want to read the entire private letter rulings.) Also see the subsection,

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<sup>1</sup> Other Private Letter Rulings which dealt with qualifying easements include PLR 8630056; PLR 8638012; PLR 8652013; PLR 8711054; PLR 8713016; PLR 8721017; PLR 8722047; PLR 8810009; and PLR 8810024.

Examples of Permissible Easement Terms and Conditions, *supra*.

Accordingly, in very recent PLR 9603018 the IRS, in ruling that the easement was a qualified conservation contribution, discussed the restrictions and reservation of rights contained in the easement as follows:

*The deed of easement generally prohibits mining (or other similar activities), commercial or industrial uses of the Property, construction of any building or other structure (except as expressly reserved by taxpayers or approved by Donee), destruction of trees or shrubbery, installation of underground storage tanks or dumping of trash, and other uses of the Property that would impair its conservation value.*

*Taxpayers have reserved several rights in the deed of easement, including appropriate use and enjoyment, selective tree removal, and farming. Certain agriculture and forestry activities also are reserved by taxpayers as well as the right to construct sheds, fencing, and track for equestrian activities within specified locations in Area B (which comprises almost one-fourth of the Property). Taxpayers reserve the right to subdivide and sell portions of the Property, although any successor in title to any portion of the Property is subject to the terms of the Easement.*

*Taxpayers reserve the right to construct one additional residence and associated improvements within Area C (which is identified on a map attached to the deed of easement as located near the edge of the Property but which taxpayers have represented is not visible from the road that borders the edge of the Property), additional associated improvements within Area A (which already contains a residence), and no more than five new residences and associated improvements within Limited Building Sites associated with specifically designated Building Envelopes. The residential construction permitted on these parcels does not require Donee approval, but may not interfere with the essential scenic quality of the Property or with the governmental conservation policies being furthered by the Easement.*

*The deed also reserves to taxpayers the right to relocate the Building Envelopes and to construct structures outside the specified areas, both of which actions require Donee approval. The deed provides that Donee approval shall be withheld if the use of the site for the proposed activity would interfere with the essential scenic quality of the Property. Other factors to be considered by Donee in granting approval for construction include the protection of water quality, the need for additional road construction, and the extent to which the proposed activity would otherwise impair conservation values of the Property.*

*The deed provides Donee with the following rights: (a) To prevent anyone from conducting any activity on the Property that is inconsistent with the purpose of the Easement; (b) to enter upon the Property (other than the residential sites) to monitor compliance with the Easement; and (c) to enforce the terms of the Easement by appropriate legal proceedings....*

*\* \* \* \**

*The purpose of the Easement is “to assure that the Property will be retained forever predominantly in its scenic, agricultural, natural, and open space condition.” However, the deed allows portions of the Property to be subdivided and conveyed into separate ownership. Taxpayers have retained the right to construct one new residence and associated improvements within one designated area, additional associated improvements within another designated area, and five new residences and associated improvements in specified Limited Building Sites, which they have retained the personal right to relocate. They also have retained the right to construct additional residences in other areas, subject to Donee approval.*

*Notwithstanding these reserved rights, the deed of easement provides an adequate means by which Donee may enforce--and protect the purposes of--the open space nature of the Easement. Where Donee approval is required, Donee must deny residential construction*

*approval where it would impair the scenic qualities of the Property. Where Donee approval is not required, taxpayers and Donee have agreed in the deed that construction will not interfere with the essential scenic quality of the Property. Donee also can inspect the Property and enforce the Easement by appropriate legal proceedings.*

*Therefore, we conclude that the proposed Easement comes within the spirit of Example (4) of section 1.170A-14(f) of the regulations by providing adequate protection against impairment of the view in the event that new residences are constructed on any of the designated areas.*

In PLR 8626075 the IRS described the restrictions as follows:

*You propose to grant to the Conservancy a perpetual easement granting the right of public view of the property, in its present open, wooded and scenic condition, from the waters of the Lake, from the promenade strip and from County Highway. Under the terms of the easement, no change, disturbance, alteration or impairment of the natural, ecological, scenic, educational and scientific values of the property is permitted without the express written consent of the Conservancy. The property is restricted to use for conservation and single family residence purpose only. No multi-family units, motels, hotels or commercial business shall be constructed on the property, the property cannot be partitioned, subdivided into smaller parcels, nor divided into separate ownership interests through the creation of condominiums or otherwise.*

*However, you reserve the right to divide off and sell a parcel for construction of a single-family residential structure, including accessory facilities and improvements. Such construction is subject, however, to prior written approval of the Conservancy with respect to the location, in order to avoid any adverse impact upon scenic, ecological and water quality value of the property.*

*No commercial or industrial activity shall be allowed*

*or undertaken, and no filling, excavation mining or drilling, or removal of topsoil or other material. No manipulation or alteration of lakeshore shall be permitted, except that a non-commercial boat house or boat launching facility may be constructed for each single-family residential structure. No cutting, destruction or removal of trees and plants shall be permitted unless the trees are dead, seriously diseased or posing a threat to structures or roads. You also reserve the limited right to gather and remove dead wood for personal use.*

Lastly, in PLR 9052028 the restrictions were summarized:

*Partnership, a State general partnership, owns a large tract of undeveloped coastal forest land containing almost pristine timber, salt marshes, brackish marshes, and freshwater ponds. It represents an almost undisturbed natural habitat for a wide variety of wildlife and plants, including at least one variety found nowhere else in State. Similar lands are rapidly disappearing in State because of coastal recreational development. Partnership has transferred to X an easement in perpetuity on the land. Under the terms of the easement no vegetation can be cut or removed, except for cutting of timber in accordance with agreed-upon forestry practices; commercial and industrial activity (with the exception of controlled timbering) is not allowed on the property; dumping, excavating, mining, and drilling are prohibited on the property; disruption of tidal and other waters is prohibited; off-road operation of motorized vehicles, except in connection with permitted forestry operations, is prohibited; construction of all kinds, except for maintenance of insubstantial structures currently existing on the property, is prohibited; sub-division of the property is prohibited; and, clear-cutting of timber on the property is prohibited. The effect of the easement is to perpetually bar Partnership or its successors from developing or exploiting the land in any way other than by approved, perpetual yield forestry activities, and to preserve the natural state of the property. No new structures may be built on it.*

## **B. Exclusively for Conservation Purposes**

### **1. General**

As indicated above, I.R.C. §170(h) requires, in part, that the contribution be given “exclusively for conservation purposes.” The preceding Section dealt with the “conservation purpose” requirement. This Section discusses the “exclusive” requirement.

### **2. Donative Intent**

“Under the law of charitable contributions generally, if a donor makes a contribution to a charity with the expectation of receiving certain benefits back from the charity, the contribution is not deductible. In such a situation, the donor has not made a ‘gift’, but is rather ‘trading’ or ‘bartering’ for something. If the only benefits the donor receives back are ‘incidental’, such as the favorable publicity that might result from a large gift to a college or museum, the donation is still deductible.” Small, *The Federal Tax Law of Conservation Easements* at pg. 12-2.

Two tests for the requisite donative intent have developed over the years. One requires that the transfer must be motivated by “detached and disinterested generosity,” rather than expected economic benefit. Another test examines whether the donor received, or expected to receive, a *quid pro quo* in exchange for the transfer. *See generally* 521 TMP *Charitable Contributions: Income Tax Aspects* at pgs. A-18 to A-21. Several cases have denied charitable contribution deductions to real estate developers for the donation of land to charities where the development was directly and substantially benefitted by the transfer. *See e.g., Ottawa Silica Co. V. U.S., 699 F.2d 1124 (D.C. Cir.1983)*. For example, a charitable contribution deduction was disallowed where a real estate developer transferred parcels of land to school and recreation districts in order to secure approval of the taxpayer's subdivision plans. *Perlmutter v. Comr., 45T.C. 311(1965)*. *See also Woodside Mills v. U.S., 260 F2d 935 (4th Cir. 1958)*(transfer of land by builder not deductible where required to obtain a zoning change).

As stated below in December of 1996 the IRS issued final Regulations dealing with the donative intent issue.

Taxpayers have also been denied charitable contribution deductions where the donation relieves them of a financial burden. For example, in *Wolfe v. Comr., 54 T.C. 1707 (1977)* the taxpayers were denied a charitable contribution deduction for the donation of sewer systems because the sewer system continued to benefit

the donor's property and the transfer relieved them of the burden of maintaining the sewer systems. *See also* PLR 9151031.

*“[A] transfer of property with an expectation of an economic benefit to the taxpayer/transferor, in his trade or business, is not a charitable contribution and would not be made exclusively for conservation purposes. Hence a developer's gift of a scenic easement which enhances the value of the remaining land of the developer, in excess of the diminution of value of the land over which the scenic easement is granted would not generate a charitable deduction.” R. Koenig & K. Goodman, Scenic and Conservation Easements can Yield Tax Benefits at Little Cost to Owner, 15 Estpln 78 (1988).*

The IRS has challenged deductions on the grounds that the donor lacked donative intent. *See Strotler v. Commissioner*, T.C. Memo 1987-275. (The Tax Court rejected the argument under the facts of this case.)

In TAM 9239002, the IRS National Office considered the effect of the absence of donative intent on a taxpayer-developer's ability to deduct the value of a conservation easement. The taxpayer in that ruling purchased a parcel of land zoned for residential and agricultural use. He proposed developing commercial structures and refurbishing existing buildings. His development plans required certain zoning changes which the county accommodated through passage of two ordinances. The second ordinance required that the taxpayer execute a conservation easement as a condition of the zoning change, for which the taxpayer subsequently claimed a charitable contribution deduction.

The TAM first noted that:

*If a taxpayer receives a return benefit from a charity, but the size of the taxpayer's payment to a charity is clearly out of proportion to the benefit received from the charity, the taxpayer may claim a deduction for the difference between the payment to the charity and the market value of the benefit received in return, on the theory that the payment has the “dual character” of a purchase and a contribution. American Bar Endowment at 117, citing Rev. Rul. 67-246, 1967-2 C.B.*

104.

*Rev. Rul. 67-246 established a two-part test for determining when part of a dual character payment is deductible. First the payment is deductible only if, and to the extent it exceeds the market value of the benefit received. Second, the excess payment must be “made with the intention of making a gift.” Rev. Rul. 67-246 further states that, generally, where a transaction involving a payment is in the form of a purchase of an item of value, the presumption arises that gift was not made for charitable contribution purposes, the presumption being that the payment in such case is the purchase price. If a charitable contribution deduction is claimed with respect to the payment, the burden is on the taxpayer to establish that the amount paid is not the purchase price of the privileges or benefits and that part of the payment, in fact, does qualify as a gift.*

The taxpayer then argued in turn that donative intent is not an essential requirement for a charitable contribution deduction when a conservation easement is granted. The taxpayer reasoned that because Section 1.107A-14(h)(3) of the Regulations does not use the specific words “donative intent,” the Regulation supersedes prior case law and donative intent is no longer a requirement. The IRS rejected this reasoning holding that when a payment has the dual character of a purchase and a contribution, the excess payment must be made with the intention of making a gift and that Section 1.170A-14(h)(3)(I) contemplates situations where the benefit received is less than the amount transferred.

The taxpayer also argued that the open space conservation easement given in 1985 was valuable at that time even though 95% of the land had been zoned since 1979 as agricultural open space. The taxpayer further asserted that the conservation easement was more valuable than the zoning ordinances it received. The IRS nevertheless took the position that the 1985 transaction involved quid pro quo giving rise to the presumption that a gift was not made for Section 170 purposes, and the burden is on the taxpayer to rebut that presumption.

In summary, the IRS held that a charitable contribution would be properly allowed in this case if (1) the taxpayer establishes that the value of the open space easement was more valuable than the benefits received from the variance changes (taking into account

that the property was zoned as agricultural open space when the transfer took place in 1985), and (2) the taxpayer establishes that the excess value was purposely contributed.

The IRS issued final Regulations on December 16, 1996 which impact this area. First, the new Regulation, §1.170A-1(h), incorporates the two part test for donative intent adopted by the U.S. Supreme Court in *United States v. American Bar Endowment*, 477 U.S. 105 (1986). Under this Regulation, a deduction is not allowed for a payment to a charity in consideration for goods or services except to the extent the amount of the payment exceeds the fair market value of the goods and services. In addition, a deduction is not allowed unless the taxpayer intends to make a payment in excess of the fair market value of the goods or services.

Second, under new Regulation §1.170A-13 (f), a donor who makes a gift of \$250 or more to a charity must obtain a written substantiation from the donee. This substantiation statement must indicate, in part, whether the donor received any benefits in return, and, if so, a description of the benefits and a good faith estimate of their value.

Lastly, the new Regulations provide that where a charity receives a quid pro quo contribution, it must provide the donor with a statement explaining that only the amount by which the donor's payment exceeds the fair market value of the benefits is deductible.

### **3. Exclusively for Conservation Purposes**

“The final requirement of a qualified conservation contribution is that the contribution must be *exclusively* for one or more of the permitted conservation purposes.” 521 TMP Charitable Contributions: Income Tax Aspects at pg. A-43. Internal Revenue Code 170(h)(1)(C) defines “exclusively for conservation purposes” as imposing two requirements: (1) the conservation purpose must be protected. A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity; and (2) no surface mining permitted.

Regulation 1.170A-14 provides that in order to meet the requirements of this Section, a donation must be exclusively for conservation purposes. Section 1.170A-14(e)(1) of the regulations provides that a deduction will not be denied when incidental benefit inures to the donor merely as a result of conservation restrictions limiting the use of the property. In

addition, under Section 1.170A-14(e)(2) of the regulations, a contribution will not be exclusively for conservation purposes if the contribution accomplishes one such conservation purpose, but permits destruction of other significant conservation interests.

The IRS very recently dealt specifically with the exclusive use requirement in PLR 9537018. The taxpayer in that case was in the business of growing and harvesting timber. It owned property contiguous to a national forest. It proposed giving a conservation easement on a portion of the property. The property contained a variety of animals including the endangered bald eagle and two species of special concern to the U.S. Fish & Wildlife Service, wolverine and Northern goshawk.

Under the deed granting the conservation easement, Taxpayer retained the right to engage in the following activities that the deed stated were consistent with the easement:

1. Use the two residential structures present on the property, and construct and use five additional such structures, with residential structures allowed to a total of \* \* \* square feet and additional outbuildings allowed to a total of \* \* \* square feet,
2. Maintain, repair, and reconstruct the above structures,
3. Construct and improve roads needed for access to the above structures and to logging areas,
4. Graze and pasture horses, cattle, and mules in field areas, and grow and harvest feed crops,
5. Construct new fences and maintain, repair, and reconstruct existing fences,
6. Install, maintain, repair, and reconstruct docks and water, power, and septic or sewer utilities,
7. Use agricultural chemicals in a limited manner,
8. Use biological weed and insect control agents,
9. Construct utility systems,
10. Harvest timber with restrictions discussed below,
11. Hunt, fish, and use the property for other recreational purposes.

The following activities were prohibited under the easement:

1. Any activity, not authorized under the easement, that disturbs, alters, or impairs the significant relatively natural ecological features of the property, or other significant conservation interests,
2. Addition of nonnative plant species,
3. Addition of nonnative animal species and establishment or

- maintenance of a commercial feed lot,
4. Keeping pigs, sheep, goats, birds, bees, or beehives,
  5. Wild game farming,
  6. Exploring for or extracting minerals, hydrocarbons, soil, sand, gravel, or rock,
  7. Division or subdivision,
  8. Construction of structures other than those provided for in the easement,
  9. Construction of roads other than as specifically provided for in the easement,
  10. Use of motorcycles or other motorized recreational vehicles in the wetlands areas,
  11. Manipulation, destruction, diversion, or withdrawal of water from the wetlands and lakes areas,
  12. Dumping refuse,
  13. Animal trapping other than to control predatory animals,
  14. Changing the topography, and
  15. Any commercial activity, except permitted agricultural and timber uses.

The taxpayer reserved, in the easement, a limited right to construct buildings on the property, although he had no current plans to construct buildings. The taxpayer anticipated that, if such structures were to be built, they would be used for short-term residence and business retreat purposes. The easement did not allow Taxpayer to separately sell or lease any of the buildings that might be constructed.

The easement allowed timber harvesting under the following conditions. The taxpayer was required to follow State Act and use Best Management Practices. Best Management Practices were forest stewardship guidelines developed by University of State, State Department of Lands, State Forest Products Commission, as well as other state and federal agencies.

All wetlands, lakes, streams, and bird of prey nesting sites were required to be treated as special protection areas and no logging was allowed within 75 feet of those areas. Clear cuts (cut areas on which regeneration averages less than 10 feet in height) were restricted to five or fewer acres in size, and clear cut areas containing trees ten years old or younger would not exceed two percent of the total timberland. Additionally, there could be no more than one clear cut per 100 acres without the consent of Donee. The easement incorporates a Forest Management Plan, developed by Taxpayer and Donee, that provided guidelines for

Taxpayer's management of the property.

The IRS held under these facts that the “exclusive use” requirement had been satisfied and it stated:

*1. Incidental Benefit.*

*Taxpayer has reserved the right to use a small portion of the property that contains residential structures and the right to construct a limited number of additional residential structures and outbuildings. The buildings present on the property are used for business retreats and by the caretaker of the property. Any buildings to be constructed in the future will be used as short term residences or for business retreats. The buildings cannot be sold or leased separately from the balance of the property. Consequently, we conclude that the reservation of the right to use existing residential structures and to construct additional residential structures does not create more than an incidental benefit and, consequently, does not preclude the deduction.*

*Taxpayer owns acreage surrounding the property. The surrounding property will not be subject to the easement, but will be managed as timberland in a manner consistent with the property that is subject to the conservation easement. The surrounding property will not be developed. Consequently, we conclude that the granting of the easement does not result in more than incidental benefit to Taxpayer's surrounding property.*

*2. Inconsistent Use.*

*Taxpayer's timber harvesting and other potential activities (constructing buildings or roads) will in some cases result in dislocation of wildlife. However, the property will contain enough forested areas so that wildlife dislocation resulting from Taxpayer's activities generally will be temporary. Further, wetland areas and bird of prey nesting sites will be granted special protection from timber activities. Consequently, despite the dislocation of wildlife that such activities entail, we conclude that the activities do not impair significant conservation interests.*

*Since any benefit inuring to Taxpayer from the*

*conservation easement is incidental and since Taxpayer's reserved activities have been limited so as not to impair significant conservation interests, we conclude that the conservation easement is exclusively for conservation purposes.*

#### **4. Destruction of Other Conservation Interests**

Generally, a deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests. For example, the preservation of farmland pursuant to a State program for flood prevention and control would not qualify if under the terms of the contribution a significant naturally occurring ecosystem could be injured or destroyed by the use of pesticides in the operation of the farm. However, this requirement is not intended to prohibit uses of the property, such as selective timber harvesting or selective farming if, under the circumstances, those uses do not impair significant conservation interests. (See PLR 9537018 (selective timber harvesting) quoted at length above.)

A use that is destructive of conservation interests will be permitted only if such use is necessary for the protection of the conservation interests that are the subject of the contribution. For example, a deduction for the donation of an easement to preserve an archaeological site that is listed on the National Register of Historic Places will not be disallowed if site excavation consistent with sound archaeological practices may impair a scenic view of which the land is a part. A donor may continue a pre-existing use of the property that does not conflict with the conservation purposes of the gift.

#### **5. Examples**

The regulation provides several examples relative to the conservation purposes requirement:

*Example 1.* State S contains many large tract forests that are desirable recreation and scenic areas for the general public. The forests' scenic values attract millions of people to the State. However, due to the increasing intensity of land development in State S, the continued existence of forestland parcels greater than 45 acres is threatened. J grants a perpetual easement on a 100-acre parcel of forestland that is part of one of the State's scenic areas to a qualifying organization. The easement imposes restrictions on the use of

the parcel for the purpose of maintaining its scenic values. The restrictions include a requirement that the parcel be maintained forever as open space devoted exclusively to conservation purposes and wildlife protection, and that there be no commercial, industrial, residential, or other development use of such parcel. The law of State S recognizes a limited public right to enter private land, particularly for recreational pursuits, unless such land is posted or the landowner objects. The easement specifically restricts the landowner from posting the parcel, or from objecting, thereby maintaining public access to the parcel according to the custom of the State. J's parcel provides the opportunity for the public to enjoy the use of the property and appreciate its scenic values. Accordingly, J's donation qualifies for a deduction under this Section.

*Example 2.* A qualified conservation organization owns Greenacre in fee as a nature preserve. Greenacre contains a high quality example of a tall grass prairie ecosystem. Farmacre, an operating farm, adjoins Greenacre and is a compatible buffer to the nature preserve. Conversion of Farmacre to a more intense use, such as a housing development, would adversely affect the continued use of Greenacre as a nature preserve because of human traffic generated by the development. The owner of Farmacre donates an easement preventing any future development on Farmacre to the qualified conservation organization for conservation purposes. Normal agricultural uses will be allowed on Farmacre. Accordingly, the donation qualifies for a deduction under this Section.

*Example 3.* H owns Greenacre, a 900-acre parcel of woodland, rolling pasture, and orchards on the crest of a mountain. All of Greenacre is clearly visible from a nearby national park. Because of the strict enforcement of an applicable zoning plan, the highest and best use of Greenacre is as a subdivision of 40-acre tracts. H wishes to donate a scenic easement on Greenacre to a qualifying conservation organization, but H would like to reserve the right to subdivide Greenacre into 90-acre parcels with no more than one single-family home allowable on each parcel. Random building on the property, even as little as one home for each 90 acres, would destroy the scenic character of the view. Accordingly, no deduction would be allowable under this Section.

*Example 4.* Assume the same facts as in example (3), except

that not all of Greenacre is visible from the park and the deed of easement allows for limited cluster development of no more than five nine-acre clusters (with four houses on each cluster) located in areas generally not visible from the national park and subject to site and building plan approval by the donee organization in order to preserve the scenic view from the park. The donor and the donee have already identified sites where limited cluster development would not be visible from the park or would not impair the view. Owners of homes in the clusters will not have any rights with respect to the surrounding Greenacre property that are not also available to the general public. Accordingly, the donation qualifies for a deduction under this Section.

*Example 5.* In order to protect State S's declining open space that is suited for agricultural use from increasing development pressure that has led to a marked decline in such open space, the Legislature of State S passed a statute authorizing the purchase of "agricultural land development rights" on open acreage. Agricultural land development rights allow the State to place agricultural preservation restrictions on land designated as worthy of protection in order to preserve open space and farm resources. Agricultural preservation restrictions prohibit or limit construction or placement of buildings except those used for agricultural purposes or dwellings used for family living by the farmer and his family and employees; removal of mineral substances in any manner that adversely affects the land's agricultural potential; or other uses detrimental to retention of the land for agricultural use. Money has been appropriated for this program and some landowners have in fact sold their "agricultural land development rights" to State S. K owns and operates a small dairy farm in State S located in an area designated by the Legislature as worthy of protection. K desires to preserve his farm for agricultural purposes in perpetuity. Rather than selling the development rights to State S, K grants to a qualified organization an agricultural preservation restriction on his property in the form of a conservation easement. K reserves to himself, his heirs and assigns the right to manage the farm consistent with sound agricultural and management practices. The preservation of K's land is pursuant to a clearly delineated governmental policy of preserving open space available for agricultural use, and will yield a significant public benefit by preserving open space against increasing development pressures.

### **6. Enforceable in Perpetuity**

Under Section 170(h)(5)(A) of the Code, a contribution is not exclusively for conservation purposes unless the purposes are protected in perpetuity. See S.C. Code §27-8-30(c)(Supp.1996) of the Conservation Easement Act of 1991(subject to certain exceptions “a conservation easement is unlimited in duration unless the instrument creating it provides otherwise.”) Any interest in the property retained by the donor (and the donor’s successors in interest) must be subject to legally enforceable restrictions (for example, by recordation in the land records of the jurisdiction in which the property is located) that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation. In the case of a contribution of a remainder interest, the contribution will not qualify if the tenants, whether they are tenants for life or a term of years, can use the property in a manner that diminishes the conservation values which are intended to be protected by the contribution.

### **7. Property Subject to a Mortgage**

In the case of conservation contributions made after February 13, 1986, no deduction will be permitted under Section 170 for an interest in property which is subject to a mortgage unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity. (See PLR 9537018, “Although the property is subject to a lien, Taxpayer will obtain from the lien holder an agreement subordinating the lien holder’s interest in the property to the Donee. The subordination agreement will be recorded immediately before recording the Deed of Conservation Easement.”)

The subordination requirement does *not* prevent a bank or other mortgagee from recovering the entire principal and interest owed. It merely means that the conservation easement remains in full force and effect in the event of a foreclosure and subsequent resale of the property. Suggested subordination language is found in the *Conservation Easement Handbook* which is published by the Land Trust Exchange and the Trust for Public Land.

### **8. Remote Future Event**

A deduction shall not be disallowed merely because the interest which passes to, or is vested in, the donee organization may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that

such act or event will occur is so remote as to be negligible. See paragraph (e) of Reg.1.170A -1. For example, a state's statutory requirement that use restrictions must be rerecorded every 30 years to remain enforceable shall not, by itself, render an easement nonperpetual.

In *Stotler v. Commissioner*, T.C. Memo. 1987-275, the IRS argued that a conservation easement did not satisfy the Internal Revenue Code requirement that an easement be granted in perpetuity in order to qualify as a charitable deduction. The IRS said that the easement was not granted in perpetuity because the property owners had a statutory right to petition the easement holder to abandon it, and there was a possibility that the property would be condemned and the easement would terminate.

Because the requirements for abandonment were so extensive, the court rejected the IRS's argument, reasoning that the possibility the easement would be abandoned was so remote as to be negligible. The court also rejected the IRS argument that the easement violated the perpetuity requirement because language in the deed provided that the easement would terminate in the event the property were condemned for public use. The court reasoned that even though there was a possibility that part of the land would be condemned for the construction of a dam, the possibility was remote and even if implemented would affect only a tiny fraction of the burdened land.

### **9. Protection of Conservation Purpose where the Donor Retains Rights**

In the case of a donation made after February 13, 1986, of any qualified real property interest when the donor reserves rights the exercise of which may impair the conservation interests associated with the property, for a deduction to be allowable under this Section the donor must make 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. Such documentation is designed to protect the conservation interests associated with the property, which although protected in perpetuity by the easement, could be adversely affected by the exercise of the reserved rights. (See e.g. PLR 9632003, "Taxpayers have represented that the conservation values of the Property are documented in a report to be kept on file at the offices of Donee, which the parties have agreed provides an accurate representation of the Property as of the effective date of the donation and which is intended to serve as an objective information baseline for

purposes of monitoring compliance with the terms of the easement.”) Such documentation may include:

- (A) The appropriate survey maps from the United States Geological Survey, showing the property line and other contiguous or nearby protected areas;
- (B) A map of the area drawn to scale showing all existing man-made improvements or incursions (such as roads, buildings, fences, or gravel pits), vegetation and identification of flora and fauna (including, for example, rare species locations, animal breeding and roosting areas, and migration routes), land use history (including present uses and recent past disturbances), and distinct natural features (such as large trees and aquatic areas);
- (C) An aerial photograph of the property at an appropriate scale taken as close as possible to the date the donation is made; and
- (D) On-site photographs taken at appropriate locations on the property. If the terms of the donation contain restrictions with regard to a particular natural resource to be protected, such as water quality or air quality, the condition of the resource at or near the time of the gift must be established.

The documentation, including the maps and photographs, must be accompanied by a statement signed by the donor and a representative of the donee clearly referencing the documentation and in substance saying, “This natural resources inventory is an accurate representation of [the protected property] at the time of the transfer.”

### **10. Changed Conditions**

“Although a conservation purpose must be protected in perpetuity, the regulations recognize that changed conditions may frustrate the conservation purpose of a particular gift.” 521 TMP *Charitable Contributions: Income Tax Aspects* at pg. A-44.

If a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation under this paragraph can make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee's proceeds (determined below) from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original

contribution.

In case of a donation made after February 13, 1986, for a deduction to be allowed under this Section, at the time of the gift the donor must agree that the donation of the perpetual conservation restriction 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 restriction at the time of the gift bears to the value of the property as a whole at that time. See Regulation 1.170A-14(h)(3)(iii) relating to the allocation of basis. For purposes of this paragraph (g)(6)(ii), that proportionate value of the donee's property rights shall remain constant. Accordingly, when a change in conditions gives rise to the extinguishment of a perpetual conservation restriction under paragraph (g)(6)(I) of this Section, the donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction, unless state law provides that the donor is entitled to the full proceeds from the conversion without regard to the terms of the prior perpetual conservation restriction.

## VII. VALUATION

### A. General

A taxpayer is generally entitled to a charitable deduction in an amount equal to the fair market value of the contribution at the time of the contribution. Fair market value is defined in Regulation 1.170A-1(c)(2) as “the price at which the property would change hands between a willing buyer and willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.” Similarly, *The Appraisal of Real Estate* (8thEd.) at pg. 33 provides a current definition of market value as:

*The most probable price in cash [or]...[equivalent] to cash, for which the appraised property will sell in a competitive market under all conditions requisite to fair sale, with the buyer and seller each acting prudently, knowledgeably, and for self-interest, and assuming that neither is under undue duress.*

In 1973, the IRS noted in Revenue Ruling 73-339 that “open space

easements in perpetuity may be valued separately and distinctly. However, more often than not open space easements in perpetuity are granted by deed of gift so there is usually no substantial record of market place sales to use as a meaningful or valid comparison. *As a consequence, the valuation of an open space easement in perpetuity is generally made on the basis of the 'before and after' approach.* Thus, the difference between the fair market value of total property before the granting of the easement and the fair market value of the property after the grant is the fair market value of the easement given up.” (Emphasis added.) The IRS has issued two Revenue Rulings which indicate that the “before and after” method is the correct method for appraising conservation easements. See Rev.Ruls. 77-339 and 76-376.

In 1988 the IRS promulgated Regulation 1.170A-14 which, as stated below, provides that comparable sales should be examined first. “Only if no such record of sales exists, according to the Regulation, should the before-and-after test be used. The substantive rule, in the overwhelming majority of cases, will continue to be the before-and-after rule because very few areas of the country will have a significant number of sales of easements or of encumbered properties to make any valid comparisons.” Small, *The Federal Tax Law of Conservation Easements* at pg.254 (1986).

The before-and-after test essentially boils down to what is the difference, if any, in the value of the property (valued at its highest and best use) with and without the easement. The Senate Finance Committee Report to the 1980 amendments to Section 170(f)(3) noted that this test should not be “applied mechanically.” The Report stated:

*The amount of the deduction for the contribution of a conservation easement or other restriction is the fair market value of the interest conveyed to the recipient. However, because markets generally are not well established for easements or similar restrictions, the willing buyer/willing seller test may be difficult to apply...As a consequence, conservation easements are typically (but not necessarily) valued indirectly as the difference between the fair market value of the property involved before and after the grant of the easement. [Citations omitted] Where the test is used, however, the committee believes it should not be applied mechanically.*

*For example, where before and after valuation is used, the fair market value of the property before contribution of the easement should take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would be developed. Where applicable, valuation of the property before contribution should take into account zoning, conservation, or historic preservation laws that would restrict development of the property. Valuation of the transfer should take into account the impact of the transfer on other property, as in the case where restrictions on one parcel of property serve to increase the value of adjacent property...The committee also intends that, as the use of conservation easements increases, valuation would increasingly take into account the selling price value, in arm's-length transactions, of other properties burdened with comparable restrictions.*

IRS Publication 561, Determining the Value of Donated Property, contains an excellent summary of the valuation rules regarding conservation easements. This Publication states in part:

*In determining the value of [easement] restrictions, you should take into account the selling price in arm's length transactions of other properties that have comparable restrictions. If there are no qualified sales, the restrictions are valued indirectly as the difference between the FMVs of the property involved before and after the grant of the restriction.*

*The FMV of the property before contribution of the restriction should take into account not only current use but the likelihood that the property, without the restriction, would be developed. You should also consider any zoning, conservation, or historical preservation laws that would restrict development. Granting an easement may increase, rather than reduce, the value of property, and in such a situation no deduction would be allowed.*

*Example. You own 10 acres of farmland. Similar land in the area has an FMV of \$2,000 an acre. However, the land in the general area that is restricted solely to farm use has an FMV of \$1,500 an acre. Your county wants to preserve open space and prevent further development in*

your area.

You grant to the county an enforceable open space easement in perpetuity on 8 of the 10 acres, restricting its use to farmland. The value of this easement is \$4,000, determined as follows:

FMV of the property before granting easement:  
\$2,000 X 10 acres . . . . . \$20,000  
FMV of the property after granting easement:  
\$1,500 X 8 acre . \$12,000  
\$2,000 X 2 acres 4,000  
. . . . . \$16,000  
Value of easement . . . . . \$4,000

If you later transfer in fee your remaining interest in the 8 acres to another qualified organization, the FMV of your remaining interest is the FMV of the 8 acres reduced by the FMV of the easement granted to the first organization.

The Vermont Land Trust has provided an excellent summary of these rules as follows:

*Determining the value of a conservation easement is a two-three-step process.*

*The first step is to establish the fair market value of the property before it is restricted.*

*The second step is to determine the fair market value after the property is restricted. This step requires that the landowner and the Land Trust have agreed upon the terms of the conservation easement, so that the appraiser knows what rights the landowner is retaining and giving up. The difference between the “before” and “after” appraisals is considered to be the value of the conservation easement.*

*The third step applies only if the landowner or a member of the landowner’s family owns land in the vicinity of the conserved property which is not covered by the conservation easement. In this case, the appraiser must consider whether the value of the unrestricted property is being enhanced by the easement. If so, the easement value must be reduced by the amount of the enhancement. Tax*

*Benefits of Donating Conservation Easements, Vermont  
Land Trust Technical Bulletin.*

**B. Regulation 1.170A-14**

On January 14, 1986 the IRS published final regulations on gifts of conservation easements. The regulations were codified at Regulation 1.170A-14. This Regulation provides that the value of the contribution under Section 170 in the case of a charitable contribution of a perpetual conservation restriction is the fair market value of the perpetual conservation restriction at the time of the contribution. See 1.170A-7(c). If there is a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a governmental program), the fair market value of the donated easement is based on the sales prices of such comparable easements. If no substantial record of market-place sales is available to use as a meaningful or valid comparison, as a general rule (but not necessarily in all cases) the fair market value of a perpetual conservation restriction is equal to the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property after the granting of the restriction.

The amount of the deduction in the case of a charitable contribution of a perpetual conservation restriction covering a portion of the contiguous property owned by a donor and the donor's family (as defined in Section 267(c)(4)) is the difference between the fair market value of the entire contiguous parcel of property before and after the granting of the restriction.

If the granting of a perpetual conservation restriction after January 14, 1986, has the effect of increasing the value of any other property owned by the donor or a related person, the amount of the deduction for the conservation contribution shall be reduced by the amount of the increase in the value of the other property, whether or not such property is contiguous. Section 1.170A-14(h)(3)(I) of the Regulations state that if, as a result of the donation of a perpetual conservation restriction, the donor or a related person receives, or can reasonably expect to receive, financial or economic benefits that are greater than those that will inure to the general public from the transfer, no deduction is allowable under this Section. However, if the donor or a related person receives, or can reasonably expect to receive, a financial or economic benefit that is substantial, but it is clearly shown that the benefit is less than the amount of the transfer, then a deduction under this Section is allowable for the excess of the amount transferred over the amount of the financial

or economic benefit received or reasonably expected to be received by the donor or the related person.

The IRS summarized these rules recently in PLR 9218071. This ruling stated:

*Section 1.170A-1(c)(1) of the regulations provides that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution. Section 1.170A-14(h)(3)(I) of the regulations provides that the fair market value of perpetual conservation restrictions is based on the sales of comparable restrictions. If there is no substantial record of comparable sales, generally, the fair market value is equal to the loss of value of the burdened land. If the granting of the restriction increases the value of any other property of the donor or a related person, the amount of the deduction for the conservation contribution is reduced by the amount of the increase in the value of the other property, whether or not such property is contiguous. Finally, Section 1.170A-14(h)(3)(ii) of the regulations provides that no deduction is allowable if the granting of the restriction has no effect or a positive effect on the value of the property.*

### **C. Fair Market Value Before and after Restriction**

Regulation 1.170A-14 states that where before and after valuation is used, the fair market value of the property before contribution of the conservation restriction must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property's potential highest and best use. Wetlands provide a unique example in this regard. "In th[e] case [of wetlands], government laws and regulations take the lion's share of value from the private property owner to protect the public interest. Therefore, when appraisers are estimating the value of a private property owner's interest in a wetland, they are estimating the value of a slice of the overall value pie. Appraisers should recognize this division of property right values." *Valuation of Wetlands* (Appraisal Institute at pg. 24.) Similarly in the article *Assessing Land Under Conservation Restrictions*, Assessment Journal (Vol. 1, No.4 July/August 1994 at pg. 22) the author states:

“The most important consideration when analyzing CRPs [conservation restrictions in perpetuity] from the highest and best use perspective is what is *legally* permissible? In many cases, land under a conservation restriction will have a very limited list of permissible, or legal uses.” (Emphasis in original.)

Further, there may be instances where the grant of a conservation restriction may have no material effect on the value of the property or may in fact serve to enhance, rather than reduce, the value of property. In such instances no deduction would be allowable.

In the case of a conservation restriction that allows for any development, however limited, on the property to be protected, the fair market value of the property after contribution of the restriction must take into account the effect of the development. In the case of a preservation easement such as an easement on a certified historic structure, the fair market value of the property after contribution of the restriction must take into account the amount of access permitted by the terms of the easement. Additionally, if before and after valuation is used, an appraisal of the property after contribution of the restriction must take into account the effect of restrictions that will result in a reduction of the potential fair market value represented by highest and best use but will, nevertheless, permit uses of the property that will increase its fair market value above that represented by the property's current use. The value of a perpetual conservation restriction shall not be reduced by reason of the existence of restrictions on transfer designed solely to ensure that the conservation restriction will be dedicated to conservation purposes. See 1.170A -14 (c)(3).

#### **D. Case Law**

Valuation is often the most disputed question in the gift of a conservation easement. The IRS and the Courts generally agree with the willing buyer/willing seller test, and that in the case of a conservation easement, the fair market value for charitable contribution purposes is the difference between the fair market value of the property at its highest and best use (1) immediately prior to the imposition of the easement and (2) immediately subsequent to the easement grant.

In *Clemens v. Commissioner*, T.C. Memo 1992-436, the Tax Court had to determine whether the taxpayer's or the government's analysis of value was more appropriate for purposes of a conservation easement contribution. Although all parties agreed on the before and after analysis, they disagreed over the likelihood

of future development. The taxpayer's expert prepared a report assuming that there would be forty lots derived from the property, and then used an anticipated use valuation technique to treat the parcel as a forty-lot single-family subdivision with a value of \$2.66 million. After subtracting the "after" value of \$1.75 million, the taxpayer's expert concluded that the donated property was worth \$910,000. The IRS's expert also used the before and after approach, but found it unlikely that forty lots would ever be approved for development. The IRS argued that the appropriate value was not \$910,000, but only \$110,000. Based on alternative assumptions, the Service concluded that the maximum deduction in this situation was \$350,000.

Nevertheless, the court in *Clemens* came down on the side of the taxpayer, concluding, based largely on the taxpayer's expert's report, that the value of the conservation easement was \$703,000.

In *Schapiro v. Commissioner*, T.C. Memo, 1991-128, the Tax Court considered the grant of two conservation easements to a charitable organization. As is often the case, there was no question that these easements satisfied the criteria for a charitable contribution deduction; the only question was their appropriate valuation.

Both the taxpayers' expert and the government's expert in *Schapiro* concluded that it was proper to value the property by comparing the fair market value of the property encumbered by the easement before the granting of the restriction, and its fair market value afterwards.

The taxpayers' expert used a modified development analysis to determine the value of the land before the granting of the easement. Within this analysis, he used a market data approach to value the hypothetical subdivided tracts. At issue was the question of the cost of any potential development which generally requires substantial expenditures. The taxpayers' expert concluded that the taxpayers were sophisticated enough to subdivide the property without the need of a commercial developer and that the development costs could accordingly be fairly nominal. In addition, the taxpayers' expert took the position that sales commissions should not be taken into account because they are inappropriate in the context of the market data approach.

The Tax Court adopted the taxpayers' expert's approach and held that not only was it appropriate to consider the development potential of the property, but also that it was proper to assume that

the taxpayers would not need to pay for certain development costs (including the developer's profit and overhead as well as sales commissions) in order to reap the benefits that development could be expected to produce.

The IRS issued an AOD on *Schapiro* indicating that while it feels the Tax Court erred, it did not take an appeal because of the lack of a satisfactory record. The AOD indicates that the court's failure to take into account items such as developer's profit and overhead and sales commissions resulted in an overstatement of the value of the properties prior to the grant of the two easements.

In *Thayer v. Commissioner*, 36 T.C.M. 1504 (1977) the United States Tax Court used the before-and-after approach to determine the value of a conservation easement granted to the Virginia Outdoors Foundation, a private charitable organization. The taxpayer and IRS disagreed over the value of a conservation easement that the taxpayer had granted prohibiting further development on Overlook Farm, a sixty-acre parcel on the Potomac River in Fairfax County, Virginia. The major disagreement between the parties' appraisal experts was over what the highest and best use of the farm was before the easement was granted. The taxpayer's expert argued that the property's highest and best use before the easement was subdividing it into five to eight luxury homesites and that the highest and best use after the easement was as a country estate. The IRS expert contended that the topography of the land and unavailability of water and sewage facilities made the property unsuitable for development, and thus the highest and best use both before and after the easement was as a country estate. The court, considering local opposition to development and existing zoning restrictions, found that subdivision into two to four luxury homesites was the highest and best use of the property in the absence of the easement. Using the before-and-after approach, the court deducted the fair market value of the easement. The taxpayer was entitled to a deduction in that amount.

In several cases the Tax Court has approved reductions in value of between 25 percent and 33 percent, although the Tax Court has also approved reductions of 75 percent *Stanley Works and Subsidiaries v. Commissioner*, 87 T.C. 389 (1986) and 90 percent, *Stotler v. Commissioner*, 53 T.C.M. 973 (1981).

The September/October 1995 issue of *The Back Forty*, at page 6 contains the following excellent summary of the valuation case law:

*Although each easement valuation case is decided on its own merits, and each is fact-specific, a few general propositions are repeated in numerous cases and can be considered established case law:*

- *Because open-space easements are most frequently created by deed of gift, there is rarely an established market from which to derive fair market value and, as a result, a “before and after” analysis is appropriate. This analysis entails comparison of the fair market value of the property before the easement is granted with the value of the property after the easement is granted.*
- *The fair market value of the property prior to the contribution is determined by the “highest and best use” to which such property could be put on the date of valuation. Value is not affected by whether the actual owner has put the property to its highest and best use. Realistic, objective potential uses control valuation. Emphasis is placed on the highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future.*
- *The valuation of the property is a question of fact determined on the basis of the entire record.*
- *The taxpayer bears the burden of proof with respect to valuation.*
- *In determining value from expert testimony, the court is not restricted to choosing one valuation over another, but may extract relevant findings from each in drawing conclusions.*
- *In examining expert testimony, the court is not bound by the opinion of expert witnesses when, after weighing all the evidence in light of their demonstrated qualifications, the experts’ opinions are contrary to the court’s own judgement. Because the court may find one expert more persuasive on one element of valuation and another more persuasive on another element, the court may embrace or reject expert testimony, whenever in its best judgement it is appropriate to do so.*

### **E. Appraisal Guidelines**

“The ...Treasury Regulations provide the Internal Revenue Service's interpretation of some of the major issues to be addressed in the course of appraising conservation easements. However, the Congress, the Internal Revenue Service and the courts have never

dealt comprehensively with the process of easement appraisals. Similarly, none of the professional appraisal societies has published procedures that deal comprehensively with the appraisal of conservation easements.” *Appraising Easements* (Land Trust Alliance) at pg.9. This publication, *Appraising Easements*, is the most comprehensive discussion of appraising conservation easements. Interested persons may also want to consult *The Valuation of Wetlands* published in 1996 by the Appraisal Institute.

Also of interest are the guidelines used by the 16 federal agencies which exercise eminent domain powers. These guidelines are contained in *Uniform Appraisal Standards for Federal Land Acquisitions*. This document states at pages 56-57:

*In making an appraisal for an easement acquisition, it is imperative that the appraiser have a clear understanding of the specific terms of the easement involved, as the burden on the land upon which the easement is imposed (the servient estate) and the concomitant impact on the value of the affected land will vary according to the character of the easement. (There is no such thing, for example, as a ...generic scenic easement.) Also, full consideration should be given to and due allowance made for the rights remaining in the owner.*

*Every easement acquisition is a partial acquisition leaving a remainder estate in the owner. This is true even where the entire ownership is impressed with the easement: because an easement is less than the fee, there is a remainder estate in the land within the easement. If the easement is impressed upon less than the full area of the entire ownership, the portion of the ownership outside the easement is also a remainder. Federal courts have long held that the appropriate measure of compensation in a partial taking case is the difference between the value of the whole parcel before the taking and the value of the remainder after the taking. The courts accordingly have held this to be the proper measure of compensation in easement takings. Valuing only the strip subject to the easement violates the rule that "comparing the fair market value of the entire tract affected by the taking before and after the taking ... states the correct measure of value in federal court condemnation."*

IRS Publication 561, *Determining the Value of Donated Property*, contains the general requirements for qualified appraisals. This publication is quoted at length below.

#### **F. Allocation of Basis**

Regulation 1.170A-14 provides that in the case of the donation of a qualified real property interest for conservation purposes, the basis of the property retained by the donor must be adjusted by the elimination of that part of the total basis of the property that is properly allocable to the qualified real property interest granted. The amount of the basis that is allocable to the qualified real property interest shall bear the same ratio to the total basis of the property as the fair market value of the qualified real property interest bears to the fair market value of the property before the granting of the qualified real property interest. When a taxpayer donates to a qualifying conservation organization an easement on a structure with respect to which deductions are taken for depreciation, the reduction in the basis of the property retained by the taxpayer must be allocated between the structure and the underlying land.

#### **G. Examples**

Regulation 1.170A-14 provides a number of examples. In the examples illustrating the value or deductibility of donations, the applicable restrictions and limitations of Regulation 1.170A -4, with respect to reduction in amount of charitable contributions of certain appreciated property, and 1.170A -8, with respect to limitations on charitable deductions by individuals, must also be taken into account. The relevant examples are quoted below.

*Example 2. In 1984 B, who is 62, donates a remainder interest in Greenacre to a qualifying organization for conservation purposes. Greenacre is a tract of 200 acres of undeveloped woodland that is valued at \$ 200,000 at its highest and best use. Under 1.170A -12(b), the value of a remainder interest in real property following one life is determined under 25.2512-5 of the Gift Tax Regulations. (See 25.2512-9 with respect to the valuation of annuities, life estates, terms for years, remainders, and reversions transferred after December 31, 1970 and before December 1, 1983. With respect to the valuation of annuities, life estates, terms for years, remainders, and reversions transferred before January 1, 1971, see T.D. 6334, 23 FR 8904, November 15, 1958, as amended by T.D. 7077, 35 FR*

18464, December 4, 1970). Accordingly, the value of the remainder interest, and thus the amount eligible for an income tax deduction under Section 170(f), is \$55,996 (\$200,000.27998).

*Example 3.* Assume the same facts as in example (2), except that Greenacre is B's 200-acre estate with a home built during the colonial period. Some of the acreage around the home is cleared; the balance of Greenacre, except for access roads, is wooded and undeveloped. See Section 170(f)(3)(B)(I). However, B would like Greenacre to be maintained in its current state after his death, so he donates a remainder interest in Greenacre to a qualifying organization for conservation purposes pursuant to Section 170 (f)(3)(B)(iii) and (h)(2)(B). At the time of the gift the land has a value of \$200,000 and the house has a value of \$ 100,000. The value of the remainder interest, and thus the amount eligible for an income tax deduction under Section 170(f), is computed pursuant to 1.170A -12. See 1.170A -12(b)(3).

*Example 4.* Assume the same facts as in example (2), except that at age 62 instead of donating a remainder interest B donates an easement in Greenacre to a qualifying organization for conservation purposes. The fair market value of Greenacre after the donation is reduced to \$110,000. Accordingly, the value of the easement, and thus the amount eligible for a deduction under Section 170(f), is \$90,000 (\$200,000 less \$110,000).

*Example 5.* Assume the same facts as in example (4), and assume that three years later, at age 65, B decides to donate a remainder interest in Greenacre to a qualifying organization for conservation purposes. Increasing real estate values in the area have raised the fair market value of Greenacre (subject to the easement) to \$130,000. Accordingly, the value of the remainder interest, and thus the amount eligible for a deduction under Section 170(f), is \$41,639 (\$130,000 x .32030).

*Example 6.* Assume the same facts as in example (2), except that at the time of the donation of a remainder interest in Greenacre, B also donates an easement to a different qualifying organization for conservation purposes.

*Based on all the facts and circumstances, the value of the easement is determined to be \$100,000. Therefore, the value of the property after the easement is \$100,000 and the value of the remainder interest, and thus the amount eligible for deduction under Section 170(f), is \$ 27,998 ( $\$100,000 \times .27998$ ).*

*Example 7. C owns Greenacre, a 200-acre estate containing a house built during the colonial period. At its highest and best use, for home development, the fair market value of Greenacre is \$300,000. C donates an easement (to maintain the house and Greenacre in their current state) to a qualifying organization for conservation purposes. The fair market value of Greenacre after the donation is reduced to \$125,000. Accordingly, the value of the easement and the amount eligible for a deduction under Section 170(f) is \$175,000 ( $\$300,000$  less  $\$ 125,000$ ).*

*Example 8. Assume the same facts as in example (7) and assume that three years later, C decides to donate a remainder interest in Greenacre to a qualifying organization for conservation purposes. Increasing real estate values in the area have raised the fair market value of Greenacre to \$180,000. Assume that because of the perpetual easement prohibiting any development of the land, the value of the house is \$120,000 and the value of the land is \$60,000. The value of the remainder interest, and thus the amount eligible for an income tax deduction under Section 170(f), is computed pursuant to 1.170A -12. See 1.170A -12(b)(3).*

*Example 9. D owns property with a basis of \$20,000 and a fair market value of \$80,000. D donates to a qualifying organization an easement for conservation purposes that is determined under this Section to have a fair market value of \$ 60,000. The amount of basis allocable to the easement is \$ 15,000 ( $\$60,000/\$80,000=\$15,000/\$20,000$ ). Accordingly, the basis of the property is reduced to \$5,000 ( $\$20,000$  minus  $\$15,000$ ).*

*Example 10. E owns 10 one-acre lots that are currently woods and parkland. The fair market value of each of E's lots is \$15,000 and the basis of each lot is \$ 3,000. E grants*

to the county a perpetual easement for conservation purposes to use and maintain eight of the acres as a public park and to restrict any future development on those eight acres. As a result of the restrictions, the value of the eight acres is reduced to \$1,000 an acre. However, by perpetually restricting development on this portion of the land, E has ensured that the two remaining acres will always be bordered by parkland, thus increasing their fair market value to \$22,500 each. If the eight acres represented all of E's land, the fair market value of the easement would be \$112,000, an amount equal to the fair market value of the land before the granting of the easement ( $8 \times \$15,000 = \$120,000$ ) minus the fair market value of the encumbered land after the granting of the easement ( $8 \times \$1,000 = \$8,000$ ). However, because the easement only covered a portion of the taxpayer's contiguous land, the amount of the deduction under Section 170 is reduced to \$97,000 ( $\$150,000 - \$53,000$ ), that is, the difference between the fair market value of the entire tract of land before ( $\$150,000$ ) and after ( $(8 \times \$1,000) + (2 \times \$22,500)$ ) the granting of the easement.

*Example 11.* Assume the same facts as in example (10). Since the easement covers a portion of E's land, only the basis of that portion is adjusted. Therefore, the amount of basis allocable to the easement is \$22,400 ( $(8 \times \$3,000) \times (\$112,000 / \$120,000)$ ). Accordingly, the basis of the eight acres encumbered by the easement is reduced to \$1,600 ( $\$24,000 - \$22,400$ ), or \$200 for each acre. The basis of the two remaining acres is not affected by the donation.

*Example 12.* F owns and uses as professional offices a two-story building that lies within a registered historic district. F's building is an outstanding example of period architecture with a fair market value of \$125,000. Restricted to its current use, which is the highest and best use of the property without making changes to the facade, the building and lot would have a fair market value of \$100,000, of which \$80,000 would be allocable to the building and \$20,000 would be allocable to the lot. F's basis in the property is \$50,000, of which \$40,000 is allocable to the building and \$10,000 is allocable to the lot. F's neighborhood is a mix of residential and commercial uses, and it is possible that F (or another owner) could

*enlarge the building for more extensive commercial use, which is its highest and best use. However, this would require changes to the facade. F would like to donate to a qualifying preservation organization an easement restricting any changes to the facade and promising to maintain the facade in perpetuity. The donation would qualify for a deduction under this Section. The fair market value of the easement is \$25,000 (the fair market value of the property before the easement, \$125,000, minus the fair market value of the property after the easement, \$100,000). Pursuant to 1.170A-14(h)(3)(iii), the basis allocable to the easement is \$10,000 and the basis of the underlying property (building and lot) is reduced to \$40,000.*

## **VIII. SUBSTANTIATION AND APPRAISAL REQUIREMENTS**

### **A. General Filing and Appraisal Requirements**

In order to deduct the value of a gift of a conservation easement with a fair market value in excess of \$5,000 the taxpayer will need to complete and file (1) IRS Form 1040 Sch.A; (2) Form 8283 Part B; and (3) an appraisal summary. The Donor will also need to have previously obtained a qualified written appraisal.

### **B. Record Requirements**

Regulation 1.170A-14 provides that if a taxpayer makes a qualified contribution and claims a deduction, the taxpayer must maintain written records of the fair market value of the underlying property before and after the donation and the conservation purpose furthered by the donation and such information shall be stated in the taxpayer's income tax return if required by the return or its instructions.

In addition, the Revenue Reconciliation Act of 1993 (RRA 1993) made important changes in the substantiation requirements. Internal Revenue Code §170(f)(8)(A), as amended by RRA 1993 Section 13172(a), provides that as a general rule no deduction shall be allowed for any contribution of \$ 250 or more unless the taxpayer substantiates the contribution by a contemporaneous written acknowledgment of the contribution by the donee organization that meets the requirements below. Where the charity has provided goods or services to the donor in

exchange for the making of the contributions, (quid pro quo) this acknowledgment must include a good faith estimate of the value of the goods or services. On December 13, 1996, the IRS issued final Regulations which provide additional guidance regarding the substantiation and quid pro quo rules.

Under the new Regulation, §1.170A-13 (f), an acknowledgment meets the requirements if it includes the following information: (i) the amount of cash and a description (but not necessarily the value) of any property other than cash contributed; (ii) whether the donee organization provided any goods or services in consideration, in whole or in part, for any property described in clause (i); and (iii) a description and good faith estimate of the value of any goods or services referred to in clause (ii) or, if such goods or services consist solely of intangible religious benefits, a statement to that effect. (The new Regulations impose special disclosure requirements for quid pro quo contributions, see §1.6115-1.)

No particular form is prescribed for the acknowledgment, and it may be contained in a letter, postcard or computer generated form. The charity may give a separate acknowledgment for each contribution or an annual acknowledgment that sets forth the required information.

Under the new Regulation, 1.170A-13 (f)(3), an acknowledgment will be considered to be contemporaneous if the taxpayer obtains the acknowledgment on or before the earlier of (i) the date on which the taxpayer files the original return for the taxable year in which the contribution was made, or (ii) the due date (including extensions) for filing the taxpayer's original return for that year. Taxpayers should make sure that the acknowledgment is dated and should retain any postmarks or other evidence of the date of receipt.

Taxpayers must complete and file Form 8283 if the amount of the claimed deduction for non-cash items exceeds \$500. If the claimed deduction for an easement exceeds \$5,000, the taxpayer must obtain a qualified appraisal and must attach to his return the Form 8323 which is signed by the qualified appraiser. A qualified appraisal must include a description of the property, the method of valuation used to determine the fair market value of the property, information about the

appraiser, and a description of the Appraiser's fee arrangement. In addition, a representative of the donee charity must sign the form 8323, acknowledging receipt of the gift and providing certain other information. If the donee organization disposes of the property within two years of receipt, the organization must file a Form 8262, Donee Information Return, and provide a copy to the taxpayer.

### **C. Appraisal Requirements**

IRS Publication 561, *Determining the Value of Donated Property* contains an excellent summary of the Appraisal Requirements. This Publication states in part:

*Generally, if the claimed deduction for an item or group of similar items of donated property is more than \$5,000, you must get a qualified appraisal made by a qualified appraiser and you must attach an appraisal summary to your tax return....*

*A qualified appraisal is an appraisal document that:*

- 1) Relates to an appraisal made not earlier than 60 days prior to the date of contribution of the appraised property,*
- 2) Does not involve a prohibited appraisal fee,*
- 3) Includes certain information (covered later), and*
- 4) Is prepared, signed, and dated by a qualified appraiser (defined later).*

*You must receive the qualified appraisal before the due date, including extensions, of the return on which a charitable contribution deduction is first claimed for the donated property. If the deduction is first claimed on an amended return, the qualified appraisal must be received before the date on which the amended return is filed.*

*An appraisal summary must be attached to your tax return. Generally, you do not need to attach the qualified appraisal itself, but you should keep a copy as long as it may be relevant under the tax law.*

Publication 561 also notes that a qualified appraisal must include the following information:

- 1) A description of the property in sufficient detail for a person who is not generally familiar with the type of property to determine that the property appraised is the property that was (or will be) contributed,
- 2) The physical condition of any tangible property,
- 3) The date (or expected date) of contribution,
- 4) The terms of any agreement or understanding entered into (or expected to be entered into) by or on behalf of the donor that relates to the use, sale, or other disposition of the donated property.
- 5) The name, address, and taxpayer identification number of the qualified appraiser and, if the appraiser is a partner, an employee, or an independent contractor engaged by the person other than the donor, the name, address, and taxpayer identification of the partnership or the person who employs or engages the appraiser,
- 6) The qualifications of the qualified appraiser who signs the appraisal, including the appraiser's background, experience, education, and any membership in professional appraisal associations,
- 7) A statement that the appraisal was prepared for income tax purposes,
- 8) The date (or dates) on which the property was valued,
- 9) The appraised FMV on the date (or expected date) of contribution,
- 10) The method of valuation used to determine FMV, such as the income approach, the comparable sales or market data approach, or the replacement cost less depreciation approach, and
- 11) The specific basis for the valuation, such as any specific comparable sales transaction.

“Qualified Appraisal” is defined in Regulation 1.170A-13 (c)(3). A qualified appraisal must be performed by a “qualified appraiser,” which is defined in Regulation 1.107A-13 (c)(5). A qualified appraiser is an individual who declares on the appraisal summary that he or she:

- Holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis,
- Is qualified to make appraisals of the type of property being valued, because of his or her qualifications described in the appraisal,
- Is not an excluded individual (see below), and
- Understands that an intentionally false overstatement of the

value of property may subject him or her to the penalty for aiding and abetting an understatement of tax liability.

An appraiser must complete Part III of Section B (Form 8283) to be considered a qualified appraiser. More than one appraiser may appraise the property, provided that each complies with the requirements, including signing the qualified appraisal and appraisal summary.

The following persons cannot be qualified appraisers with respect to particular property:

- 1) The donor of the property, or the taxpayer who claims the deduction.
- 2) The donee of the property.
- 3) A party to the transaction in which the donor acquired the property being appraised, unless the property is donated within 2 months of the date of acquisition and its appraised value does not exceed its acquisition price. This applies to the person who sold, exchanged, or gave the property to the donor, or any person who acted as an agent for the transferor or donor in the transaction.
- 4) Any person employed by, married to, or related under section 267(b) of the Internal Revenue Code, to any of the above persons. For example, if the donor acquired a painting from an art dealer, neither the dealer nor persons employed by the dealer can be qualified appraisers for that painting.
- 5) An appraiser who appraises regularly for a person in (1), (2), or (3), and who does not perform a majority of his or her appraisals made during his or her tax year for other persons.

In addition, a person is not a qualified appraiser for a particular donation if the donor had knowledge of facts that would cause a reasonable person to expect the appraiser to falsely overstate the value of the donated property. For example, if the donor and the appraiser make an agreement concerning the amount at which the property will be valued, and the donor knows that such amount exceeds the FMV of the property, the appraiser is not a qualified appraiser for the donation.

As stated above, the appraisal must be performed no earlier than 60 days before the gift is made, although in many circumstances an earlier appraisal can be updated.

## **IX. ACCURACY RELATED PENALTIES**

A charitable organization which knowingly provides a false written acknowledgment to a donor may be subject to the penalty provided in Section 6701 for aiding and abetting an understatement of tax liability.

In addition, Sections 6662 and 6663 impose accuracy and fraud-related penalties. The most serious of these is the fraud penalty contained in Section 6663, which imposes a penalty equal to 75% of the portion of the tax underpayment attributable to fraud. Intentional overvaluation of contributed property or of an easement could very well constitute fraud.

In 1989 Congress enacted new Section 6662, which contains updated versions of the former accuracy related penalties for overvaluation of property (former Section 6661) as well as negligence (former Section 5553 (a)). Section 6662 now imposes a single penalty amounting to 20% of the tax underpayment for any of the following situations:

1. Negligence
2. Substantial understatement of income tax
3. Substantial overstatement of value; and
4. Substantial estate or gift tax valuation understatement.

The penalty is 20% of the underpayment of tax related to the overstatement if: (1) The value or adjusted basis claimed on the return is 200% or more of the correct amount, and (2) The taxpayer underpaid his tax by more than \$5,000 because of the overstatement. The penalty is 40%, rather than 20% if : (1) The value or adjusted basis claimed on the return is 400% or more of the correct amount and, (2) The taxpayer underpaid his tax by more than \$5,000 because of the overstatement.

*The above concepts are most easily understood by illustration. Take the example of the hypothetical taxpayer Imogen Loomis, who claims the value of a donated easement to be \$250,000. Imogen claims that the “before” value of the property is \$850,000 and that the “after” value is \$600,000. When Imogen is audited, the easement is actually determined to be valued at \$100,000, because the correct “before” value was \$700,000. As a result,*

*assume Imogen owes \$50,000 more in taxes. In addition, because the value of the easement as claimed by Imogen (\$250,000) is greater than 200% of the actual value of the easement (\$100,000) Imogen owes a penalty equaling 20% of the additional taxes owed. In this case, the penalty equals 20% of \$50,000 or \$10,000. Imogen would owe the Internal Revenue Service both the \$50,000 in taxes she should have paid, plus statutory interest on that deficiency, and an additional \$10,000 penalty. John Wadsworth, Penalties for the Overvaluation of Easements, Back Forty Anthology (5.65)*

Under Section 6664(c), a reasonable cause exception applies in the context of both the accuracy-related penalty and the fraud penalty. Under the general rule, a penalty will not be imposed on that portion of an underpayment if it is shown that there was a reasonable cause for such portion and that the taxpayer acted in good faith.

The exception is limited, however, when the underpayment is attributable to a substantial or gross valuation overstatement with respect to charitable deduction property. For charitable contribution property, the reasonable cause exception does not apply unless: (a) The claimed value of the property was based on a qualified appraisal made by a qualified appraiser; and (b) In addition to obtaining the qualified appraisal, the taxpayer made a good faith investigation of the value of the contributed property. (The definition of "qualified appraisal" and "qualified appraiser" were discussed earlier.)

In addition, the Revenue Reconciliation Act of 1993 replaced the "not frivolous" with the "reasonable basis" standard thus making it easier for the IRS to apply the accuracy-related penalty. As a result taxpayers can avoid the understatement penalties by adequate disclosure only if the position has at least a reasonable basis.

S.C. Code §§12-54-40 and -155 (Supp. 1996) impose similar penalties for underpayment and understatement of taxes contained in state tax returns.

## **X. SUMMARY OF SELECTED OTHER STATE STATUTES**

The following are selected Sections from other state laws.

### **A. State Income Tax Act of 1926**

S.C. Code Ann. § 12-7-1225 (Law. Co-op. 1996) allows a tax credit of 25% of all expenditures to a maximum of two thousand five hundred (\$2,500.00) dollars per year for constructing and installing or restoring ponds, lakes, or water impoundments or control structures for irrigation, water supply, sediment control, erosion control or aquaculture and wildlife management. The credit does not apply to water impoundments in or adjacent to and filled primarily by coastal waters. To qualify for the credit, the taxpayer must obtain a construction permit issued by SCDHEC.

S.C. Code Ann. § 12-7-1250 (Law. Co-op. 1996) gives a corporation a tax credit of 50%, not to exceed ten thousand (\$10,000.00) annually, of expenses incurred in building or improving an infrastructure project. An infrastructure project includes water lines, sewer lines, their related facilities, and roads that: (1) do not exclusively benefit the taxpayer; (2) are built to applicable standards; (3) are dedicated to public use or, in the case of water and sewer lines and their related facilities served by a private water and sewer company, the water and sewer lines are deeded to a qualified private entity.

Section 12-7-2415 requires individual income tax return forms to allow contributions to South Carolina nongame wildlife and natural areas programs. The contribution may not increase or decrease the income tax liability of the taxpayer and may be made by reducing the income tax refund of the taxpayer by the amount designated or by accepting additional payment from the taxpayer by the amount designated, whichever is appropriate. The total amount of contributions goes into a special fund, the "Nongame Wildlife and Natural Areas Fund."

### **B. Sales and Use Tax Act**

S.C. Code Ann. § 12-36-2120(50) (Law Co-op 1996) exempts property, material, machinery and equipment used in recycling from sales tax.

### **C. Assessment of Property Taxes**

S.C. Code Ann. § 12-37-220A(8) exempts industrial pollution control equipment from property taxes.

### **D. Pollution Control Facilities**

In general, the bonds authorized by Chapter 3, “Pollution Control Facilities,” of Title 48, “Environmental Protection and Conservation,” and the income from those bonds are exempt from state taxes. S.C. Code Ann. § 48-3-120 (Law. Co-op. 1987). The issuance of bonds pursuant to the Pollution Control Facilities Act does not automatically exempt the pollution control facility from taxation. § 48-3-130. Whether the pollution control facility is exempt from taxation is determined under applicable general laws for tax exemption. *Id.*

### **E. South Carolina Water Quality Revolving Fund Authority Act**

S.C. Code Ann. § 48-5-30 (Law Co-op. 1996) creates the South Carolina Water Quality Revolving Fund Authority which administers the Water Pollution Control Loan Fund. The fund is comprised of capitalization grants pursuant to the Clean Water Act, funds appropriated by the General Assembly, payments received by a project sponsor in repayment of a loan, net proceeds of bonds issued by the Authority, interest or other income earned on the investment from the monies in the Fund, and additional monies from public or private sources. S.C. Code Ann. §§ 48-5-20(6) and -50. The fund may be used to make loans to “project sponsor.” S.C. Code Ann. § 48-5-40(c). A “project” is defined as a publicly owned treatment work, management programs authorized under the Clean Water Act, development of conservation plans authorized under the Clean Water Act, and other projects the Authority and DHEC determine are permissible under the Clean Water Act. S.C. Code Ann. § 48-5-20(10). The Authority is exempt from taxes, as is the income from property or loan obligations or bonds acquired by or issued by the Authority. S.C. Code Ann. § 48-5-140.

### **F. Soil and Water Conservation Districts Act**

Property acquired by Soil and Water Conservation Districts are exempt from taxes. S.C. Ann. § 48-9-1290 (Law Co-op. 1987).

