

Conservation Easements

A CONSERVATION EASEMENT is a voluntary legally binding restrictive covenant between landowners and either a tax-exempt qualified Land Trust or government entity to perpetually restrict development or exploitation of all or part of owned land. The landowner benefits from federal tax incentives for the donated land as a charitable contribution.

A conservation easement is a voluntary legally binding restrictive covenant between a landowner or landowners and a third party for the purpose to restrict development or exploitation of all or part of owned land.

To encourage preservation of lands with worthy conservation values, the United States Congress has provided for significant tax incentives to landowners who donate qualifying conservation easements. Classified as a charitable contribution, the primary incentive to conserve appropriate land is an income tax deduction under Section 170(h) of the Internal Revenue Code (IRC).

The landowner (which can be a partnership) who donates a qualified conservation easement to a qualified land trust or government entity and also fulfills the requirements of the regulations may be eligible for federal income tax deductions. In most cases, the value of a conservation easement donation is determined by a “qualified appraiser” to be the difference between the fair market value of the property before the easement takes effect and the fair market value of the conserved property after the easement is implemented.



The third party accepting the grant of easement must be either a government entity or a Land Trust that qualifies as a tax-exempt Section 501(c)(3) organization and is eligible to receive charitable donations. Land Trusts and governmental grantees are effectively given the task of being the “guardians” and protectors of the preserved lands. Their role is to monitor and enforce the permanent legal restrictions that an easement has imposed on a conserved property. These restrictions can be limitations on development, mineral extraction and many other types of land uses. The landowner continues to own the land and may use it for various purposes that do not conflict or diminish the conservation value of the property. The owner of the property may also choose to sell the land or deed it to others. However, the conservation easement is a deed restriction, recorded at the courthouse, which runs with the land and gives the Land Trust power and rights to permanently enforce the restriction placed on the property.





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Rules and Regulations

The classification of the grant of a conservation easement as a charitable deduction is governed under I.R.C. Section 170(h) as well as the corresponding Treasury Regulations beginning at Section 1.170A-14. In order to claim a tax deduction under these regulations, there are numerous provisions and requirements, such as:

- The contribution must support a valid conservation purpose, such as protection of natural habitat or presentation of a view visible to the public
- The easement must be in perpetuity
- The easement must convey a qualified real property interest
- The easement must be conveyed to a qualified organization
- The value of the easement donation must be established by a qualified appraiser
- Uses inconsistent with the existing conservation values must be prohibited

The existing conditions of the property at the time of the grant of easement must be thoroughly documented via a Baseline Documentation Report (BDR), including existing topography, soils and a biological survey. This study is implemented by the Land Trust and is usually conducted by a wildlife biologist or trained professional. Preparation of the BDR requires one or more site visits to delineate the conservation values and purposes of the property and to provide a complete and accurate assessment of the ecology and natural resources found on the land as of the time the easement is granted

Congress has repeatedly indicated its desire to encourage private preservation of environmentally important property.

Certain states allow conservation donation deductions to be used for state tax purposes and some states even provide supplementary tax credits for conservation easements. These aspects vary significantly from state to state.

On December 17, 2015, Amendment #H.R. 2029 once again reinforced Congress' support of private land conservation efforts by making the previously temporary enhanced incentives permanent.



Income Tax Benefits

Current Federal tax rules relating to the income tax benefits associated with the donation of a conservation easement include the following:

- The value of the easement is deductible from the donor's Adjusted Gross Income from all sources (including capital gains and passive income)
- For most owners, the amount of these deductions the owner can utilize in any year is equal to 50% of the donor's Adjusted Gross Income, making conservation easements one of the most generous tax incentive programs in the Code
- Unused portions of the deduction can be carried forward an additional 15 years for most ownership types
- Deductions generated by certain types of entities, such as partnerships, LLCs, and S Corporations can generally pass through to the underlying ownership
- For C corporations, the amount of the deduction is limited to 10% of taxable income, with a 10 year carry-forward of unused deductions

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Conservation Partnerships

In a “conservation partnership”, a landowner partners with others, usually by following these steps:

The landowner places the qualified land into a partnership structure, typically an LLC

The landowner evaluates the property for its development and conservation potential

A development plan showing the realistic development potential of the property is prepared

An appraisal is done to determine the potential value of the property should it be developed, as well as the value of a conservation donation

The owner then invites friends, family or others to acquire partnership interests at a price determined by the owner

Typically, the partnership is structured so that residual development or other economic opportunities survive if the land is conserved. These partnership transactions are often structured as “Reg-D” direct real estate investments, offered privately or syndicated through a licensed broker-dealer.

To complete the transaction, a subscription to purchase a partnership interest must be submitted by the prospective investor and accepted by the seller. The subscription will typically require the payment of the investor’s full purchase price into escrow, which is refundable if the transaction fails to close.

After closing, the partners vote to select one of three options for the property:

1 Hold property for appreciation over time

2 Develop property for profit

3 Conserve the property permanently

If the partnership elects to conserve, a Conservation Agreement with a qualified Land Trust is executed and recorded. The final appraisal is completed and issued. Tax benefits then flow to the partners in proportion to their partnership interests through their individual K-1 forms and can be immediately used to offset up to 50% of the partner’s adjusted gross income for the year the property is conserved. Any excess deductions can be used in the following years, for up to a total of 16 years.

The operation of the partnership, including the designation of the Manager, is governed by the Operating Agreement of the LLC. Non-managing partners typically have a limited range of rights and responsibilities. The partnership itself is fully responsible for the costs of completing the directive of the members’ vote, and funds to accomplish this are usually set aside at closing as operating reserves for this purpose. Capital calls are rare and typically require unanimous approval of all partners.

However, should the development option be selected, additional capital needs could result in ownership dilution for partners who do not participate in voluntary capital calls. If the land is conserved, the partnership can be expected to continue in place for at least four years, and the governing Operating Agreement provides the rules for dissolution.



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Risks

Despite the intent of Congress to promote land conservation by the private sector, the IRS has been aggressive in auditing these types of transactions, attempting to find what they perceive to be “bad” easements. Unfortunately, these attempts by the IRS to disqualify or discount bad easements have resulted in many qualified easements being examined. The IRS’s highest focus has been verifying the “intent of the conservation need or purpose” and /or establishing the appropriate deduction value of the donation.

There is no way to eliminate the possibility of an audit. For partnerships, the audit defense process is typically professionally managed by the tax matters partner and does not require much involvement from the members. However, the conclusion of an audit can take several years, and if an adverse decision is reached by the IRS or the courts, each partner is individually responsible for their share of any deficiency found.

NOTE: For a complete understanding of the risks involved in these partnership transactions, potential investors are urged to thoroughly review the offering material provided on any transaction. The best means of facilitating land conservation while minimizing audit risk is to participate with industry experts who are knowledgeable in this field and who are well experienced in this type of transaction. Obtaining a well-supported and defensible appraisal of the donation value by a highly qualified appraiser is of critical importance. It is further advisable that contingencies or reserves be established in advance to cover the cost of defense, should that be necessary.

Conclusion

Conservation partnerships are a great means for accredited individuals to enjoy the full extent of economic benefits afforded under the U.S. tax code by participating in the preservation of environmentally sensitive lands. By allowing the original landowner an avenue to realize an economic incentive for their land conservation efforts while making the tax benefits available to those who can use them, conservation partnerships are greatly increasing the pace of land conservation in the U.S., furthering Congressional intent. All participants in a successful conservation effort can be gratified knowing that current and future generations will receive a perpetual benefit from the private protection of these essential wildlife habitats and our precious natural environments.

