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The Tax Rules Surrounding the Donation of a Permanent Conservation Easement

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Overview

A popular tax technique in some areas of the country where scenic values are high involves the donation of a permanent conservation easement. A conservation easement is a voluntary restriction on the use of land that a landowner negotiates with a private charitable conservation organization (commonly referred to as a "land trust") or government agency that the landowner chooses to "hold" the easement. That means that the donee organization has the right to enforce the restrictions that the easement imposes. The donor can receive a charitable deduction for the donation if the transaction is structured properly. But, those rules must be strictly satisfied to get the desired tax benefit. Numerous cases have been litigated that illustrate how closely the rules must be followed. Indeed, in Notice 2004-1, 2004-28, IRB 31, the IRS announced that it was increasing its scrutiny of conservation easement transactions. The audit activity and the litigated cases have picked up steam since that time. WALTR's [annotation list](#) denotes many of the litigated cases in recent months.

Clearly, the IRS is skeptical of charitable deductions derived from donations where the donor retains a substantial and continuing interest in the property subject to the donation. This is particularly the case where the donor retains extensive rights to continue to use such property, as is the case with many conservation easements. In the past, IRS has primarily limited its inquiry to the valuation of the easement itself. That is no longer the case. Compliance with all of the Code and regulatory requirements is necessary.

The Basics

While the terms of conservation easements are entirely up to the landowner and the land trust to negotiate, the Code establishes requirements that must be met if the donation of an easement is to qualify for federal tax benefits. Also, many states (such as Colorado) also grant tax benefits for easement donations that comply with the federal requirements.

Conservation easements do not generally provide third parties, or the public, with the right to access or use the land subject to the conservation easement. But, the grantor of the easement may

provide for public use. However, unless the purpose of the easement is the conservation of some feature that is meaningless without public access, such as the preservation of a scenic view, no public access is required to qualify for federal tax benefits. This is likely to be an important point for many landowners.

The protection of farm and ranch land, timberland, and open space are common objectives of donors of conservation easements. This is especially likely to be true where the land is under residential or commercial development pressure and where local planning regulations identify such activities as valuable to the community. In addition, the protection of wetlands, floodplains, important wildlife habitat, scenic views, and historic land areas and structures are also appropriate purposes for easements.

As indicated above, easements that are permanent, donated by the landowner (or conveyed pursuant to a qualified bargain sale), and that conserve publicly significant natural resource values are eligible for federal and state tax benefits. The amount of the deduction is tied to the value of the easement that is donated. That means that appraisals must be conducted and the appraisal approach documented so as to withstand IRS scrutiny. The IRS, if they challenge a transaction, will conduct their own expert appraisal of the property. Often, the court battle comes down to which appraisal is deemed to be most accurate – the taxpayer's or the government's.

What the IRS appears to not like, even though the Code and regulations allow it is the fact that a conservation easement permits the continuation of the agricultural uses by the landowner at the time the easement is donated. In other words, after the easement donation is made which carries out tax benefits if done properly, the landowners can still conduct farming and/or ranching activities on the property. In addition, land subject to a conservation easement may be freely sold, donated, passed on to heirs and transferred in every normal fashion, so long as it remains subject to the restrictions of the easement in the hands of the heir(s) or transferee(s). Such dispositions do not negate the tax benefits of donating the easement. Likewise, it is possible for the donor to retain some rights to limited residential development and still receive the associated tax benefits so long as the retention of such rights does not conflict with the conservation purposes of the easement. Because of these characteristics, the IRS requires strict compliance with all of the Code requirements and the applicable regulations.

Requirements for Federal Tax Benefits

Generally, a federal tax deduction is not allowed for the contribution of less than the donor's entire interest in the property donated. However, a conservation easement is an exception to the general rule. The Regulations specify that a qualified conservation contribution is the contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes in perpetuity. *Treas. Reg. §1.170A-14.*

Four basic requirements must be satisfied to get a charitable deduction for an easement donation:

- The Easement Must Convey a "Qualified Real Property Interest";
- The Contribution Must Be to a "Qualified Organization";
- The Easement Must Be "Exclusively for Conservation Purposes";
- The Conservation Easement Must Be In Perpetuity; and

- The transaction must not be an "excess benefit transaction"

New IRS Guidance

There are a lot of details in those requirements, and now the IRS has released its audit technique guide for donated permanent conservation easements. It is a very helpful document that details how the IRS instructs its auditors that are examining returns that claim a deduction for the donation of a permanent conservation easement. The hope is that by studying the document and understanding the IRS view on easement transactions, the transactions can be structured properly to get the desired tax benefits and not get the taxpayer tangled-up in unnecessary litigation on the issue.

The complete IRS Conservation Easement Audit Techniques Guide is at:

<https://www.irs.gov/businesses/small-businesses-self-employed/conservation-easement-audit-techniques-guide>