

TRENDS IN QUALIFIED CONSERVATION EASEMENTS

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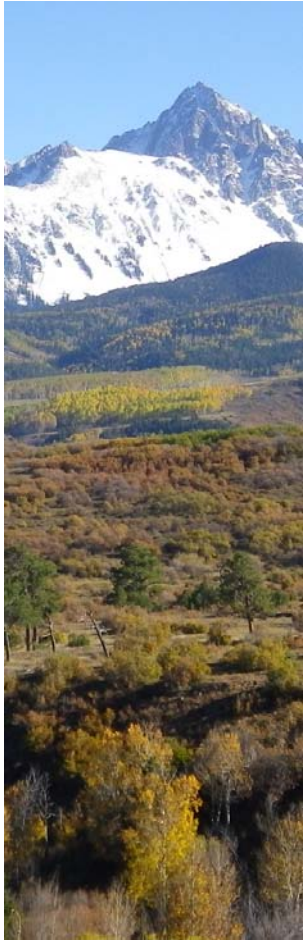
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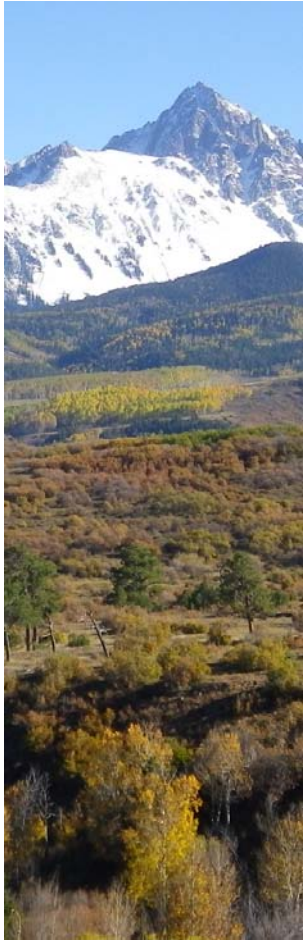
What is a Conservation Easement?

- ▶ An easement interest granted by a landowner to a land trust or governmental entity that voluntarily restricts the development and use of the land with an objective of land preservation.
- ▶ An easement in gross - a real property interest created by Colorado statute that becomes valid and effective only when recorded in the real property records where the land is located. *C.R.S. § 38-30.5-106.*



What is a Conservation Easement?

- ▶ Can be purchased, donated, or a combination of the two (bargain sale), and can later be transferred to a successor grantee.
- ▶ Has a separate monetary value which can be determined by an appraisal.



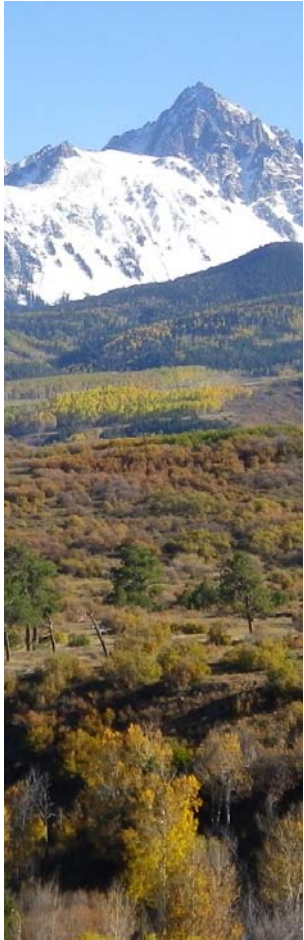


Legal Rights Unaffected by Conservation Easement

- ▶ Landowner retains full ownership of the land.
- ▶ Can sell the land.
- ▶ Can pass land on to future generations.
- ▶ Can obtain a loan secured by the land.

What is the Duration of a Conservation Easement?

- ▶ Perpetual, unending forever.
 - ▶ Perpetual terms are required to be eligible for federal tax benefits.
 - ▶ Shall be perpetual unless otherwise stated in the conservation easement. *C.R.S. § 38-30.5-103(3).*
- ▶ A term of years less than forever. Term easements do not qualify for Colorado or federal tax benefits.





Legal Authority for Conservation Easements

- ▶ Colorado has a statute authorizing conservation easements. *C.R.S. §§ 38-30.5-101, et seq.*
 - ▶ Grants a right to the owner of the conservation easement (grantee) “to prohibit or require a limitation upon . . . land or water area . . . [to maintain the land or water area] predominantly in a natural, scenic or open condition, or for wildlife habitat, or for agricultural, horticultural, wetlands, recreational, forest, or other use or condition consistent with the protection of open land, environmental quality or life-sustaining ecological diversity . . .”



Legal Authority for Conservation Easements

- ▶ To be eligible for federal and state tax benefits, a conservation easement must comply with Colorado statute and *I.R.C. § 170(h)*.
 - ▶ Pursuant to *I.R.C. § 170(h)(1)*, a “qualified conservation contribution” means a contribution:
 - ▶ (A) of a qualified real property interest,
 - ▶ (B) to a qualified organization,
 - ▶ (C) exclusively for conservation purposes.

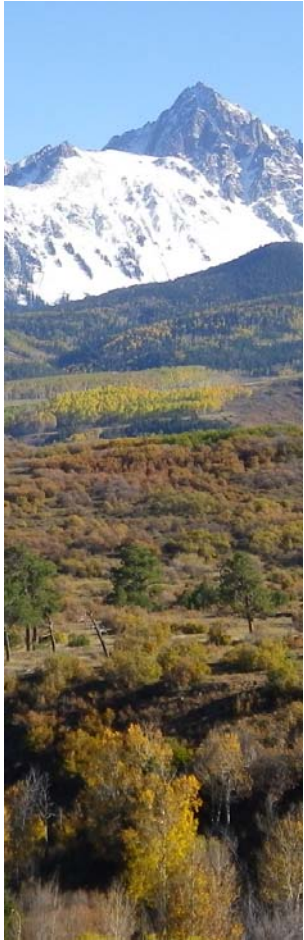


Legal Authority for Conservation Easements

- ▶ *I.R.C. 170(h)(2)* provides that “qualified real property interest” means any of the following interests in real property:
 - ▶ (A) the entire interest of the donor other than a qualified mineral interest,
 - ▶ (B) a remainder interest, and
 - ▶ (C) a restriction (granted in perpetuity) on the use which may be made of the real property.

Who is the Grantee of a Conservation Easement?

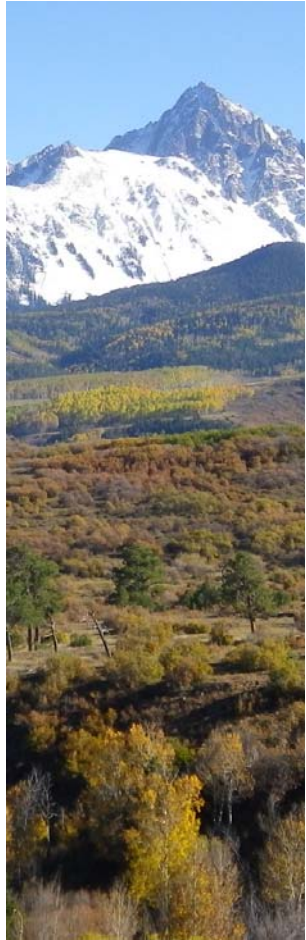
- ▶ Under Colorado law, eligible grantees are governmental entities and charitable organizations exempt under *I.R.C. § 501(c)(3)*, which organization was created at least two years prior to the receipt of the conservation easement.





Who is the Grantee of a Conservation Easement?

- ▶ *I.R.C. § 170(h)(3)* defines “qualified organization” as 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.



Conservation Purposes Defined

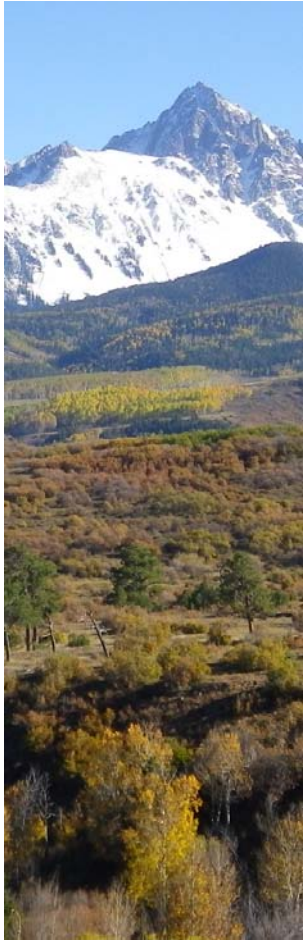
I.R.C. § 170(h)(4)

- ▶ The preservation of land areas for outdoor recreation by, or the education of, the general public, or
- ▶ The protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem, or
- ▶ 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
- ▶ The preservation of historically important land or a certified historic structure.

Exclusively for Conservation Purposes

I.R.C. § 170(h)(5)(A) Conservation purposes must be perpetual

A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.





Exclusively for Conservation Purposes

I.R.C. § 170(h)(5)(B) No surface mining permitted

- ▶ (i) In general
- ▶ Except as provided in clause (ii), in the case of a contribution of any interest where there is a retention of a qualified mineral interest, subparagraph (A) shall not be treated as met if at any time there may be extraction or removal of minerals by any surface mining method.
- ▶ (ii) Special rule
- ▶ With respect to any contribution of property in which the ownership of the surface estate and mineral interests were separated, subparagraph (A) shall be treated as met if the probability of surface mining occurring on such property is so remote as to be negligible.



Exclusively for Conservation Purposes

A conservation easement will not be “exclusively for conservation purposes” unless:

- ▶ Any loan encumbering the property is subordinate to the conservation easement interest by the lender. *Treas. Reg. § 1.170A-14(g)(2)*.
- ▶ There is a clearly identified parcel of property to be subject to the conservation easement and no “swaps” are permitted. See *Belk v. Commissioner, 774 F.3d 221 (4th Cir. 2014)(Belk III), affirming 140 T.C. No. 1 (U.S.T.C. 2013)(Belk I) and T.C. Memo. 2013-154 (U.S.T.C. 2013)(Belk II)*.



Documentation of Conservation Purposes

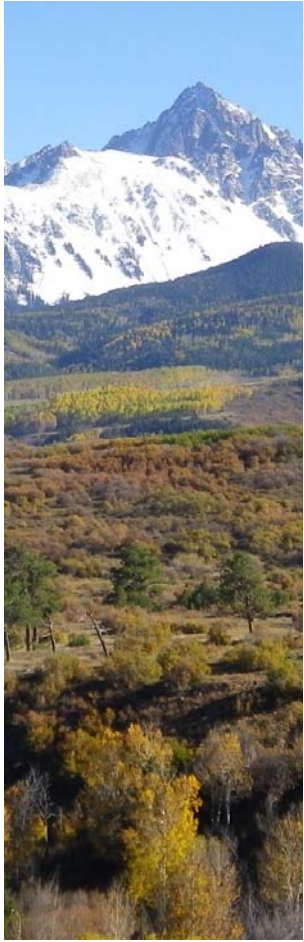
Baseline Documentation (*Treas. Reg. § 1.170A-14(g)(5)*)

- ▶ Provides biological information about the land and must be completed prior to the grant of the conservation easement.
- ▶ Consists of maps, aerial images, photos, inventory of flora and fauna, and analysis of biological features of the land.
- ▶ Provides basis for determination of conservation values.
- ▶ Must be acknowledged at the time of conveyance by both grantor and grantee.

Qualified Mineral Interest

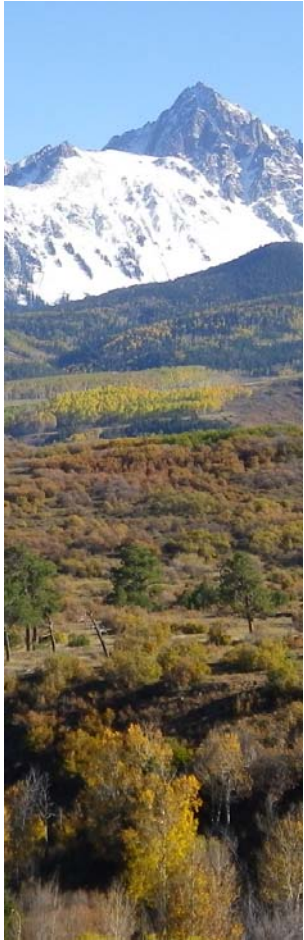
I.R.C. § 170(h)(6)

- ▶ “Qualified mineral interest” means:
- ▶ (A) subsurface oil, gas, or other minerals, and
- ▶ (B) the right to access to such minerals.



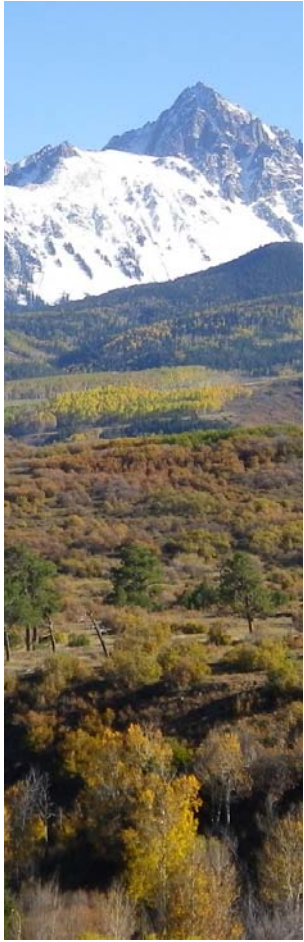
Mineral Report Required

- ▶ If title to minerals has been severed from the land, a mineral report is required. *Treas. Reg. § 1.170A-14 (g)(4)(ii)*.
- ▶ Mineral report must show that the “probability of surface mining occurring on such property is so remote as to be negligible.” *Treas. Reg. § 1.170A-14 (g)(4)(ii)(3)*.



Remoteness Test

- ▶ “Whether the probability of extraction or removal of minerals by surface mining is so remote as to be negligible is a question of fact to be made on a case by case basis . . . [considering] [g]eological, geophysical or economic data showing the absence of mineral reserves on the property, or the lack of commercial feasibility at the time of the contribution of surface mining the mineral interest.” *Treas. Reg. § 1.170A-14(g)(4)(ii)*.



Oil and Gas Development

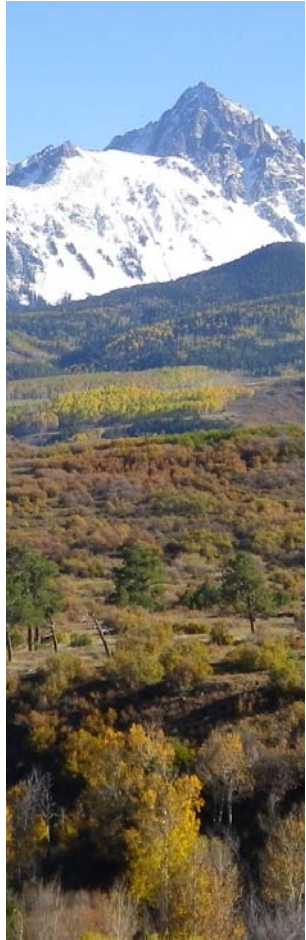
- ▶ “However, a deduction under this section will not be denied in the case of certain methods of mining that may have [a] limited, localized impact on the real property but that are not irretrievably destructive of significant conservation interests. For example, a deduction will not be denied in a case where production facilities are concealed or compatible with existing topography and landscape and when surface alteration is to be restored to its original state.” *Treas. Reg. § 1.170A-14(g)(4)(i)*.





Common Reserved Rights

- ▶ Maintain existing or build new residence within a building envelope.
- ▶ Conduct ranching and other agricultural activities.
- ▶ Conduct certain limited recreational activities.
- ▶ Maintain infrastructure necessary for the exercise of reserved rights including water wells, roads, trails, fences, etc.
- ▶ Proper land management to protect the conservation values.

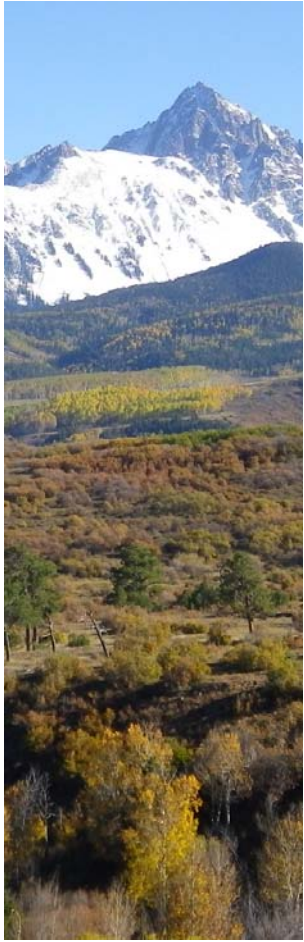


Typical Prohibited Activities

- ▶ No construction of buildings unless expressly permitted.
- ▶ No subdivision of title.
- ▶ No industrial uses.
- ▶ No commercial uses that harm the conservation values.
- ▶ No surface mining.
- ▶ No timber harvesting.
- ▶ No surface disturbance.
- ▶ No transfer of water rights.

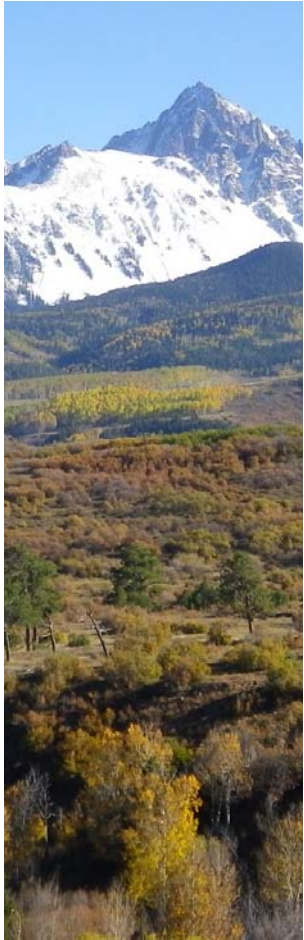
Grantee's Rights

- ▶ Monitor the land to check for violations.
- ▶ Enforce the terms of the conservation easement.
- ▶ Require restoration of land if damaged in violation of the conservation easement.



Other Provisions

- ▶ Distribution of proceeds in the event of condemnation, termination or extinguishment.
- ▶ Enforcement.
- ▶ Amendment.
- ▶ No merger.
- ▶ Relinquishment of development rights.



Value of the Conservation Easement

Treas. Reg. § 1.170A-14(h)(3)

- ▶ If a substantial record of comparable marketplace sales of conservation easements exists, the value of the conservation easement is based on comparable sales.

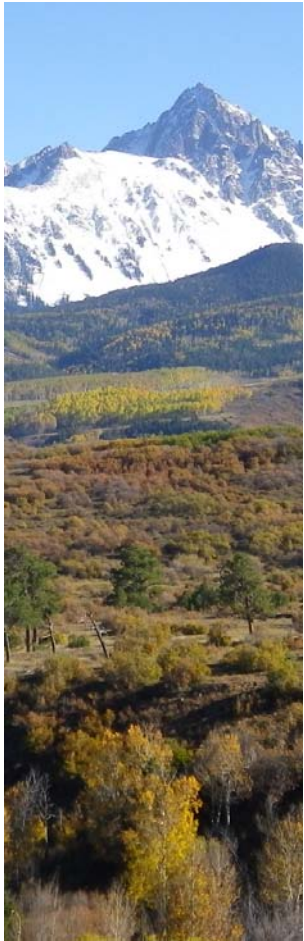
- ▶ If not:

Fair market value of the land before the grant of the conservation easement

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Fair market value of the land after the grant of the conservation easement

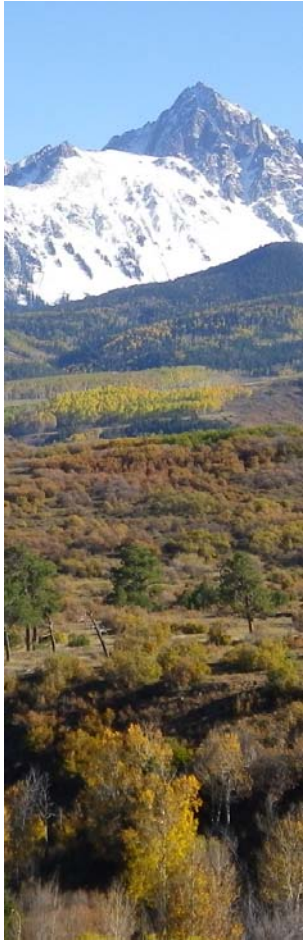
= Value of the Conservation Easement



Value of the Conservation Easement

Treas. Reg. § 1.170A-14(h)(3)

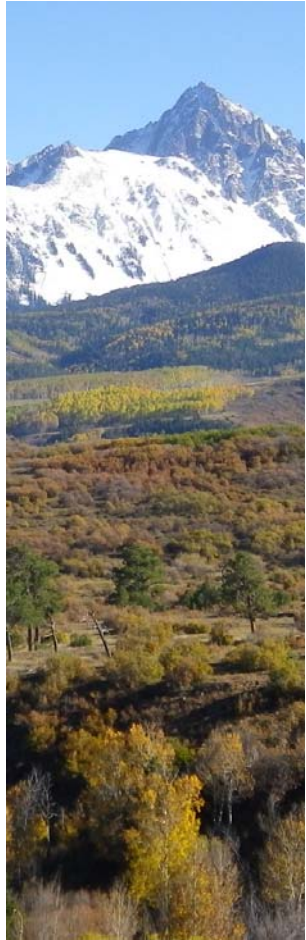
- ▶ If the conservation easement covers only a portion of the land owned by the landowner, the value is equal to the value of all contiguous land owned by the landowner or his family before the easement minus the value of all land after the easement.
- ▶ The appraisal must also value the enhancement of any land owned by the landowner, his family or any related parties.





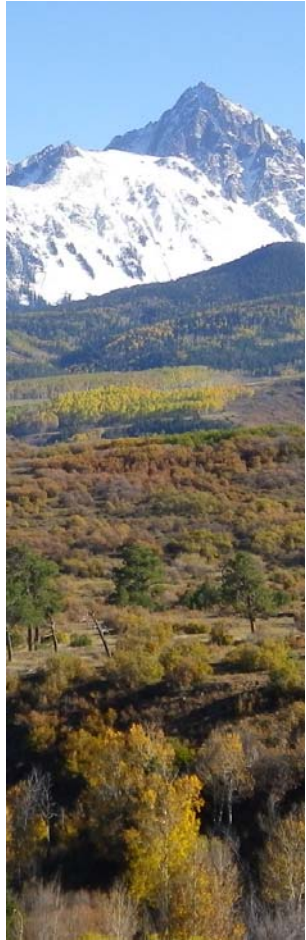
Federal Tax Benefits

- ▶ Charitable income tax deduction, taken as an itemized deduction on the federal income tax return.
- ▶ Estate tax reduction.
- ▶ Estate tax exclusion.



Federal Income Tax Deduction

- ▶ Can deduct an amount equal to the value of the conservation easement up to a maximum of 50% of your contribution base (essentially adjusted gross income (AGI)). *I.R.C. § 170(b)(1)(E)(i).*
- ▶ Carry forward remainder until used or 15 years, whichever occurs first. *I.R.C. § 170(b)(1)(E)(ii).*
- ▶ Can be used against ordinary income as well as capital gains.



Federal Income Tax Deduction

- ▶ Limited to tax basis in the conservation easement until the land has been owned for more than one year, and for dealer property (i.e. owned by a developer and held for sale to customers in the ordinary course of a trade or business).
I.R.C. § 170(e)(1)(A).
- ▶ Must have donative intent and no “quid pro quo.” *Treas. Reg. § 1.170A-14(h)(3)(i).*
- ▶ Must allocate basis in the property between conservation easement and remainder property. *Treas. Reg. § 1.170A-14(h)(3)(iii).*

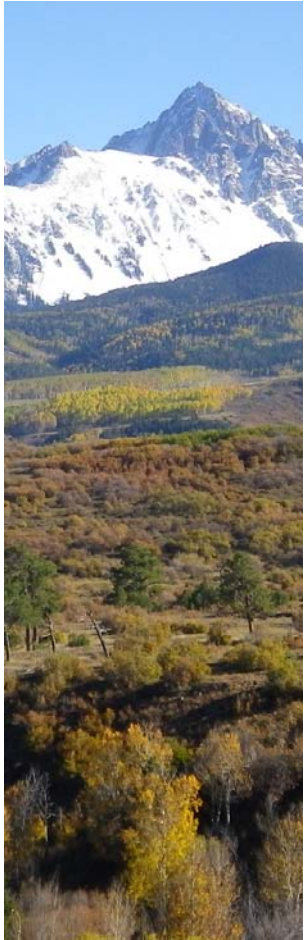


Special Rules for Farmers and Ranchers

- ▶ Qualified farmers or ranchers who donate a conservation easement can deduct the value of the conservation easement up to 100% of their contribution base (AGI) with a 15 year carry forward. *I.R.C. § 170(b)(1)(E)(iv)(I).*
- ▶ Property must be used in agriculture or livestock production and easement must provide that the property remain available for such production. *I.R.C. § 170(b)(1)(E)(iv)(II).*

What is a Qualified Farmer or Rancher?

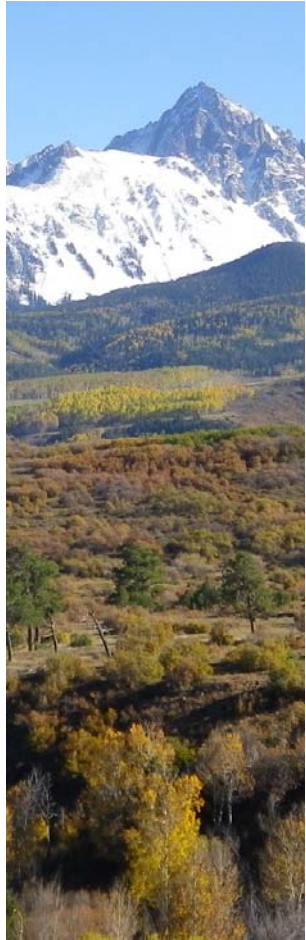
- ▶ A taxpayer whose gross income from the trade or business of farming (within the meaning of I.R.C. § 2032A(d)(5)) is greater than 50% of the taxpayer's gross income for the taxable year that the conservation easement is donated.
I.R.C. § 170(b)(1)(E)(v).





Estate Tax Reduction

- ▶ Conservation easement reduces the value of the land that will be included within the estate of the landowner upon death.
- ▶ Landowner's estate and heirs pay less in estate taxes.



Estate Tax Exclusion

- ▶ Under *I.R.C. § 2031(c)*, the taxpayer's estate may exclude up to 40% of the residual value of the land from the taxable estate (reduced pursuant to *I.R.C. § 2031(c)(2)*) if:
 - ▶ The conservation easement was granted by the decedent or a family member (as defined in *I.R.C. § 2032A(e)(2)*).
 - ▶ The conservation easement prohibits more than "a de minimus use for a commercial recreational activity."
 - ▶ The partial exclusion is capped at \$500,000.

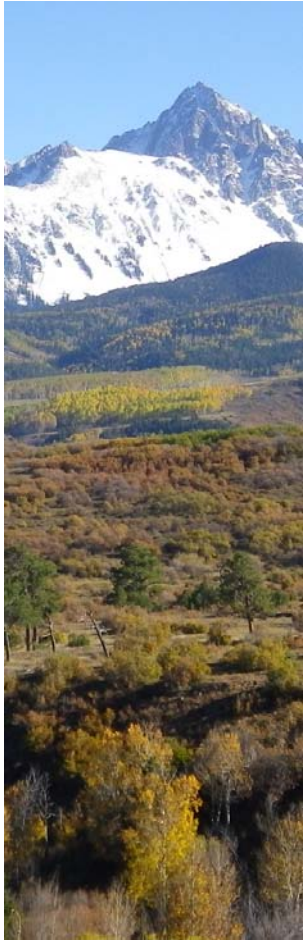


Colorado Tax Benefits

- ▶ State Income Tax Credit -- *C.R.S. § 39-22-522*
 - ▶ Colorado income tax credit for a donated conservation easement of up to \$1,500,000 with a 20 year carry forward.
 - ▶ Credit is calculated as 75% of the first \$100,000 of the value of the conservation easement and 50% of the remaining value.
 - ▶ Credit can be transferred one time by the donor of the conservation easement by gift or sale.

Colorado Tax Benefits

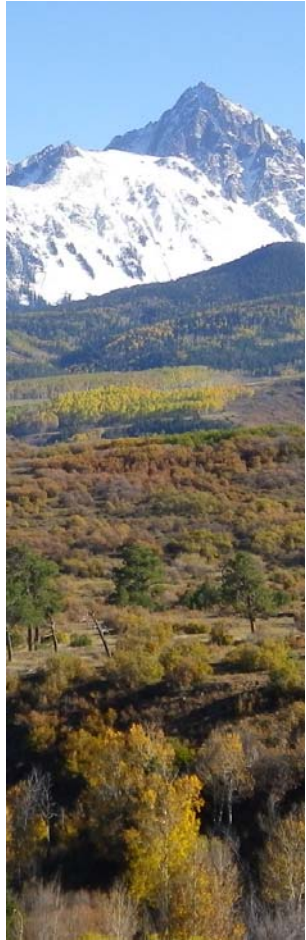
- ▶ Property Tax Classification Retention or Reduction
 - ▶ Lands consisting of at least 80 acres that have been classified as agricultural for the two years prior to the conveyance of the conservation easement may retain the agricultural tax classification. *C.R.S. § 39-1-102(1.6)(1)(III)*.
 - ▶ Other lands should receive a reduction in property taxes because of the reduced value of the residual estate.





Example

- ▶ Landowner donates a conservation easement on land valued at \$5,000,000.
- ▶ Conservation easement is valued at \$2,000,000.
- ▶ Assume landowner's AGI is \$200,000.
- ▶ What are the federal and state tax benefits?



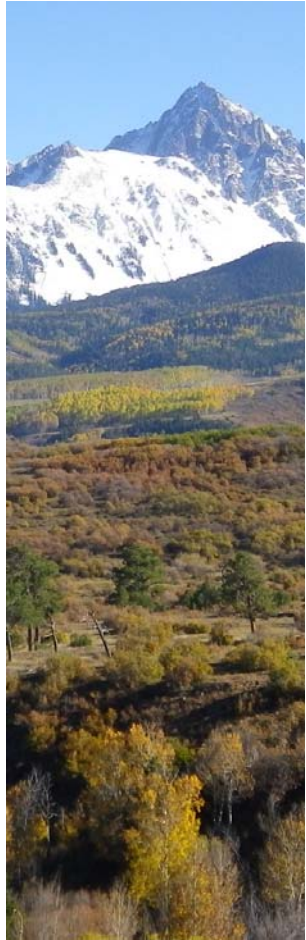
Example

- ▶ Landowner can deduct up to \$100,000 on his federal income tax return in the year of the donation, and carry forward \$1,900,000 until used or 15 years, whichever comes first.
- ▶ Landowner can apply for a Colorado state tax credit of \$1,025,000, which he can sell to a third party, or use to offset any Colorado tax due in the year of the donation or for 20 additional years.



Summary of Required Documentation

- ▶ Form 8283
- ▶ Baseline Report
- ▶ Mineral Report (if required)
- ▶ Letter from land trust acknowledging donation
- ▶ Appraisal

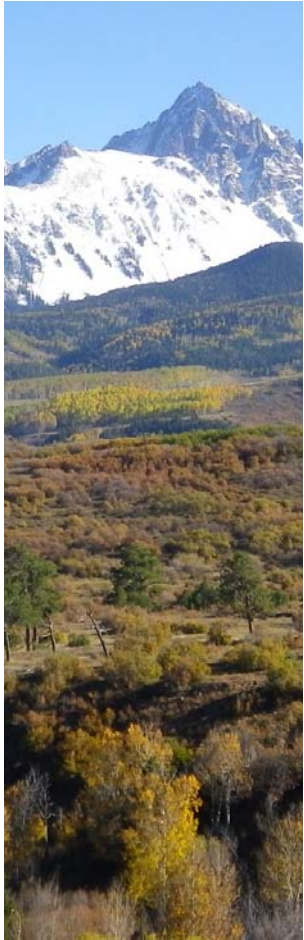


Form 8283

- ▶ Required as part of income tax return to document charitable donation or bargain sale of conservation easement.
- ▶ Must be signed by land trust and appraiser.
- ▶ Must include information regarding the cost basis and acquisition date of the property.
- ▶ Requires an attachment specific to the conservation easement.

Form 8283 Attachment

- ▶ Identify the conservation purposes.
- ▶ Show the fair market value of the property before and after the donation.
- ▶ State whether the donation was made in order to get a permit or other approval from a local or other governing authority and whether the donation was required by a contract.
- ▶ If the donor or a related person has any interest in other property nearby, describe that interest.





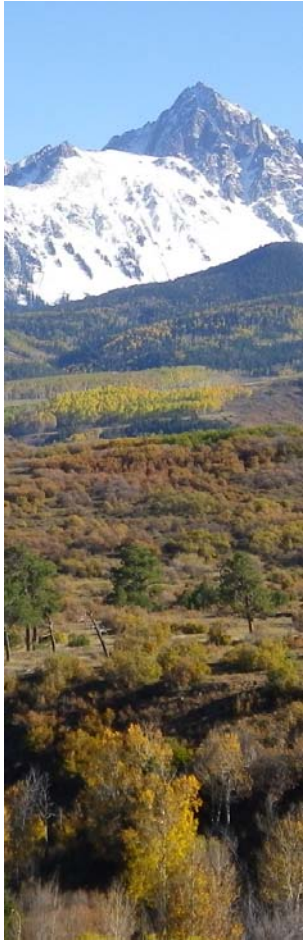
Acknowledgment Letter

- ▶ No deduction is allowed for a charitable donation of \$250 or more unless the taxpayer substantiates the contribution with a contemporaneous written acknowledgment obtained from the donee. *I.R.C. § 170(f)(8)(A)*.
- ▶ Must be obtained prior to the date of filing of the income tax return for the year of the donation, or the due date (including extension) for the filing of such return. *I.R.C. § 170(f)(8)(C)*.

Acknowledgment Letter

- ▶ The amount of cash and a description (but not value) of any property other than cash donated.
- ▶ Whether the donee provided any goods or services in consideration for the donation.
- ▶ A description of any goods or services provided and a good faith estimate of the value of such goods or services.

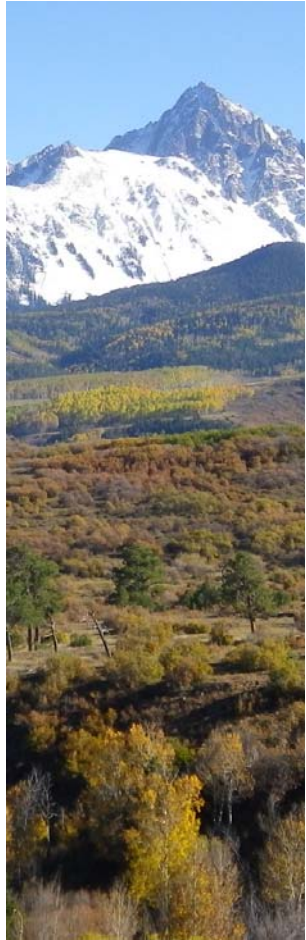
I.R.C. § 170(f)(8)(B).





Documentation of Value

- ▶ Under *I.R.C. § 170(f)(11)(C)*, taxpayers are required to obtain a qualified appraisal for donated property for which a deduction of more than \$5,000 is claimed.
- ▶ If the value of the conservation easement is greater than \$500,000, a full copy of the qualified appraisal must be attached to the income tax return. *I.R.C. § 170(f)(11)(D)*.
- ▶ Section 1219 of the Pension Protection Act of 2006 (PPA) amended *I.R.C. § 170(f)(11)(E)* and provides statutory definitions of a qualified appraisal and qualified appraiser.



Qualified Appraiser

- ▶ *I.R.C. § 170(f)(11)(E)(iii)* further provides that an individual will not be treated as a qualified appraiser unless that individual:
 - ▶ (1) demonstrates verifiable education and experience in valuing the type of property subject to the appraisal, and
 - ▶ (2) has not been prohibited from practicing before the Internal Revenue Service by the Secretary under § 330(c) of Title 31 of the United States Code at any time during the 3-year period ending on the date of the appraisal.

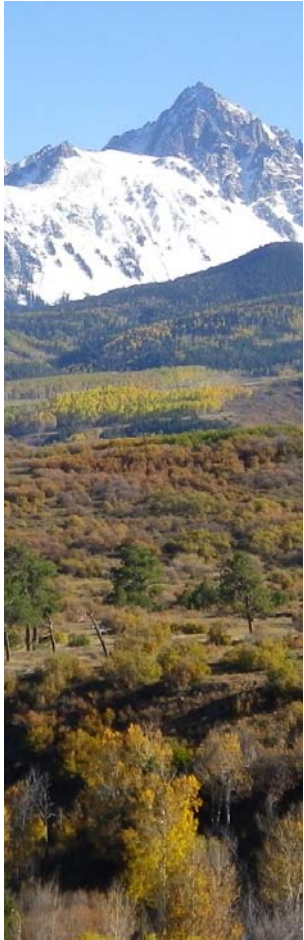


Qualified Appraisal

- ▶ An appraisal will be treated as a qualified appraisal if the appraisal complies with all of the requirements of *Treas. Reg. § 1.170A-13(c)* (except to the extent the regulations are inconsistent with *I.R.C. § 170(f)(11)*), and is conducted:
 - ▶ by a qualified appraiser,
 - ▶ in accordance with generally accepted appraisal standards, consistent with the substance and principles of USPAP.

Post Mortem Conservation Easements

- ▶ A conservation easement can be made by a will. A gift by a will is considered effective as of the date of death and will reduce estate taxes of the decedent. *I.R.C. § 2055(a) and 2055(f).*
- ▶ A conservation easement can be donated by the estate after death and qualify for an estate tax deduction if the property meets the requirements of I.R.C. § 2031(c) and state law. *I.R.C. § 2031(c)(9) and 2055(f).*



Questions?

