

## Charitable conservation easements

By Louis Vlahos

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A cursory review of IRS enforcement efforts over the last few years reveals that the government has dedicated substantial resources to auditing charitable conservation easements. The IRS vigilance in this area has been warranted since there have been many abuses over the years, ranging from aggressive valuations by appraisers, to misrepresentations by taxpayers of the public benefit generated by the easement. Concern over these issues led the Obama administration, as part of the 2014 budget, to propose limitations on deductions for certain conservation easements.

This should not come as a surprise to taxpayers or their advisers. The IRS announced in 2004 that it would be taking stricter enforcement action as to improper charitable deductions based upon conservation easements. In light of the increased scrutiny of conservation easements, it behooves any taxpayer contemplating the grant of an easement to understand its basic requirements and reporting obligations.

### Requirements

An income tax deduction may be allowed for the fair market value of a "qualified conservation contribution," provided certain requirements are satisfied. A qualified conservation contribution is the contribution of a "qualified real property interest" to a "qualified organization," which is made exclusively for conservation purposes. The contribution cannot be part of a quid pro quo exchange; for example, where the easement is granted to a county in exchange for a zoning change or exemption.

A qualified real property interest includes a "restriction (granted in perpetuity) on the use which may be made of real property." Any interest in the property retained by the donor must be subject to legally enforceable restrictions that will prevent uses that are inconsistent with the conservation purpose of the donation.

A qualified organization is a public charity that is dedicated to promoting

conservation purposes and that has the resources to enforce the easement. Toward this end, the donation must give the charity the right to inspect the property and to enforce the easement by appropriate legal proceedings.

### Acceptable conservation purposes

There are several "conservation purposes" for which the contribution may be made; for example, preservation of land areas for recreation by, or for the education of, the general public; the protection of a relatively natural habitat of fish, wildlife or plants, or similar ecosystem; the preservation of open space (including farmland and forest land) for the scenic enjoyment of the general public, or pursuant to a clearly delineated federal, state or local governmental conservation policy, which will yield a significant public benefit; or the preservation of an historically important land area or a "certified historic structure."

A taxpayer's stated conservation purpose will be closely examined by the IRS to ensure the presence of a real public benefit.

### Value of a conservation easement

The amount of the donation, and of the related tax deduction (subject to various limits), is the fair market value of the easement as of the date it is donated. A deduction is permitted only if the easement diminishes the value of the property it encumbers.

As a general rule, the fair market value of a conservation easement is equal to the difference between (a) the fair market value of the to-be-encumbered property before the easement is granted and (b) the fair market value of the property after the easement is granted. If the granting of the easement increases the value of any other property owned by the taxpayer or a related person, the amount of the deduction for the easement must be reduced by the amount of the increase in value of the other property, whether or not it is contiguous to the encumbered property. If the taxpayer or a related person can reasonably expect to receive, as a result of

the donation, an economic benefit greater than that which will inure to the general public, no deduction is allowable.

In order to determine a property's fair market value, one must first determine its "highest and best use." This is not necessarily its current use. Rather, it is the highest and most profitable use for which the property is adaptable and needed. Generally speaking, this use must be physically possible upon the property, legally permissible and financially feasible. Of the possible uses, the most profitable is the highest and best. This analysis is very fact-intensive. It is also important to the IRS since it provides the starting point for valuing the conservation easement and may be a point of contention in an audit.

Once the highest and best use is determined, a number of valuation methods may be applied in arriving at the property's fair market value.

A taxpayer must substantiate the value of the conservation easement by submitting with its federal tax return a "qualified appraisal" of the value for the easement prepared by a "qualified appraiser."

### Qualified appraisals

A qualified appraiser is someone who: "(I) has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements . . . , (II) regularly performs appraisals for which the individual receives compensation, and (III) meets such other requirements as may be prescribed [by the IRS]...."

A qualified appraisal is an appraisal of property which is conducted by a qualified appraiser in accordance with "generally accepted appraisal standards"..., and must include (i) a description of the property that is sufficiently detailed for an unfamiliar reader to ascertain that the property that was appraised is the property that was contributed, (ii) a description of the physical condition of the property, (iii) the terms of any restriction on the use of the property, once donated, (iv) the appraised fair market value of the property on the date of the contribution, (v) the method of valuation used to determine the



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fair market value, and (vi) the specific basis for the valuation.

### Reporting

In addition to the usual reporting requirements for charitable contributions, the taxpayer must also prepare and file IRS Form 8283, Noncash Charitable Contributions. The appraiser and the charitable organization are required to complete portions of this form. The charitable organization must also report on its annual tax return that it received and holds conservation easements and it must set forth, among other things, specific information as to the purposes of such easements and its enforcement thereof.

### Conclusion

The granting of a conservation easement for the purpose of generating a charitable contribution deduction should not be undertaken lightly. As the foregoing discussion demonstrates, the applicable rules are complicated and the necessary substantiation is detailed. As a result of the various reporting requirements, coupled with the IRS's increased enforcement activity with respect to such easements, a taxpayer can find himself in a situation where he owns permanently encumbered property for which no income tax deduction was allowed.

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