Local, State and Federal Tax Incentives for Conservation Easements

Third Edition

The Honorable Mark Sanford, Governor
Burnet R. Maybank, III, Director

December 2005

PREFACE TO THIRD EDITION

In 2005 the South Carolina General Assembly adopted important changes relative to charitable deductions resulting from gifts of conservation easements and other non-cash charitable contributions. This Third Edition incorporates the 2005 legislative changes.

Burnet R. Maybank, III
Director, S.C. Department of Revenue
December 2005

State of South Carolina

Office of the Governor

MARK SANFORD
GOVERNOR

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GREETINGS

South Carolina's scenic and historic places are some of the state's greatest resources. As development reaches new heights, greater pressure is put on our natural environment.

Through state and federal programs such as the South Carolina Heritage Fund, South Carolina Conservation Bank, Wetland Reserve Program, Farmland Protection Program and private agreements between local land trusts and private land owners, some of the state's most valuable private property can be protected through conservation easements, outright grants and funding assistance for conservation and rehabilitation plans. The deduction of conservation easements from state and federal taxes serves as a powerful incentive to promote further protection of ecologically important and sensitive areas.

This publication assists private land owners, land trusts, attorneys, appraisers, real estate agents and other conservation professionals in understanding the requirements and implications of the tax incentives for conservation easements in South Carolina. The layout of the book is designed to be useful to a wide range of users.

Formatting and organization have been edited for easier location of essential information for newcomers and detailed examples for professionals. Several existing sections from the old edition have been updated and several new sections have been added, including sections on other state and federal programs and subsections on land trusts and the exchange of easements for zoning issue. We hope you find the information provided useful. Take care.

Sincerely,

Mark Sanford

MS/bm.lb

South Carolina Department of

Natural Resources

John E. Frampton
Director

Dear Landowner:

South Carolina is uniquely rich in natural resources that contribute greatly to the welfare of the people of our state, our economy and to the quality of life enjoyed by its residents and visitors. South Carolinians consider this natural wealth as part of our heritage and we are constantly seeking ways to conserve natural resources for future generations.

One of the ways that state and federal governments encourage the protection and conservation of our landscape is through tax incentives for private landowners to conserve their properties, in perpetuity, through tools such as donated conservation easements. This system of partnering between private landowners, public agencies and land trusts, via tax incentives and credits, is working well with thousands of acres of land being protected permanently.

On behalf of the South Carolina Department of Natural Resources, we wish to endorse this publication and commend its authors on a necessary, timely and well-written manual for using tax incentives to foster the protection of private lands.

Sincerely,

Michael G. McShane
Chairman, SCDNR Board

John E. Frampton
Director, SCDNR

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Burnet R. Maybank, III

December 2005

LOCAL, STATE, AND FEDERAL TAX ASPECTS OF CONSERVATION EASEMENTS

THIRD EDITION

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INTRODUCTION

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

What 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.

The "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*, such as enjoyment or education of the public, the protection of an important habitat, the protection of scenic open space or open space that has been identified by government as worthy of protection, and the protection of historic property. Generally, 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, river or lake; then your donation is more likely to qualify for a deduction. You also 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.)

How 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 with generally underdeveloped or only partially developed land, the "value" for estate tax purposes is equal to the highest amount someone would pay if the land were sold for development.

As an example, 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 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 (remember, this is only an example), let's say the value of Riverview as a 200-acre "estate" that could never be developed further 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. [*Editor's Note*: In practice, particularly where wetlands are involved, the value of a conservation easement is frequently less than the example used here.]

Essentially the rule is *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.*[1]

[1] Stephen J. Small, *Preserving Family Lands: Essential Tax Strategies for the Landowner* (Rev'd 3rd Ed.).

CHAPTER I. GENERAL

Conservation easements have been used by governmental agencies to protect privately owned land since the 1930s and have become the most popular option for preservation, currently protecting over 2.6 million acres.[2] Such easements offer important federal, state and local tax advantages, and they generally must comply with the South Carolina Conservation Act as well as federal income tax rules relating to "qualified conservation contributions." These federal tax rules are discussed in detail below.

For federal tax purposes, conservation easements are "qualified conservation contributions" defined as a contribution of (1) a qualified real property interest (2) to a qualified organization (3) exclusively for conservation purposes.[3] Generally a taxpayer is not entitled to take a charitable deduction for a contribution (not made in trust) of a *partial* interest in property. (A conservation easement is a partial interest in property; however, Internal Revenue Code § 170(f) provides an exception for qualified conservation contributions.)

Conservation easements are particularly important in South Carolina. The state's population has grown rapidly in the last fifty years, from 1.3 million to over 4 million, a 300% increase.[4] This growth in population has been accompanied by a movement from rural to urban areas.[5] The rate of growth is expected to continue into the future, with South Carolina topping 5 million residents by 2025.[6] South Carolina was ranked tenth nationally in loss of rural lands with 25,000 of the 12.4 million acres (200 acres per day) of forest land converted per year--six times the national rate.[7] In reaction to these trends, the State enacted the South Carolina Conservation Incentives Act and the Conservation Bank Act to provide incentives for landowners to grant easements protecting their property and to allocate State funds to assist in buying easements.[8]

Protection of private lands through the establishment of land trusts on the local, state and national scale has grown rapidly during the last half-century and especially recently. The number of local land trusts has risen from around 50 in the 1950s to approximately 1,300 today, with the peak of growth coming in the late 1980s to mid-1990s when an average of one new local land trust was being created each week.[9] Originally, most of these trusts

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[2] F. J. Lipman, *No more parking lots: How the Tax Code Keeps Trees Out of a Tree Museum and Paradise Unpaved*, 27 Harv. Envtl. L. Rev. 471, 491 (2003) (citations omitted).
[3] IRC § 170(h)(1).
[4] Jeffery L. Beacham, *The Wildest Bank Around*, South Carolina Wildlife, 18 (Jan.-Feb. 2004) (citing U.S. Census numbers).
[5] *Id.*
[6] *Id.* at 20.
[7] *Id.* at 21; *Conservation Easements More Important Each Day*, Island Packet Online, http://www.islandpacket.com/editorial.v-print/story/3300398p-2945767c.html (Feb. 4, 2004).
[8] S.C. Code §§ 48-59-10 to -140 (Supp. 2002).
[9] Richard Brewer, *Conservancy: The Land Trust Movement in America*, at 9 (Univ. Press of New England 2003).

were small, volunteer operations, but today about half of all trusts employ a paid staff.[10] This trend is even more striking considering that the total number of trusts has more than doubled in the last 20 years.[11] Local land trusts have protected over 6.5 million acres, with over 4 million of these acres being added after 1990.[12] Current growth of new trusts has slowed to approximately 2 percent, down from 5.6 percent from 1990 to 1994.[13]

CHAPTER 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 property tax savings.

B. Federal Income Tax Savings

As detailed below, the gift of a conservation easement can generate significant federal income tax deductions.

1. Gifts by Individuals

The ability of a donor to receive a federal income tax deduction (and the amount of any deduction) for a charitable contribution depends on a variety of factors, the most important of which include the following:

(1) The existence of a "gift" with the requisite donative intent;[14]
(2) The nature of the property:
  (a) Real vs. tangible personal property and
  (b) Long-term capital gain, short-term capital gain, or ordinary-income property;
(3) The appreciation in the property's value;
(4) The donor's tax classification (*e.g.*, corporation, partnership or individual);[15]
(5) The tax classification of the donee (*e.g.*, public charitable organization, private foundation, or governmental body); and
(6) The use of the donation by the charitable organization (related or unrelated use.)

The rules regarding charitable deductions are exceedingly complex. The discussion below assumes there was a "gift" (1, *above*) of appreciated real property (2(a) and 3) to either a governmental body or a land trust that is a public charity (5), which puts the property to a related use (6). This discussion also assumes the conservation easement was the only

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[10] *Id*. at 10.
[11] *Id*.
[12] *Id*. at 11.
[13] *Id*. at 40.
[14] The rules regarding *quid pro quo* "gifts" are discussed elsewhere.
[15] The rules relating to trust and estates are discussed elsewhere.

charitable contribution made by the donor that year. The tax classification of the property (2(b)) and the donor (4) are discussed below.

The extent to which the contribution is deductible also depends on the value of the property and compliance with the various appraisal and substantiation rules.[16] Lastly, there exists an overall limitation on the deductibility of all itemized deductions, including those for charitable contributions, known as the "AGI limitation."

a. Tax Classification of Property

Different rules apply to calculating a charitable deduction depending upon whether the property is long-term capital gain property or ordinary-income property.

i. Capital Gain Property

Capital gain property includes capital assets held for more than one year, which includes most real property used for personal purposes or for investment. It does not include ordinary income or short-term capital gain property.

Donors generally may use the fair market value (FMV) of capital gain property. A donor must, however, reduce the FMV by any amount that would have been long-term capital gain (if the donor had sold the property) if the donor chooses the 50% limit instead of the 30% limit. This is called the "percentage limitation" and is discussed later.

ii. Ordinary-Income Property

Property is ordinary-income property if its sale at FMV on the date it was contributed would have resulted in ordinary income or in short-term capital gain. Examples of ordinary-income property include capital assets held one year or less; and property used in a trade or business.

The amount a donor can deduct for a contribution of ordinary-income property is its FMV *less* the amount that would be ordinary income or short-term capital gain (had the property been sold). Generally, the rule limits the deduction to the donor's cost basis.[17] This rule applies irrespective of whether the gift is made by an individual or a corporation.

The great majority of property covered by a conservation easement will not be considered ordinary-income property except in the case of certain real estate developers ("dealers," discussed later) or where the conservation easement is granted shortly after purchase by the donor (rendering it short-term capital gain property).

IRC Section 1221(1) states that capital assets do not include "property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business." The

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[16] These factors are discussed elsewhere.
[17] IRS Pub. 526, *Charitable Contributions*, (Rev'd Doc. 2003.) http://www.irs.gov/pub/irs-pdf/p526.pdf

IRS contends that "[i]f you own a tract of land and, to sell or exchange it, you subdivide it into individual lots or parcels, the gain normally is ordinary income."[18]

Courts often cite the following factors in determining whether property is held primarily for sale to customers in the ordinary course of a trade or business:

(1) The purpose for which the property was acquired;
(2) The purpose for which it was held;
(3) The extent of improvements made to the property by the taxpayer;
(4) The frequency, number, and continuity of sales of the property;
(5) The extent and substantiality of the disposition of the property;
(6) The nature and extent of the taxpayer's business;
(7) The extent of any advertising of the property; and
(8) The listing of the property for sale directly or through a broker.[19]

A real estate developer may hold certain real property primarily for sale to customers in the ordinary course of business and hold other property as a capital investment. The taxpayer would normally bear the burden of proving he or she held the donated land as an investor rather than as a dealer.[20]

IRC Section 1237 allows under limited circumstances certain taxpayers to receive capital gain treatment on at least a portion of certain contributions of real property that would otherwise be ordinary-income property. This section provides that a lot or parcel which is part of a larger tract owned by the taxpayer shall not be deemed to be ordinary-income property solely because the taxpayer subdivided it if (1) such tract had not previously been held for sale and in the same year the taxpayer sold it the taxpayer does not hold any other real property; (2) the taxpayer makes no substantial improvements which substantially enhance the value of the lot; and (3) the lot is held by the taxpayer for at least five years (except where it is acquired by inheritance).

In IRS Private Letter Ruling 9537018, the taxpayer was engaged in both timber growing as well as subdividing and reselling real property. The taxpayer sought a ruling that the contribution of a conservation easement on certain timberland was not a contribution of ordinary-income property.[21] After discussing the various IRS Revenue Rulings and case law, the PLR stated that "[t]he easement to be granted by taxpayer to donee is an interest in the underlying property. If the underlying property is a capital asset, the easement will also be treated as a capital asset. . . ." After noting the IRS's policy of not ruling on whether

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[18] IRS Pub. 544, *Sales and Other Disposition of Assets* (for use in Preparing 2003 Returns).
[19] See, *e.g.*, *Graves v. Commissioner*, 867 F.2d 199, 202 (4th Cir. 1989). See also *Suburban Realty Co. v. United States*, 615 F.2d 171 (5th Cir. 1980); *Houston Endowment, Inc. v. United States*, 606 F.2d 77 (5th Cir. 1979); *Biedenharn Realty Co. v. United States*, 526 F.2d 409 (5th Cir. 1976). For a recent case involving the sale of classic vehicles, see David Taylor Enterprises & Subsidiaries, TC Memo 2005-127.
[20] *Turner v. Comm'r*, 540 F.2d 1249 (4th Cir. 1976).
[21] *See* generally Stephen J. Small, Proper – and Improper – Deductions for Conservation Easement Donations, Including Developer Donations, Tax Notes at pg. 222 (Oct. 11, 2004).

property is held primarily for sale to customers in the ordinary course of business,[22] the PLR declined to express an opinion of whether the underlying property was a capital asset.

b. Percentage Limitations

As stated earlier, gifts by an individual to a public charity are deductible in the amount of the fair market value of the gift up to 50% of the taxpayer's adjusted gross income. A special limitation applies, however, to gifts of appreciated long-term capital gain real property to public charities.[23] This limitation will cover the great majority of contributions of conservation easements. IRC § 170 (b)(1)(C)(I) limits a contribution of a conservation easement to 30% (as opposed to 50%) of the taxpayer's adjusted gross income. The taxpayer may elect, however, to reduce the deduction by the amount of the property's unrealized appreciation. The reduced donation will then be subject to the 50% adjusted gross-income limitation.[24]

In summary, a taxpayer donating a conservation easement may generally deduct one of the following:

- FMV of the conservation easement up to 30% of the taxpayer's AGI
- Cost basis of the conservation easement up to 50% of the taxpayer's AGI

Any contributions in excess of this limitation may be carried forward and deducted for five years.[25]

EXAMPLE:

A gift of $500,000 is in appreciated property (basis of $300,000) by a donor with a contribution base (AGI) of $200,000. Donor can deduct the full $500,000 at a rate of $60,000 in the year of the gift and $440,000 over the next five years (subject to the 30% limit)--or deduct only $300,000, but deduct $100,000 in the year of the gift, and the other $200,000 over the next five years (subject to the 50% limit).[26]

"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."[27]

[22] See Sections 3 and 4 of Rev. Proc. 2002-3.
[23] Public charities are frequently referred to as "50% charities."
[24] IRC §§ 170(b)(1)(C) and 170(e)(1)(B). See generally, Francine J. Lipman and James E. Williamson, *Avoiding Malpractice Traps in Noncash Charitable Contributions*, 14 No. 2 Prac. Tax Law 49 (2000).
[25] The 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 (Form 1040, Line 32) referred to as the "contribution base" (see below).
[26] Edward Jay Beckwith, *Primer Charitable Contributions*, 2003 WL 22002107 at p. 5 (Georgetown Univ. Law Center CLE 2003).
[27] *Conservation Options: A Landowner's Guide* at p. 47.)

> ***[R]ecommendation***: Elect [50% ceiling] where the appreciation is small (value of increased current deduction is greater than loss of eventual deduction of appreciation) or where the 30% limit will prevent deduction of the appreciation even over the carryover period.[28]

The election is made by attaching a statement to the original income tax return for the election year.[29] "It does not appear that a taxpayer can make this election on an amended tax return."[30] "Once made, the election applies to all gifts of capital gain property to 50% [public] charities made by the donor in the tax year. In computing carryovers to this year, contributions of this property in an earlier year for which the election was *not* made are reduced as if they were subject to the reduction when made."[31]

c. Contribution Base

As stated above, the amount of a charitable deduction which may be taken in any one year for a gift of a conservation easement is limited to either 30% or 50% of the donor's "contribution base." (An additional AGI limitation is found below.) "Contribution base" is defined as adjusted gross income computed without regard to any net operating loss carryback to the taxable year.[32]

d. AGI Limitation

One additional limitation is likely to apply. In 1991, Congress enacted an overall limitation on the deductibility of certain itemized deductions, including charitable contributions—the AGI limitation. In 2003, the limitation applies if the taxpayer's adjusted gross income (line 36 of Form 1040) is more than $139,500 ($68,650 for married, filing separately.)[33] Where the limitation applies, the itemized deductions are reduced by the smaller of either 3% of the amount by which the taxpayer's adjusted gross income exceeds $139,500 ($68,650 for married, filing separately) or 80% of the itemized deductions affected by the limit. See the *Itemized Deductions Worksheet* in the *Instructions for Form 1040*, and use the worksheet on page A-6 of the Form 1040 instructions to calculate the limitation.

e. The Alternative Minimum Tax (AMT)

The AMT subjects to tax "tax preference items," which include a variety of deductions, credits and tax incentives, such as the deduction for payment of state taxes. In other words, persons subject to the AMT–which includes virtually every individual who gives a conservation easement–effectively lose a variety of deductions. The appreciation

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[28] *Federal Tax Handbook* ¶ 2131 (RIA).
[29] Treas. Reg. § 1.70A-8(d)(2)(iii).
[30] 14 No. 2 Prac. Tax Law 49, *supra*.
[31] *Federal Tax Handbook* at ¶2131 (RIA), *citing* IRC § 170(b)(1)(C)(iii); Treas. Reg. § 1.170A-8(d)(2).
[32] IRC § 170(b)(1)(F). IRC § 62 defines "adjusted gross income" as "gross income" (defined by Section 61) less the deductions listed in Section 62.
[33] *See* Rev. Proc. 2002-70. This amount is adjusted annually for inflation.

element of a gift of appreciated real property was once a tax preference item; however, Congress abolished this provision in 1993.

f. Carryforward

A taxpayer can generally carry over contributions which are not deductible in the current year because they exceed the AGI 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. Separate carryover provisions apply to excess 50% contributions[34] and excess contributions of 30% capital gain property. [35] A taxpayer is entitled to carryover contributions to public charities in excess of 50% of his or her contribution base for a five year period following the year of the contribution. Contributions of 30% capital gain property may be carried over for five years to the extent the contributions exceed 30% of the taxpayer's contribution base.[36]

Section 106 of the Charity Aid, Recovery and Empowerment (CARE) Act of 2003 (currently in a Congressional conference committee), would allow farmers and ranchers donating a conservation easement to take a deduction up to an equal amount of their adjusted gross income in any year with a 15-year carry-over.[37]

2. Gifts by Partnerships and LLCs

> The taxable income of a partnership [or LLC] generally is computed in the same manner as is the case with individuals; however, the charitable deduction is not allowed the partnership. Rather, each partner takes into account separately the partner's distributive share of the partnership's charitable contributions. A partner's distributive share of charitable contributions made by a partnership during a tax year of the partnership is allowed as a charitable deduction on the partner's tax return for the partner's tax year with or within which the tax year of the partnership ends. The aggregate of the partner's share of partnership contributions and the partner's own (directly made) contributions are subject to the various percentage limitations . . . on annual deductibility.[38]
>
> Although charitable deductions may *not* be deducted by the partnership, each partner is considered to have paid within his taxable year his distributive share of any contribution or gift made by the partnership within its taxable year ending within or with the partner's taxable year. Each

[34] *See* IRC § 170(d)(1).
[35] *See* IRC § 170(D)(ii)
[36] IRC § 170(b)(1)(C)(ii). *See generally*, 521-2nd TMP at VI. A. (pp. 366-68).
[37] "The U.S. Senate passed the CARE Act S. 476 on April 9, 2003, by a vote of 95 to 5. The House passed its companion bill, H.R. 7, on September 17, 2003. A House-Senate conference to resolve differences between the two bills was not convened before the 108th Congress adjourned in December 2004." Independent Sector, *Public Affairs: CARE Act of 2003 (S.476)*, http://www.independentsector.org/programs/gr/CAREAct2003.html (February 2, 2005).
[38] Bruce R. Hopkins, *The Tax Law of Charitable Giving* (2nd Ed.)

> partner's share of the partnership's contribution is allowed as a deduction in his personal return. The partner's share of the partnership's contribution must be added to contributions made by the partner individually limited by the percentage limitations of Section 170(b). If the partnership makes a charitable contribution of property, the basis of each partner's interest in the partnership is decreased (but not below zero) by the partner's share of the partnership's basis in the property contributed.[39]

The question in IRS Rev. Rul. 96-11 was "If a partnership makes a charitable contribution of property, are the partners' basis in their partnership interests decreased to reflect the contribution?" The ruling held that "[i]f a partnership makes a charitable contribution of property, the basis of each partner's interest in the partnership is decreased (but not below zero) by the partner's share of the partnership's basis in the property contributed." IRS Private Letter Ruling 9318017 discusses the pass-through treatment to partners of the granting of a conservation easement made by a partnership. In PLR 200208019 the IRS noted that the members of the taxpayer, and not the taxpayer itself (an LLC), would be considered as having made the charitable contribution, in proportion to members' respective partnership interests.

3. Gifts by C Corporations

Charitable contributions by C 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, or the special corporate deductions contained in IRC §§ 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.

Unlike S corporations (or individuals), a C corporation is allowed a deduction of up to one-half of the appreciation of certain ordinary-income property (*e.g.*, real property which is either short-term capital gain, or is primarily held for sale to customers)[40] contributed to a public charity.[41] To the extent contributions made by a C corporation exceed the 10% limit, the excess may be carried forward and deducted for five years.[42]

> Carryover of excess contributions. You can carry over, within certain limits, to each of the subsequent five years any charitable contributions made during the current year that exceed the 10% limit. You lose any excess not used within that period. For example, if a corporation has a carryover of excess contributions paid in 2002 and it does not use all the excess on its return for 2003, it can carry the rest over to 2004, 2005, 2006, and 2007. Do not deduct a carryover of excess contributions in the carryover year until after you deduct contributions made in that year (subject to the 10% limit). You

[39] 9 *Mertens Law of Fed Income Tax'n* §35:153 (footnotes omitted).
[40] See the discussion of dealer property, *supra*.
[41] 8 *Mertens Law of Fed Income Tax'n* § 31:118.
[42] IRC §170(d)(2).

> cannot deduct a carryover of excess contributions to the extent it increases a net operating loss carryover.[43]

4. Gifts by S Corporations

Similar to partnerships and LLCs, an S corporation may not claim a deduction for its charitable contributions at the corporate level. Instead, charitable contributions by an S corporation are reported on the S corporation's income tax return and pass through to the shareholder. They are deductible by the shareholder subject to the same percentage limitations imposed on charitable contributions by individuals, as well as the S corporation basis limitations. An S corporation's shareholder may deduct his *pro rata* share of charitable contributions only to the extent of his adjusted basis in his S corporation stock. The 10% limitation on charitable contributions made by C corporations does not apply to S corporations.

PLR 9537018 discusses the pass-through treatment to the shareholders of an S corporation of a charitable deduction made by the corporation through the granting of a qualifying conservation easement. The PLR summarizes the above rules as follows:

> Under section 1363(b)(2) of the Code, Taxpayer [the S corporation] is allowed no deduction for the qualified conservation contribution. Each shareholder of Taxpayer, however, may take into account in computing his individual tax liability his pro rata share of Taxpayer's charitable contribution as a separately stated item of deduction. The amount of deduction allowed to each shareholder, however, is subject to the individual limitations in section 170 and section 1366(d)(1). Finally, the basis of each shareholder's stock in Taxpayer is decreased by his full pro rata share of Taxpayer's qualified conservation contribution (as defined in section 170), without regard to the actual deduction allowed to the shareholder.

Regarding the impact on Earnings and Profits (E&P) of a gift of real property, the donation is "reflected in E&P in the same manner as a sale or other disposition of the property – i.e., E&P are reduced by the amount of the corporation's adjusted basis in the property. If the property has appreciated, E&P are increased by the amount of the appreciation. The Tax court holds that E&P are reduced by the full amount of the property (upto the corporation's charitable deduction ceiling), but the IRS limits the reduction to the property's adjusted basis even if the donor can deduct its full value."[44]

IRS Revenue Ruling 78-123 dealt with the effect of a gift of appreciated real property on E&P. The IRS summarized its view of the law as follows:

> The effect on earnings and profits in the instant situation is as follows: In computing its taxable income, the taxpayer is allowed to deduct, under section 170 of the Code, an amount equal to the fair market value of the

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[43] IRS Pub. 542, *Corporations, for use in Preparing 2003 Returns,* p. 6.
[44] 33A Am. Jur. 2d Federal Taxation ¶ 4283 (citations omitted.)

property other than money contributed to a recognized charity. This deduction reduces the corporation's taxable income and results in a corresponding lesser amount of income being included in the current earnings and profits. However, under section 312, the unrealized appreciation in value of the property may not reduce earnings and profits. Therefore, current earnings and profits must be increased by the difference between the fair market value of the donated property and the taxpayer's adjusted basis of the donated property. Consequently, the final result, for earnings and profits purposes, is that current earnings and profits have been decreased by the taxpayer's adjusted basis of donated property.

5. Certain Abusive Transactions

In Notice 2004-41, the IRS noted that some taxpayers were claiming inappropriate deductions for cash payments or easement transfers to charitable organizations. In certain cases the charitable organization would purchase property and place a conservation easement on it. The charity then would sell the property to a buyer for a price substantially less than what the charity paid for it. As part of the sale the purchaser then would make a "charitable contribution" to the charity, which would reimburse fully the charity for the cost of the property. The IRS noted that it may disallow all or part of any improper deductions and may impose penalties against the charity, as well as its officers, promoters and appraisers.

C. State Income Tax Savings

1. Federal Tax Conformity

The discussion above deals with the federal law governing both conservation easements and the deductibility of qualified donations. South Carolina annually conforms with the federal tax laws after certain adjustments and "add backs."[45] Except as stated below, South Carolina does not require a charitable deduction of a conservation easement to be added back for purposes of computing South Carolina taxable income.[46] Therefore, any gift to a charity or governmental entity that qualifies for a charitable deduction for federal income tax purposes "flows through" and reduces the donor's state tax liability.[47]

As stated in greater detail in the section dealing with donative intent, *supra*, in 2005 the South Carolina General Assembly adopted a special donative intent rule for noncash charitable contributions with a value in excess of $100,000, including a ban on charitable deductions for grants of conservation easements on golf courses. Taxpayers would have to add back any charitable deductions taken on federal tax returns for gifts covered by the new Act.[48]

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[45] *See* S.C. Code §12-6-50 (Supp. 2004) for the list of Internal Revenue Code provisions which are specifically not adopted by South Carolina.
[46] *See Id.* § 12-6-50.
[47] *See* S.C. Code § 12-6-3515 (Supp. 2004).
[48] *See* Section 43D of H. 3768 (2005).

2. Conservation Credit

In South Carolina, "[d]onations of land for conservation and conservation easements are typically made to nonprofit conservation organizations such as The Nature Conservancy, Ducks Unlimited (Wetlands America Trust) and the Lowcountry Open Land Trust."[49] A taxpayer who is entitled to and claims a federal charitable deduction for a gift of land for conservation or for a qualified conservation contribution donated after May 31, 2001, on a qualified real property interest located in South Carolina may also claim a South Carolina income tax credit equal to 25% of the deduction attributable to the gift of land for conservation or to the qualified real property interest located in South Carolina.[50] The credit cannot exceed $250 per acre of property to which the qualified conservation contribution or gift of land for conservation applies and the total credit claimed by a taxpayer may not exceed $52,500 per year

Any unused credit may be carried forward until used. The unused credit may be transferred, devised, or distributed, with or without consideration, to another taxpayer upon written notification to, and approval by, the Department of Revenue of the transfer.[51] The unused credit retains all its original attributes in the hands of the recipient. The gain on the sale or exchange of this credit is subject to South Carolina income taxes. Traditionally, donations were mostly made by higher income taxpayers to offset income, but with the addition of transferability of tax credits under the statute, donors who are "land rich and cash poor" can transfer their credits to receive immediate returns rather than carry their credits over an extended period.[52]

For purposes of this credit, "qualified conservation contribution" and "qualified real property interest" have the same meaning as defined in Internal Revenue Code § 170(h). The term "gift of land for conservation" is a charitable contribution of fee simple title to real property conveyed for conservation purposes as defined in IRC § 170(h)(4)(A) to a qualified conservation organization as defined in IRC § 170(h)(3).

Notwithstanding IRC § 170(h) and applicable regulations, a taxpayer is not disqualified from claiming this credit because of silvicultural (forestry-related) practices permitted by or undertaken pursuant to a conservation contribution on a real property interest, provided that: (1) the practices conform to Best Management Practices established by the South Carolina Forestry Commission existing at the time the conservation contribution is made, or at the time a particular forestry-related or silvicultural practice is undertaken; (2) the conservation contribution otherwise conforms to the requirements of IRC § 170(h); and (3) the taxpayer provides the Department of Revenue with information to determine that the taxpayer would otherwise be eligible for the deduction under IRC § 170(h). The credit is 25% of the deduction that would otherwise be allowable under IRC §

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[49] Scott Barnes and Chip Campsen, *South Carolina Incentives Act*, South Carolina Lawyer, 15 (March-April 2001) (giving a detailed look at the South Carolina Conservation Incentives Act and its practical aspects).
[50] The South Carolina Conservation Incentives Act, S.C. Code Ann. §§ 12-6-3515 *et seq.*
[51] *See* DOR Policy Document RPB#01-11.
[52] Barnes and Campsen *at* 15. see the website of the South Carolina Conservation Credit Exchange, LLC, http://www.conservesc.com for an example of a "credit broker."

170(h) but for the silvicultural and forestry-related activities performed on the real property and is subject to all the other conditions and limitations of this section.

For purposes of applying the per-acre and per-taxpayer limitations, the attribution rules of IRC § 267 apply.[53] The fair market value of all qualified donations must be substantiated by a "qualified appraisal" prepared by a "qualified appraiser" as defined under applicable federal law and regulations relating to charitable contributions. The credit is claimed on DOR Form TC-19, "Credit for Conservation or Qualified Conservation Contribution of Real Property" to be filed with individual income tax returns.

For more information, contact:

South Carolina Department of Revenue
P.O. Box 125
Columbia, SC 29214
Phone: 803-898-5000
Fax: 803-898-5822

3. 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.[54] 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.[55] The new law also provided more options for landowner participation.[56]

The Act contains a voluntary tax incentive.[57] Landowners granting easements may deduct up to the fair market value of the easement,[58] as assessed at the time of donation. 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.[59] Donors of land in fee simple may deduct from their state income taxes an amount up to the value of the land donated, as assessed at the time of donation.[60] Donors of either fee simple estates or

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[53] *See* S.C. Revenue Procedural Bulletin #01-11.
[54] S.C. Code §§ 49-29-10 *et seq.* (Supp. 2004).
[55] S.C. Code §§ 49-29-110 (Supp. 2004).
[56] *See generally* South Carolina Scenic Rivers Program, *Administrative Handbook* (Water Resources Commission 1991). (The Water Resources Commission is now known as the Land, Water and Conservation Division of the Department of Natural Resources.)
[57] S.C. Code § 49-29-100 (Supp. 2004).
[58] Fair market value is calculated as the value of the property before the easement minus the value after the easement, as stated above. *Id*.
[59] *See* S.C. Code §§ 12-37-220(B)(36) (Supp. 2003) and 49-29-100 (Supp. 2004).
[60] S.C. Code § 49-29-100 (Supp. 2004).

easements have five years from the date of donation to claim the deduction in total (or they may claim the deduction proportionately over that time).[61]

D. Estate and Gift Taxes

1. Special Note: The Elimination of Estate Taxes in 2010

The Economic Growth and Tax Relief Reconciliation Act of 2001 eliminated (for one year) the estate and generation skipping taxes (GST) (but not the gift tax) in 2010. The estate tax credit was increased to a $1 million exemption equivalent effective January 1, 2002, and is thereafter increased incrementally to $3.5 million by 2009. The Act provides that after elimination of the estate tax in 2010 certain rules will remain in effect, including those pertaining to conservation easements. As currently written, the Act eliminates the estate and GST for only a single year. Presumably after 2010, unless Congress acts, estate taxes will be calculated by the law in effect in 2006 under the Taxpayer Relief Act of 1997.[62]

2. General

In addition to the income tax charitable-contribution deduction available for conservation easements, [63] Congress has provided three estate tax benefits for qualifying conservation easements.[64] The first estate tax benefit is that the property subject to a conservation easement is included in the decedent's estate at its fair market value at the time of the decedent’s death, that is, as reduced in value by the easement.[65] The second estate tax benefit is an election to exclude from the decedent's estate any estate tax up to 40% of the remaining value of any property subject to a qualifying conservation easement.[66] (This is referred to below as the exclusion rule.) As a third estate tax benefit, the Internal Revenue Code also allows the estate to take an estate tax charitable deduction. (This is referred to below as the deduction rule.)

3. Exclusion Rule

a. General

> If a decedent’s gross estate includes real property, the property is included in the estate at its fair market value, determined by the all too familiar willing buyer/willing seller standard Reg. 20.2031-1(b). The regulations under §2031 require consideration of all relevant facts and elements of value as of

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[61] *Id*.
[62] Ronald D. Aucutt, *Planning and Drafting Strategies After the Economic Growth and Tax Relief Reconciliation Act of 2001*, SH022 ALI-ABA 1257 (2002).
[63] Portions of this chapter are reprinted with permission, Frances J. Lipman, *No More Parking Lots: How the Tax Code Keeps Trees out of a Tree Museum and Paradise Unpaved*, 27 Harv. Envtl. L. Rev. 471 (2003).
[64] *See* IRC § 2031(a) (setting forth that a decedent's gross estate includes the value of all property owned at the time of decedent’s death) and IRC § 2031(c) (describing the forty percent exclusion from a decedent's gross estate of the value of property subject to a conservation easement).
[65] IRC §§ 2031, 2051.
[66] IRC § 2031(c).

> the valuation of property in an estate which is subject to burdens or restrictions on a willing buyer, irrespective of whether the easement or restriction is a qualified conservation easement. . . .
>
> Section 2031(c) gives more benefits than the potentially subjective analysis under section 2031(a). Section 2031(c) came into the law for the first time as part of the Tax Reform Act of 1997. Section 2031(c) affords two potential opportunities: a limited but valuable exclusion from the gross estate for property subject to conservation easements and a complete deduction for the value of conservation easements, even easements contributed after death.[67]

Congress enacted this partial exclusion from estate tax in 1997 to facilitate preservation of environmentally significant land by easing "existing pressures to develop or sell off open spaces in order to raise funds to pay estate taxes."[68] The partial exclusion provides significant additional estate tax benefits to encourage the donation of conservation easements to stall over-development in the United States.[69] The Tax Code provides an election to exclude up to 40% of the value of "land subject to a qualified conservation easement"[70] from a decedent's gross estate.[71] As a result, this value is excluded from decedent's taxable estate resulting in a reduced estate tax. For example, assume a decedent owned land subject to a conservation easement at death valued at $1,000,000. The decedent's executor may elect to exclude from decedent's estate up to an additional $400,000 (subject to certain restrictions) of the land and not owe any estate tax on the excluded value.[72] If the election is made, the excluded portion of the property subject to the

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[67] W.A. Sinsheimer, *Conservation Easements in Planning and Administering Estates and Trusts*, 325 PLT/Est 337, 345 (2003).

[68] Staff of Joint Comm. on Taxation, 105th Cong., *General Explanation Of Tax Legislation Enacted In 1997* at 78 (Comm. Print 1997). This estate tax exclusion applies to decedents dying after December 31, 1997, and is estimated to have a federal revenue effect of a $7 million reduction in 1999, $15 million in 2000, $25 million in 2001, $35 million in 2002, $48 million in 2003, $51 million in 2004, $56 million in 2005, $60 million in 2006, and $64 million in 2007.

[69] *See* John A. Bogdanski, *Enough Already With the Breaks for Conservation Easements*, 78 Tax Notes 1569 (1998) (describing the exclusion as "opening the door for a double-benefit" and questioning whether the new provision is an "embarrassing technical mistake"); C. Timothy Lindstrom & Stephen J. Small, *This Is Why Conservation Easements Deserve Tax Incentives*, 79 Tax Notes 130 (1998) (responding to Professor Bogdanski by noting that Congress was motivated to provide more tax incentives by data showing that four square miles of farmland is developed per day and that one-third of Oregon (Professor Bogdanski's home state) forest landowners were over 75 years old); John A. Bogdanski, *New Tax Benefits For Conservation Easements Still Questioned*, 78 Tax Notes 500 (1998) (setting forth examples of how generous the tax benefits are for conservation easements relative to other charitable contributions and continuing to question whether Congress made a technical error and enacted an unintended benefit).

[70] IRC § 2031(c).

[71] The election must be made on the estate tax return and is due no later than the estate tax return's extended due date. IRC § 2031(c)(6). For decedents who died before January 1, 2001, the property had to be within a 25-mile radius of a national park, wilderness area or metropolitan statistical area, or within 10 miles of an urban national forest. This rule was repealed for persons dying after December 31, 2000.

[72] *See* IRC § 2031(c). Assuming the decedent granted a conservation easement many years before decedent died, which reduced the value of decedent's land at that time from $2,400,000 to $900,000, the decedent enjoyed a charitable contribution deduction of $1,500,000 during decedent's lifetime. Therefore, the conservation easement reduced the decedent's taxable estate by at least $1,900,000 of value (the excluded

easement will retain its income tax basis and will not be increased to fair market value as of the date of the decedent's death.[73]

To qualify for the exclusion, a conservation easement must satisfy all of the requirements under IRC § 170(h),[74] as well as numerous additional requirements.[75] These requirements include: a three year family ownership requirement;[76] a requirement that the easement must have been granted by the decedent, a family member, the executor, or the trustee of the trust holding the property no later than the date of the election;[77] and a requirement that the easement must prohibit more than *de minimis* commercial recreational activity use.[78] The decedent or a member of the decedent's family[79] must have owned the property protected by the conservation easement at all times for at least three years prior to death.[80] In addition, the decedent, a member of the decedent's family, the trustee of a trust holding the restricted land, or the executor of the decedent's estate must have granted the easement.[81] However, the easement can be placed on the property and donated at any time on or before the date of the election, including after the decedent's death by the decedent's

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amount of $400,000 plus the $1,500,000 reduction from the land's pre-easement fair market value plus any foregone appreciation because of the easement).

[73] IRC § 1014(a)(4).

[74] *See* IRC § 2031(c)(8)(B). Under this definition, a "qualified conservation easement" is a "qualified conservation contribution (as defined in IRC § 170(h)(1)) of a qualified real property interest (as defined in IRC § 170(h)(2)(C))." *Id.* However, the exclusion does not apply to easements when the sole purpose of the easement is historic preservation and the exclusion applies only to land and not to structures. See IRC §§ 2031(c)(1)(A), (c)(8)(B), and 170(h)(4)(A)(iv) (2000).

[75] IRC § 2031(c)(8). Section 551 of EGTRRA eliminated the requirement under IRC § 2031(c)(8)(A)(i) that the land be located in or within 25 miles of a metropolitan area (as defined by the Office of Management and Budget); national park, or wilderness area, designated as part of the National Wilderness Preservation System (unless it is determined by the Secretary that land in or within 25 miles of such a park or wilderness area is not under significant development pressure); or in or within ten miles of an urban national forest (as designated by the Forest Service). Pub. L. No. 107-16, § 551(a), 115 Stat. 38, 86 (codified at 26 U.S.C. § 2031(c)(8)(A)(i) (2001)). This elimination is effective for estates of decedents dying after December 31, 2000. *Id*. Therefore, there is no current geographic limitation for qualifying conservation easements. However, all provisions in Title V of EGTRRA (which includes this geographic limitation) do not apply to estates of decedents dying after December 31, 2010 (Section 901 of EGTTRA). Staff of Joint Comm. on Tax'n, *Present Law and Description of Proposals Relating to Federal Income and Estate Tax Provisions That Impact Land Use Conservation and Preservation* at 11 (Comm. Print 2001). Therefore, these geographic limits will be reinstated and will apply to estates of decedents dying after December 31, 2010 unless Congress extends or makes the repeal permanent. Although the geographic limitations appear restrictive, "it is believed that [they] cover about half of the land in the forty-eight contiguous states and almost all of the land on the East and West Coast."

[76] IRC § 2031(c)(8)(A)(ii).

[77] IRC § 2031(c)(8)(A)(iii) and IRC § 2031(c)(8)(C).

[78] IRC § 2031(c)(8)(B).

[79] The Tax Code defines "member of the decedent's family" for this purpose as a decedent's spouse; ancestors; lineal descendants of the decedent, spouse or parent of the decedent; and spouses of such lineal descendants. IRC §§ 2031(c)(8)(D) and 2032A(e)(2) (2000). Thereby, a family can pass the benefits of the exclusion from one generation to another. Moreover, the decedent can hold the property subject to the easement indirectly through a partnership, corporation, or trust if the decedent owns at least a thirty percent interest in the entity. IRC § 2031(c)(10); *see also* Stephen J. Small, *Understanding the Conservation Easement Estate Tax Provisions*, 87 Tax Notes 435, 438-39 (2000) (describing certain tax consequences of holding property subject to conservation easements through a corporation).

[80] IRC § 2031(c)(8)(A)(ii).

[81] IRC § 2031(c)(8)(A)(iii).

executor, regardless of whether the decedent made any provision for such easement during decedent's lifetime or through his or her trust or will.[82] (This provision allows postmortem easement donations, discussed below.)

b. Time of Granting of the Easement

In many cases the easement will be granted by the decedent during decedent's lifetime. While there is little law on the subject, the estate tax deduction is also allowed for a testamentary gift of an easement. "Recommendation: for the highest level of certainty, to the extent possible the actual language of the deed of easement should be incorporated into the will. 'Ascertainability at the date of death of the amount going to charity is the test.'"[83] Lastly, as discussed below, the easement may be granted postmortem.

c. Postmortem

A postmortem easement does not qualify for any income tax benefits, but can under IRC § 2031(c)(9) provide significant estate tax benefits.[84] Time is essential with respect to planning and placing the postmortem easement because the estate must elect to take the exclusion within 15 months of the decedent's death.[85] If the exclusion is elected, the property subject to the conservation easement will retain its income tax basis and will not be increased to fair market value in the hands of the heirs.[86]

> Example: Carryover Basis Calculation. Mr. Able owns land with a fair market value of $2,000,000 and a basis of $200,000. In 1998 he donates a qualifying conservation easement that reduces the value of his land to $1,000,000. Under Reg. §1.170A-14(h)(3)(iii), the basis of the easement is $100,000 and the basis of the land is reduced to $100,000. He dies in 2003; the land is valued in his estate at $1,000,000. His executor elects to take the §2031(c) exclusion and $400,000 of the land value (40% of $1,000,000) is excluded from his estate. That portion of the land not subject to the exclusion (60%) will receive a stepped-up basis; the portion of the land subject to the exclusion (40%) will receive a carryover basis. Accordingly, the basis of the land in the hands of his heirs is $40,000 (40% of $100,000) plus $600,000 (60% of $1,000,000), or $640,000.[87]

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[82] IRC § 2055(f).
[83] Stephen J. Small, *Tax Incentives and Land Protection Techniques*, SHO26 ALI-ABA 929, 950 (American Law Institute–American Bar Ass'n CLE 2002) (quoting *Estate of David N. Marine v. Commissioner*, 97 T.C. 368 (1991), *aff'd*, 93-1 U.S.T.C.¶ 60,131 (4th Cir. 1993)).
[84] For an example of a post-mortem election, see very recent IRS PLR 200418005.
[85] The exclusion is an election and must be made on or before the due date for filing the estate tax return, including extensions. The election is made on the estate tax return. IRC §§ 2031(c)(6), 6075(a), and 6081 (2000) (setting forth extended due date of estate tax return as nine months plus a six-month extension).
[86] IRC § 1014(a)(4) (2000).
[87] Example contributed by Stephen J. Small.

If a decedent has a taxable estate, it will probably make sense to elect the estate tax exclusion because any built-in gain will be subject to income tax at a maximum federal long-term capital gain tax rate of 20%, (15% for 2003 and later years) rather than the generally higher marginal estate tax rates.[88] If a decedent does not have a taxable estate, in most cases it will not make sense to elect the exclusion.

> Despite the extraordinary promise of the QCE [qualified conservation easement] technique, a number of issues must be resolved before a postmortem QCE is granted. These issues are discussed briefly below. One or more of these may prevent an estate from actually granting a postmortem easement on land. Because of the potentially enormous estate tax savings, however, these options should be considered carefully by an estate's executors and heirs.
>
> 1. Fiduciary issues. There may be complex fiduciary problems presented by an estate's granting a QCE. The conveyance of a QCE does not involve simply making a tax election; that would normally be authorized in a testamentary instrument. Instead, it involves the actual transfer of a property right from an estate to a qualified recipient, and effectively deprives the estate's beneficiaries of potentially valuable development rights. This must be considered from a variety of viewpoints. Do the fiduciaries have legal power to make such a conveyance? What if the beneficiaries do not agree to the conveyance?
>
> There are a few articles discussing the power of executors to convey postmortem QCEs. The analysis may hinge on how title to real property is conveyed at death under applicable state law, as well as the scope of the legal authority that fiduciaries possess over probate property. Postmortem conveyance of a QCE may well require a court action, although at least three states have enacted legislation giving fiduciaries the discretion to convey QCEs. In any event, the practical problems presented by the conveyance of a property right to a nonbeneficiary of an estate must be resolved under applicable local law before a postmortem conservation easement can be successfully transferred."[89]

"A predicate question in determining how to structure a post-mortem conservation easement donation is the vesting of title to real property in the heirs and devisees. In states [such as South Carolina][90] where title to real property vests immediately upon death in the

[88] See IRC § 2001(c) (setting forth estate tax rate schedule and lowest marginal rate of 18% on taxable estates under $10,000 and 20% on taxable estates from $10,000 to $19,999, and increasing thereafter) and IRC § 1(h)(1)(C) (setting forth maximum long-term capital gain tax rate as 15%).
[89] Robert G. Petix, Jr., *Postmortem Conservation Easements: Substantial Estate Tax Savings*, 30 Est. Plan. 273 (2003).
[90] S.C. Code Ann. §§ 62-3-101 and 62-3-709.

heirs and devisees, these heirs and devisees may, with the joinder of the personal representative, directly donate an easement."[91]

Stephen Small gives the following post-mortem § 2031(c) planning checklist:

1. Have an accurate appraisal of the subject property, any structures, reserved development rights and the easement
2. Understand and resolve any state law issues, [particularly as regards the authority of an executor to grant a conservation easement]
3. Understand and resolve any family issues
4. Reach agreement with the easement holder or donee
5. Run all the numbers
6. Perhaps record an easement or "Agreement to Extinguish" or an easement amendment
7. Have a qualified appraisal in hand [and]
8. File the 2031(c) election.

d. Retention of Development Rights

If the conservation easement retains limited development rights, the property will qualify for the exclusion, but the value of any retained development rights[92] will not qualify for any exclusion.[93] "A development right is any right to use the land for any commercial purpose that is not subordinate to and directly supportive of the use of the land as a farm for farming purposes."[94] However, a landowner may reserve rights to continue activities such as "agricultural farming, ranching, and forestry." These activities are not considered development rights. Another example of a non-development right is when a landowner wishes to reserve his ownership rights in an existing residence on the land subject to a conservation easement.[95]

"You do not have to make this reduction if everyone with an interest in the land (regardless of whether in possession) agrees to permanently extinguish the retained development right."[96] This agreement must be filed with the estate tax return and must include the following:

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[91] Updated article, Robert H. Levin, *You're Not to Late: Post-Mortem Donations of Conservation Easements*, Tax Notes (Oct. 30, 2000).

[92] For this purpose, a "development right" is defined as "any right to use the land subject to the qualified conservation easement in which such right is retained for any commercial purpose which is not subordinate to and directly supportive of the use of such land as a farm for farming purposes." IRC § 2031(c)(5)(D) (2000); Staff of Joint Comm. on Taxation, 105th Cong., *General Explanation of Tax Legislation Enacted In 1997*, at 78-81 (Comm. Print 1997) (setting forth the following as examples of farming activities that are not development rights: tree farming, ranching, viticulture, and the raising of other agricultural or horticultural commodities).

[93] IRC § 2031(c)(5)(A).

[94] Instructions for Form 706, p. 26 (Rev'd August 2004)(emphasis in original).

[95] Maureen Rudolph & Adrian Gosch, *Practitioner's Guide to Drafting Conservation Easements and the Tax Implications*, 4 Great Plains Nat. Resources J. 143, 178-79 (2000) (footnotes omitted).

[96] Instructions to Form 706, p. 26 (Rev'd August 2004).

1. A statement that the agreement is made pursuant to IRC section 2031(c)(5);
2. Detailed list of all persons holding an interest in the land;
3. Description of real property;
4. Description of retained development right that is being extinguished;
5. A clear statement of consent that is binding on all parties under applicable local law:
   a. To take whatever action is necessary to permanently extinguish the retained development rights;
   b. To be personally liable for additional taxes if the agreement is not timely implemented; and
6. A statement that if the agreement is not timely implemented the holders will file and pay the additional taxes.[97]

All parties to the agreement must sign it. The agreement must be implemented by the earlier of two years after the date of the decedent's death or the date of sale of the land subject to the conservation easement. If the parties fail to terminate any development rights within such period, estate taxes on the development rights will be immediately due and payable.[98]

An easement that retains more than a *de minimis* right to use the land for commercial recreational use does not qualify for the exclusion.[99] The Joint Committee on Taxation has stated that rights retained to grant "hunting or fishing licenses" on the land protected by the easement are *de minimis*,[100] but major commercial use for golf courses or ski resorts would not be *de minimis*. Through this limitation, Congress intends to encourage open space preservation for conservation purposes such as scenic open space or habitat, rather than for commercial recreational purposes. The exclusion applies to the individual granting the easement and any member of the decedent's family.[101] As a result, this estate tax benefit will apply to all family members of the decedent who hold the property protected by the easement at their death.[102] The estate tax benefits continue generation after generation until the property leaves the donor's family.[103]

> Neither the statute nor the legislative history gives us any guidance on how to extinguish retained development rights. It appears that there are at least two ways to do this. The preferred option is likely to depend on the particular set of facts:

[97] Instructions to Form 706, p. 26 (Rev'd August 2004); *see* IRS Private Letter Ruling 200014013 regarding the particulars for an "Agreement to Extinguish."
[98] IRC § 2031(c)(5)(C). It is arguable that no interest is due on the tax payment, because the tax liability arises at such time and is not due at an earlier time.
[99] IRC § 2031(c)(8)(B).
[100] Staff of Joint Comm. on Taxation, 105th Cong., *General Explanation of Tax Legislation Enacted In 1997*, at 78-81 (Comm. Print 1997).
[101] IRC §§ 2031(c)(8)(A)(iii) and 2031(c)(8)(C).
[102] For this purpose, a "family member" is broadly defined as an ancestor of the individual; a spouse; a lineal descendant of the individual, of the individual's spouse, or of a parent of the individual; or the spouse of any lineal descendant. IRC §§ 2031(c)(8)(C) and 2032A(e)(2).
[103] Reprinted with permission, Frances J. Lipman, *No More Parking Lots: How the Tax Code Keeps Trees out of a Tree Museum and Paradise Unpaved*, 27 Harv. Envtl. L. Rev. 471 (2003).

> i. Amend the existing conservation easement solely to eliminate the specific rights.
> ii. Amend and restate the entire existing conservation easement.[104]
>
> Although it is understood that the executor can donate a postmortem easement in order to eliminate otherwise prohibited commercial recreational activities and therefore allow the estate to be eligible for 2031(c), note the complex and difficult state law and other issues that arise in connection with postmortem charitable gifts. . . . See Letter Ruling 200014013 (December 22, 1999), the first letter ruling issued under 2031(c), ruling (among other things) that the right to carry on commercial recreational activities is a retained development right that can be extinguished postmortem.[105]

e. Amount of Exclusion of Remaining Property Value

Assuming the various requirements discussed above are met, the amount that can be excluded is 40% of the difference between the gross value of the property minus the value of the easement.

> Example. Greenacre is worth $1.5 million, and a QCE worth $500,000 is granted on Greenacre. The gross value of Greenacre (or $1.5 million) minus the value of the easement (or $500,000) equals $1 million which, multiplied by 40%, equals $400,000; that amount is excludable from the gross estate under the Exclusion Rule.[106]
>
> There are a number of subordinate rules, however, that restrict the apparent generosity of the Exclusion Rule. First, there is an absolute cap on the amount that may be excluded under the Exclusion Rule. For decedents dying in 2002 and later, the exclusion limitation is $500,000.[107] Consequently, the most that an estate can exclude from the gross estate under the Exclusion Rule is $500,000.
>
> Example. Greenacre is worth $4 million, and a QCE worth $2 million is granted on Greenacre. Without the cap limitation, 40% of the post-easement value of the land (i.e., 40% of $2 million), or $800,000, would be excludable under the Exclusion Rule. But, because of the cap limitation of Section 2031(c)(3), only $500,000 can be excluded from the gross estate under the Exclusion Rule.

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[104] Stephen J. Small, *Tax Incentives and Land Protection Techniques*, SHO26 ALI-ABA 929, 957 (American Law Institute–American Bar Ass'n CLE 2002).
[105] *Id*. at 958-59.
[106] See generally Schedule U to Form 706, p. 38 (U.S. Estate Tax Return) (Rev'd Aug. 2004), on how to calculate the exclusion amount.
[107] IRC §§ 2031(c)(1)(B) and 2031(c)(3).

Second, if the value of the QCE is less than 30% of the gross value[108] of the property, then the 40% exclusion will be reduced by two percentage points for each percentage point (or fraction thereof) by which the QCE's value is less than 30% of the gross value of the subject property.[109]

Example. Greenacre is worth $4 million, and a QCE worth $500,000 is granted on Greenacre. Because the QCE is worth only 12-1/2% of the gross value of the land (i.e., $500,000 is 12-1/2% of $4 million), the amount eligible to be excluded under the Exclusion Rule is only $105, 000. This is calculated as follows: 30% - 12-1/2% = 18-1/2% x2=37%; 40% - 37% = 3%; 3% of $3.5 million = $105,000.

Third, the Exclusion Rule does not apply to the extent the land is 'debt-financed property'[110] and to the extent that the owner retains a development right with respect to the land subject to the QCE. Helpfully, Section 2031(c)(5)(B) allows heirs who have received an interest in the subject property to terminate by agreement a development right that had been retained by the decedent.[111] This, too, is a postmortem election that should be considered by heirs to decrease estate tax liability.

Fourth, the Exclusion Rule applies equally to an interest in a partnership, corporation, or trust so long as at least 30% of the entity was owned—directly or indirectly—by the decedent.[112] In this case, the amount excluded under Section 2031(c) is reduced on a pro rata basis by the percentage not owned by the estate. Ownership, in these circumstances, is determined under the same rules governing qualified family owned business interests in Section 2057(e)(3).[113]

Form U to the Estate Tax Return notes that:

> You must reduce the land value by the value of any development rights retained by the donor in the conveyance of the easement. A development right is any right to use the land for any commercial purpose that is not subordinate to and directly supportive of the use of the land as a farm for farming purposes.

[108] *I.e.*, the value of a property unencumbered by debt and subject to a conservation easement.
[109] IRC § 2031(c)(2).
[110] Defined in IRC § 2031(c)(4)(B)(i) as property with respect to which there is "acquisition indebtedness" on the date of the decedent's death. "Acquisition indebtedness" is defined in IRC § 2031(c)(4)(B)(ii).
[111] In Ltr. Rul. 200014013, for example, transferees of real property were permitted to agree in writing to terminate the retained development right on a postmortem basis so as to qualify the land for the benefits of a QCE under IRC § 2031(c).
[112] IRC § 2031(c)(10).
[113] Robert G. Petix, Jr., *Postmortem Conservation Easements: Substantial Estate Tax Savings*, 30 Est. Plan. 273 (2003).

Note. If the value of the retained development rights reported on Line 7 was different at the time the easement was contributed than at the date of death, see the Caution at the beginning of the Schedule U instructions.

You do not have to make this reduction if everyone with an interest in the land (regardless of whether in possession) agrees to permanently extinguish the retained development right. The agreement must be filed with this return and must include the following information and terms:

1. A statement that the agreement is made pursuant to IRC section 2031(c)(5).
2. A list of all persons holding an interest in the land that is subject to the qualified conservation easement. Include each person's name, address, tax identifying number, relationship to the decedent, and a description of their interest.
3. The items of real property shown on the estate tax return that are subject to the qualified conservation easement (identified by schedule and item number).
4. A description of the retained development right that is to be extinguished.
5. A clear statement of consent that is binding on all parties under applicable local law:
    a. To take whatever action is necessary to permanently extinguish the retained development rights listed in the agreement; and
    b. To be personally liable for additional taxes under IRC section 2031(c)(5)(C) if this agreement is not implemented by the earlier of:
        - The date that is 2 years after the date of the decedent's death, or
        - The date of sale of the land subject to the qualified conservation easement.
6. A statement that in the event this agreement is not timely implemented, that they will report the additional tax on whatever return is required by the IRS and will file the return and pay the additional tax by the last day of the 6th month following the applicable date described above.

All parties to the agreement must sign the agreement.

* * * *

You must reduce the reported value of the easement by the amount of any consideration received for the easement. If the date of death value of the easement is different from the time the consideration was received, you must reduce the value of the easement by the same proportion that the consideration received bears to the value of the easement at the time it was granted. For example, assume the value of the easement at the time it was granted was $100,000 and $10,000 was received in consideration for the easement. If the easement was worth $150,000 at the date of death, you must reduce the value of the easement by $15,000 ($10,000/$100,000 x $150,000) and report the value of the easement on line 10 as $135,000."[114]

f. Exclusion Election

The election to use the §2031(c) exclusion must be made before the due date for filing the estate tax return, with extensions. The election will apply to a qualified conservation easement whether the easement was created before the date of death, as long as the easement is created before the due date for filing the estate tax return, with extensions. Finally, the exclusion is available to estates of decedents where the land is owned by a partnership, corporation, or trust (note the statute does not mention LLC's *yet, since LLC's are "corporation" one might assume that they are likewise covered*) if at least 30 percent of the entity is owned (directly or indirectly) by the decedent, using the §2057 QFOBI rules to determine ownership.[115]

As stated above, the exclusion is elected on a timely filed Form 706, United States Estate and GST Tax Return. "You must file Form 706 to report Estate and Generation Skipping Transfer Tax, within 9 months after the date of decedent's death unless you receive an extension of time to file."[116]

The election is irrevocable.[117] New Schedule U of Estate Tax Form 706 states that the election will be deemed made if Schedule U is filed and the qualified conservation easements are excluded from the gross estate.[118]

4. Deduction Rule

As stated above, conservation easements offer three estate tax benefits: (1) a reduction in the value of the gross estate subject to taxation; (2) an estate tax exclusion, and (3) an estate tax charitable deduction (covered below).

The Deduction Rule is a separate and distinct rule from the Exclusion Rule. It permits an estate to take an estate tax charitable deduction under Section 2055(f) for a QCE granted to a qualified charity. In effect, estate taxes will be assessed only against the net value of property subject to the QCE. This is an extremely powerful mechanism to decrease estate tax liability because there is no cap on the allowed deduction (as there is under

[114] Instructions for Form 706, p. 26 (Rev'd August 2004).
[115] Warren A. Sinsheimer, *Conservation Easements in Planning and Administering Estates and Trusts*, 325 PLI/Est 337, 346 (2003).
[116] Instructions for Form 706, p. 2 (Rev'd August 2004).
[117] IRC Section 2031(c)(6).
[118] Betty J. Orvell, *Estate and Gift Tax Charitable Deduction and Estate Planning Using the Charitable Deduction*, SJ008 ALI-ABA 313 (2003).

the Exclusion Rule). The charitable transfer of the QCE can be made on a postmortem basis,[119] which has been allowed since subsection (9) was added to the original Section 2031(c) by Congress in the Internal Revenue Service Restructuring and Reform Act of 1998. Like any other charitable deduction, such a transfer of a QCE will reduce a taxable estate at its highest marginal rate.

> Example. The decedent died in 2003. His gross estate totals $2.5 million, comprised of Greenacre (worth $2 million) and $500,000 in other assets. Absent a QCE, there will be an estate tax liability of approximately $680,000. Assume instead that a QCE worth $750,000 is granted on Greenacre. Under the Exclusion Rule, $500,000 will be excluded from the gross estate, and under the Deduction Rule, the $750,000 QCE will be entitled to an estate tax charitable deduction. After the application of these two rules, the estate tax liability will be approximately $102,500, or a savings of $577,500.[120]

The above discussion related to estates. The paragraph below discusses trusts.

In Revenue Ruling 2003-123, the IRS clarified its position that a trust is not allowed either a charitable deduction under Section 642(c) or a distribution deduction under Section 661(a)(2) with respect to a contribution to charity of trust principal that meets the requirements of a qualified conservation contribution. While a trust is generally allowed an unlimited charitable deduction, IRC § 642(c) specifically requires that a charitable deduction is available only if the source of the contribution is gross income. In the facts of the revenue ruling, the trustee conveyed a conservation easement in a 20-acre parcel which the trust owned. The revenue ruling held that the contribution was made with respect to trust principal, not from gross income of the trust. Because the contribution of the conservation easement was not paid from trust's gross income, under IRC § 642(c) the trust was not allowed a charitable deduction.

5. Special Use Valuation for Farm Land

Under Section 2032A, the executor may elect to value certain farm land at its farm use value rather than its fair market value. The total value of the special use property may not be decreased from FMV by more than $850,000 for decedents dying in 2004. Real property may qualify for the Section 2032A election if

(1) The property was used by a decedent or a family member for farming or was rented for such use,
(2) The real property was acquired or passed from the decedent to a qualified heir,

[119] IRC § 2031(c)(9).
[120] Robert G. Petix, Jr., *Postmortem Conservation Easements: Substantial Estate Tax Savings*, 30 Est. Plan. 273, 274-75 (2003).

(3) The real property was owned and used for farming by the decedent or a member of the decedent's family during five of the eight years before the decedent's death (ownership may be direct or indirect through a corporation, partnership or trust which qualifies as closely held business under I.R.C. Section 6166),

(4) There was material participation by the decedent or a family member during five of the eight years before the decedent's death, and

(5) The qualified property meets the following percentage requirements:

    (i) At least 50% of the adjusted value of the gross estate consists of the adjusted value of real or personal property that was being used as a farm and that was acquired or passed from the decedent to a qualified heir, and

    (ii) At least 25% of the adjusted value of the gross estate consists of the adjusted value of the qualified farm.

The election is made by checking "Yes" to Line 2 of Part 3, *Elections by the Executor*, Form 706, and by attaching a completed Schedule A-1. The executor may elect a regular or protective election.

Because the special-use valuation election creates a potential tax liability for the recapture tax of Section 2032A (c), it must be signed by any person who had an interest in the property as of the decedent's death, whether present or future, vested or contingent. The recapture tax applies if, within ten years after the date of the decedent's death and before the death of the qualified heir, the qualified heir disposes of any interest in the property to someone outside of the family or ceases to use the property for a qualified use.

"For many years the IRS treated the donation of an easement on property subject to a § 2032A election as triggering recapture." However, § 2032A has been amended and now the donation of an easement in such cases will not trigger recapture."[121] "Many estates qualifying under Section 2032A will also qualify for deferral and installment payments of federal estate tax under Section 6166."[122]

"This Code section is fraught with traps and Landowners must pay very careful attention to all of the requirements."[123] "In the vast majority of cases when an estate is eligible for the 2031(c) exclusion it will make sense to make the election. Obviously, if the taxable estate is below the unified credit threshold the election will not be necessary or warranted."[124]

6. Recap of Recent Legislative Changes Pertaining to Conservation Easements

[121] (SHO26 ALI-ABA 929 at p. 12).
[122] *Id.*
[123] *Id.* Form 706, p. 7 (Rev'd August 2004) contains a detailed checklist for the Section 2032A Election.
[124] SHO26 ALI-ABA 929.

Congress has liberalized the estate tax rules pertaining to conservation easements several times in the past ten years. In 1997, The Taxpayer Relief Act provided the estate tax exclusion (in addition to the existing income tax deduction). Second, the IRS Restructuring and Reform Act of 1998 added new Section 2031(c)(9) to make clear that a post-mortem easement may be granted by an executor. Third, effective January 1, 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 repealed the geographical restrictions which required the land subject to the easement be located near a metropolitan area, national park, or Urban National Forest; and the reduction of the applicable percentage is determined by measuring the value of the easement at the time of creation rather than the date of death.[125]

E. Property Taxes

1. General

The calculation of real property taxes in South Carolina involves three elements: the assessment ratio, millage, and valuation.

a. Assessment Ratio

The South Carolina Constitution provides in Article X, § 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.
- 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.

[125] Orvell, SJ008 ALI-ABA 313, *supra*, at 362.1

Code § 12-37-220(B)(14) 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.

The valuation of the property is multiplied by the proper assessment ratio to produce the assessed value of a particular piece of property. Taxes are levied based upon this assessed value, i.e., the combined millage times the assessed value.

Many properties for which conservation easements are contemplated are already taxed as agriculture, that is they are taxed at the 4% assessment ratio for agriculture property and use the specified agricultural valuation formula. Previously under S.C. Code § 12-43-232(3)(d) any "unimproved real property subject to a perpetual conservation easement as provided in Chapter 8 of Title 27 *must be* classified as agricultural real property" (emphasis added), even if the property was not used for agricultural purposes.[126] The definition of what constitutes "unimproved property" for purposes of this section was at issue in *Lindsey v. Templeton.*[127] The taxpayers in that action owned lots covered by a conservation easement in Ravens Bluff Plantation subdivision. None of the lots had any structures in the form of houses, barns, or other buildings on them and consequently the taxpayers argued they were "unimproved" for purposes of obtaining ag-use classification. Chief Administrative Law Judge Marvin Kittrell agreed with the Charleston County Assessor that the land did not qualify for ag-use, and stated:

> 7. Raw property or property lying in its natural state which has been platted, staked, divided into lots and had roads built leading to the lots therein and wherein underground electrical and phone services have been made available, is transformed into improved realty.
> 8. The addition or construction of a structure on real property is not essential for real property to be converted into "improved property."

Because of concerns over the growing number of non-traditional conservation easements (e.g., easements on golf courses and common areas of real estate subdivisions as well as "backyard" easements) in 2005 the General Assembly eliminated the mandatory language. The statute now provides that unimproved real property subject to an easement is classified as agricultural real property "if the property otherwise would have qualified as agricultural real property subject to satisfactory proof to the assessor."[128]

b. Millage

[126] Agricultural purpose is defined as where land "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).
[127] 96-ALJ-17-0216 (1996).
[128] Section 43 of Act No. 145, 2005 S.C. Acts (H.3768).

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 would equal $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).

c. Valuation

i. General

Article III, § 29 of the South Carolina Constitution states that "[a]ll 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, S.C. Code § 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.
> . . .

As Chief Administrative Law Judge Marvin Kittrel has stated, "'Fair market value is the measure of true value for [property] taxation purposes. There is no valid distinction between market value for sales purposes and market value for taxation purposes under S.C. Code Ann. § 12-37-930 (Supp. 1998)."

> The property's highest and best use must be considered in calculating the property's value. "Highest and best use" may be defined as "the reasonable, probable and legal use of vacant land or improved property, which is physically possible appropriately supported, financially feasible, and that results in the highest value."[129]

Obviously, the granting of a conservation easement may affect a property's fair market value. Section 27-8-70 of the Conservation Easement Act of 1991 recognizes this 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."[130]

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[129] *Harris v. Georgetown Co. Assessor*, 2003 WL 1542789 (S.C. Admin. Law Judge Div.)

[130] In fact, *Uniform Standards of Professional Appraisal Practice* (2004 ed.) Rule 1-2E, http://www.appraisalfoundation.org/s_appraisal/sec.asp?CID=3&DID=3 (Feb. 12, 2004), specifically requires

ii. Methods for Determining Fair Market Value

In *South Carolina Tax Comm'n v. South Carolina Tax Bd. 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.

iii. Agricultural Property Valuation

As stated above, unimproved real property subject to a conservation easement may be classified as agricultural real property when it meets the statutory requirements.[131] Two rules govern valuation of agricultural property: one for "land used for the growth of timber," and one for "the growth of other agricultural products."[132] "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.[133]

CHAPTER 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.[134]

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, IRC § 170(a)(1) permits a deduction for any "charitable contribution," as defined in subsection (c). IRC § 170(c) 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;

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an appraiser, when developing a real property appraisal to consider easements, restrictions, or other items of a similar nature.

131 See Regulation 117-114, *Definition of Agricultural Real Property*.

132 S.C. Code § 12-43-220(d)(2)(A) (Supp. 2003 – Revised 2000 bound edition)

133 *See* Regulation 117-126, *Use Value Procedure for Cropland and Timberland.*

134 521 TMP, *Charitable Contributions: Income Tax Aspects* at p. A-2.

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 was amended specifically to provide a charitable deduction for a qualified conservation contribution. IRC § 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. These elements are terms of art which are defined in both the statute and regulations, as discussed below.

CHAPTER IV. QUALIFIED REAL PROPERTY INTEREST

A. General

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 Treasury 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.

B. Entire Interest

If a donor divides his property interest prior to donation to retain control of more than a qualified mineral interest or to reduce the real property interest donated, the real property interest donated shall not be considered an entire interest.[135] 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.

C. 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

[135] Treas. Reg. § 1.170A-14 (2004).

restrictive covenant or equitable servitude).[136] 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."[137]

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.

Generally, the easement is not enforceable in perpetuity until it is recorded.[138]

CHAPTER V. QUALIFIED ORGANIZATION: LAND TRUSTS

A. General

The IRS long ago recognized that "efforts to preserve and protect the natural environment for the benefit of the public serve a charitable purpose,"[139] and consequently organizations formed to preserve and promote the natural environment were entitled to Section 501(c)(3) status.[140] Nevertheless,

[136] *See* S.C. Code §27-8-30(c)(Supp.2004) 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").
[137] Treas. Reg. § 1.170A-14(b)(2).
[138] *See* Treas. Reg. § 1.170A-14(g) and *Satullo v. Commissioner*, T.C. Memo 1993-614, *aff'd* 67 F.3d 314 (11th Cir. 1995).
[139] Rev. Rul. 76-204.
[140] *See also* Rev. Rul. 70-186 and Rev. Rul. 67-292. *But see* Rev. Rul 78-384 (nonprofit organization that owns farmland and restricts its use to farming or other uses the organization deems ecologically suitable, but is not operated for the purpose of preserving ecologically significant land, and does not otherwise establish that it serves a charitable purpose, does not qualify for 501(c)(3) status).

not all charitable organizations eligible to receive deductible charitable contributions are eligible to receive deductible qualified conservation contributions. Organizations qualified to hold a conservation easement are generally limited to federal, state and local government agencies and public charities. Qualified organizations must also have a commitment to protect the conservation purposes of the contribution and have the resources necessary to enforce the conservation restrictions placed on the property. Therefore, private foundations are not permitted to receive qualified conservation contributions.[141]

Most conservation easements in South Carolina are donated to a land trust. The Land Trust Alliance defines a "land trust" as a "nonprofit organization that, as all or part of its mission, works to conserve land by undertaking or assisting direct land transactions – primarily the purchase or acceptance of donations of land or easements."[142] The great majority of land trusts in South Carolina have a regional focus. There are several national trusts that accept easements in this state, such as The Nature Conservancy and Ducks Unlimited.

According to a 2004 report by the South Carolina Department of Revenue, at least 49 Land Trusts held easements donated between 1999 and 2001 on property located in South Carolina. According to the Nature Conservancy, land trusts have easements protecting over 200,000 acres in South Carolina, with an additional 26,000 acres protected through ownership or other agreements. In 2002 alone, the Lowcountry Open Land Trust added 16 easements for 8,410 acres, The Nature Conservancy added 15 easements for 21,747 acres, and Ducks Unlimited passed the 100,000-acre total in South Carolina.[143]

The Land Trust Alliance is a national group which assists land trusts in building quality and organizational competence. It publishes the *Land Trust Standards and Practices*, which consists of 15 standards for responsible and professional operation of land trusts. Many land trusts in South Carolina are members of the LTA.

Governmental units may also accept conservation easements.[144]

B. Legal Requirements

1. General

As stated above, I.R.C. § 170(h) requires "qualified conservation contributions" to be made to a "qualified organization." IRC § 170 defines a "qualified organization" to mean an organization which

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[141] Lipman, 27 Harv. Envtl. L. Rev. 471, *supra*, at 494-95 (citations omitted).
[142] Land Trust Alliance, *1998 National Directory of Conservation Land Trusts* at v (1998).
[143] Lynne Langley, *Tax Incentives Boost Low Country Conservation Easements*, The Post and Courier, http://www.charleston.net/stories/042803/sta_28conserve.shtml (April 28, 2003).
[144] *See*, *e.g.*, IRS PLR 200418005 (Conservation Fund was found to be an integral part of a municipality under Rev. Rul 87-2 and this was a qualified organization).

(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.

Treas. Reg. § 1.170A-14(c)(1) states (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). IRC § 170(b)(1)(A)(vi) refers to organizations which meet all of the following characteristics:

- Organized within the United States;
- Organized and operated exclusively for charitable purposes;
- Have no part of their net earnings inuring to the benefit of any private shareholder or individual;
- 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.[145]

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

Treasury Regulation § 1.170A-14 provides that to be considered an eligible donee under the section, an organization must be a qualified organization, have a "commitment" to

[145] *See also* S.C. Code § 27-8-20(2) (Supp. 2004) of the South Carolina Conservation Easement Act of 1991.

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.[146] The Land Trust Alliance Standards state in this regard: "G. Funds for Stewardship and Enforcement. The land trust has a secure and lasting source of dedicated or operating funds sufficient to cover the costs of stewarding its land and easements over the long term and enforcing its easements, tracks stewardship and enforcement costs, and periodically evaluates the adequacy of its funds. In the event that full funding for these costs is not secure, the board has adopted a policy committing the organization to raising the necessary funds."[147]

Under Treasury Reg. § 1.170A-14(c)(2), 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).

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 Land Trust Alliance's Standards advise:

> B. Nonprofit Incorporation and Bylaws. The land trust has incorporated according to the requirements of state law and maintains its corporate status. It operated under bylaws based on its corporate charter or articles of incorporation. The board periodically reviews the bylaws.
>
> C. Tax Exemption. The land trust has qualified for federal tax-exempt status and complies with requirements for retaining this status, including prohibitions on private inurement and political campaign activity, and limitations and reporting on lobbying and unrelated business income. If the land trust holds, or intends to hold conservation easements, it also meets the Internal Revenue Code's (IRC) public support test for public charities. Where applicable, state tax-exemption requirements are met.[148]

2. Governmental Units as Donees

In IRS PLR 199927014 and PLR 200002020 the IRS held that governmental bodies were eligible donees. In PLR 199927014 the IRS stated:

[146] *See also* S.C. Code §§ 27-8-20(4) and -40 (Supp. 2004) (dealing with the right of holders and third parties to enforce the terms of conservation easements).
[147] Land Trust Standards and Practice, Standard 6: Financial and Asset Management (Land Trust Alliance) (rev'd 2004).
[148] Land Trust Standards and Practice, Standard 2: Compliance with Laws (Land Trust Alliance) (rev'd 2004).

Under §170(h)(3)(A) of the Code and §1.170A-14(c)(1)(i) of the Regulations, the term "qualified organization" includes a governmental unit described in §170(b)(1)(A)(v). Under §170(c)(1), a governmental unit includes State or political subdivision thereof. Generally, an agency that is an integral part of a governmental unit is eligible to receive deductible charitable contributions.

The IRS held in that PLR that the donee, a school district, was an integral part of the county, and thus a qualified organization. The IRS also held that the school district had the commitment and resources to enforce the restrictions contained in conservation easement because the easement ensured an acceptable storm water drainage system, which was critical to the school district's requirement to obtain a surface management license to construct and operate a new high school.

In PLR 200002020 the IRS stated that

[u]nder State statute, which created Donee, Donee is authorized to protect and maintain State's natural resources. In addition, Donee is expressly authorized to accept conservation easements and has law enforcement authority and the resources to enforce the restrictions. Donee has indicated that it will enforce the restrictions. Therefore, we determine that Donee is an eligible donee.

In PLR 200502012, the IRS determined that a city-created Authority's acquisition of various property interests, including a conservation easement, did not give rise to prohibited "private business use" of bond proceeds. The Authority purchased the conservation easement so that a parcel may be preserved as open space for the scenic enjoyment of the public, for agricultural use, and to conserve the natural habitat (the "Open Space Program").

3. Items of Interest to Donors

The donor will generally want some documentary evidence that the organization is a public charity.

As a general proposition, a taxpayer has the burden of proving the amount or value of a charitable contribution that he, she or it is able to deduct. As part of this responsibility, it is incumbent upon donors to prove that the donee organizations are in fact charitable in nature. Thus, as an illustration, amounts contributed to an entity were held not deductible as charitable contributions because the donors did not prove that the entity qualified as a charitable organization.[149]

[149] Hopkins, *The Tax Law of Charitable Giving* (2nd Ed.) at p. 616.

The donor may want to check IRS Publication 78, *Cumulative List of Organizations*, which lists most qualified organizations.[150] 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).

Some of the more recent Private Letter Rulings on conservation easements have noted in their discussions of "qualified organization" that the donees are qualified to do business and are in good standing with 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. Secretary of State's Office.

IRS Rev. Proc. 82-39 summarizes several general rules of interest to donors. Section 2.01 of this revenue procedure provides that IRC § 170, 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 revenue procedure provides that contributions to organizations listed in Publication No. 78, *Cumulative List of Organizations*,[151] generally will be deductible.

Section 3.03 of IRS Rev. Proc. 82-39 addresses situations where an organization covered by Publication No. 78 ceases to qualify as an organization to which contributions are deductible under IRC § 170, such as where 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 (*e.g.*, 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.

CHAPTER VI. DEFINITION OF "*EXCLUSIVELY* FOR CONSERVATION PURPOSES"

[150] This publication, which is annually updated, is available in the reference section of many local libraries (http://www.irs.gov/charities/article/0,,id=96136,00.html).
[151] *Id*.

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 a historically important land area or a certified historic structure.

"Under the statute, each of these four prongs is a conservation purpose in and of itself, and a taxpayer's satisfaction of one of these prongs suffices to establish the requisite conservation purpose."[152]

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 of the General Public

The first permitted purpose is the donation of a qualified real property interest to preserve land areas for the outdoor recreation or education of the general public. Thus, conservation purposes would include, for example, the preservation of a water area for public boating or fishing or preservation of a hiking trail for public use. The preservation of land areas for recreation or education must be for the substantial and regular use of the general public.

> While the recreational or educational use of the land by the public must be "substantial and regular," this does not mean that the public must have unlimited access. For example, public access limits on the number of people using the property at one time, or during periods of maintenance, bad weather, or at night should be acceptable. However, "it is clear that the public must have access to the property on a consistent basis."[153]

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[152] *Glass v. CIR*, 124 T.C. 258, 277, 2005 WL 1231654 (U.S.T.C. 2005).
[153] Lipman, 27 Harv. Envtl. L. Rev. 471, 495-96 (citations omitted).

This type of conservation easement is not used frequently.

In 2005 the South Carolina General Assembly prohibited the taking of a state conservation easement tax credit or the flow through of a charitable deduction on the taxpayer's federal income tax return for the granting of a conservation easement on a golf course.[154]

2. Protection of Relatively Natural Habitat

The second permitted purpose involves the preservation of relatively natural habitats of animal or plant communities or similar ecosystems. These properties must contain valuable habitats or ecosystems, such as habitats for rare, endangered, or threatened species of animals, fish, or plants, or other natural areas, such as undeveloped islands, that represent high quality examples of either land- or water-based communities. Other natural areas qualifying under this purpose would be areas contributing to the ecological viability of a local, state, or national park, preserve, wildlife refuge, wilderness area, or similar conservation area. This second permitted purpose has one distinct difference from the first. Because the focus of the second permitted purpose is on protecting natural habitat or ecosystems, public access to the property may be restricted without jeopardizing the deduction.[155]

a. 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.

b. Examples of Significant Habitats

In the most recent conservation easement case, *Glass v. CIR*[156] the taxpayers, who owned 10 acres on the shore of Lake Michigan, gave an easement on several acres of such property covering some 410 feet of the shoreline. The IRS disallowed the charitable deduction on the basis that the easement did not protect a significant relatively natural habitat. The Tax Court disagreed largely on the basis of the testimony of the Executive Director for the Land Trust who stated that the property was a "famous" roosting spot for

[154] Section 43 of H. 3768 (2005).
[155] Lipman, 27 Harv. Envtl. L. Rev. 471, 496 (citations omitted).
[156] 124 T.C. 258, 2005 EL 1231654 (U.S. Tax Ct. 2005).

bald eagles and that the easement established a proper place for the growth and existence of Lake Huron tansy and pitcher's thistle, both threatened species.

A taxpayer's land consisting of approximately 500 acres of coastal wetlands and uplands with several structures and habitat for wood storks (a federally recognized endangered species) was declared a qualifying natural habitat because surrounding lands were being developed and development of the taxpayer's lands would negatively affect the wood storks.[157] A conservation easement granted covering 485 of 535 acres owned by a partnership was deemed to cover qualified natural habitat where officials from an adjoining state park determined that the easement would "enhance the continuation and expansion of the habitat" of several plants and animals, some of which were important to the state.[158] An opinion from a "State Division of Wildlife official" that an easement would enhance the habitat of a neighboring national forest by adding "relatively undisturbed natural habitat" where surrounding lands had been developed was sufficient to establish that the lands qualified under IRS requirements.[159] Properties under an easement were determined to be significant habitats where they provided habitat for several species of plants and animals, some of them endangered, and prey for other endangered species.[160] Property found to be the habitat for eight separate species of plant life listed by state and/or federal authorities as endangered or threatened was significant.[161]

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:

[157] IRS PLR 9218071.
[158] IRS PLR 9318017.
[159] IRS PLR 9420008.
[160] IRS PLR 9632003
[161] IRS PLR 200208019

> 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, songbirds, 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.

PLR 200208019 noted that the property qualified as it was the habitat for eight separate species of plant life listed by state and/or federal authorities as endangered or threatened.

c. Alteration by Human Activity

Treasury Reg. § 1.170A-14 (d)(3)(I) 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. (IRS 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.

d. Examples of Permissible Easement Terms and Conditions

As previously stated, Section 170(h)(2)(C) of the Internal Revenue 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.[162] Each easement should generally contain a section dealing with restricted uses of the property (*e.g.*, 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) and permitted uses of the property (*e.g.*, agriculture, forest management, farm buildings, water resources, trails, existing homestead, as well as additional homesites). 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

[162] *See generally Conservation Easements: Guide to the Legal Document* (Vermont Land Trust, Technical Bulletin).

> 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. Clear cutting 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.

e. Limitations on Public Access

Treas. Reg. § 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

The third permitted purpose is the preservation of open space, including farmland and forest land. To satisfy this requirement, the conservation contribution must satisfy one of two alternative requirements. The first alternative is preservation pursuant to a clearly delineated federal, state, or local governmental conservation policy. The second alternative is preservation for the scenic enjoyment of the general public. Regardless of which alternative is satisfied, the preservation must yield a significant public benefit. A limit on public access to property preserved for "open space" will not cause the contribution to be ineligible unless the conservation purpose would be undermined or frustrated without public access. An example of a contribution that would yield a significant public benefit would be preservation of forest land along a public highway pursuant to a government program to maintain the scenic view from the highway. To qualify as a "scenic easement" there must be visual (rather than physical) access by the public to or across the scenic features of the property.[163]

Treas. Reg. § 1.170A-14 deals at great length with an easement granted for the purpose of protecting open space. The regulation (and associated IRC § 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 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, water body, 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

[163] Lipman, 27 Harv. Envtl. L. Rev. 471, 496 (citations omitted).

(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.[164]

To satisfy the requirement of scenic enjoyment by the general public, visual access to or across the property by the general public is sufficient. Physical access to the property by the public is not required.[165] 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 Internal Revenue 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 Treasury 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 contiguous to, or an integral part of, the surroundings of existing recreation or conservation sites. Treas. Reg. § 1.170A-14 (d)(4)(iii)(A) 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

[164] *Tax Law of Easements* at p. 7-3 (emphasis in original).
[165] Treas. Reg. §1.170A-14(d)(4)(ii)(B).

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. However, such acceptance, without more, is insufficient. 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 establishes an environmental trust to accept gifts to the state that meet certain conservation purposes and where the gifts are submitted to a review requiring 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 would not be established.

A limitation on public access to property subject to a donation under this paragraph will not render the contribution 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 regulation.

(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:

> 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."[166]

(iii) Examples of "Clearly Delinated" Governmental Conservation Policies

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

[166] Small, *Tax Law of Easements* at pgs 8-2 to 8-3.

body is not sufficient. In IRS PLR 199927014, the IRS noted that the state and county had enacted water-control and conservation legislation and had identified the water control district to coordinate water usage and protection. The IRS held that the donation of an easement furthered the flood-control and water-retention policies of the water control district by providing a permanent location for water storage and drainage and was therefore pursuant to a clearly delineated policy.

In IRS PLR 200002020, the state had adopted a conservation easement act, and the county had adopted a plan to preserve agricultural property, as well as a plan to preserve and link greenways and river corridors. The property subject to the proposed easement was recognized in both plans. The donee was a governmental unit, which prior to acceptance of the easement appointed a committee to review the proposed easement, physically inspect the property, and take public input. The IRS held that, given the donee's rigorous review process and its reliance on the county plans, the donation was pursuant to a clearly delineated governmental policy. Accordingly, recent IRS 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 or 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. Treas. Reg. § 1.170A-14(d)(4)(iii) 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[167] and the South Carolina Scenic Rivers Act,[168] have relevance in this respect. The South Carolina Scenic Rivers Program, administered through the Department of Natural Resources' Land, Water and Conservation Division, is charged to protect unique and outstanding rivers.[169] 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 South Carolina 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 nonbinding agreements (as opposed to the permanent and legally binding conservation easements). Currently, there are eight state-designated scenic rivers in South Carolina.[170]

The South Carolina Heritage Trust Program, managed by the South Carolina Department of Natural Resources, was established to inventory, preserve, use and manage unique and outstanding natural or cultural areas and features of South Carolina.[171] Property owners may establish a heritage preserve by transferring fee-simple title, 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 non-permissive uses regarding the property.[172] Upon acceptance into the program, the deed or easement, along with the

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[167] S.C. Code §§ 51-17-10 to -150 (Supp. 2004).
[168] S.C. Code §§ 49-29-10 to -210 (Supp. 2004).
[169] S.C. Code § 49-29-30 (Supp. 2003). The statement of purpose reads, "[t]he 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." *Id.*
[170] The Scenic Rivers Act includes 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; five miles of the Middle Saluda in Greenville County; a 21.5-mile stretch of the Ashley in Charleston and Dorchester Counties; a 75-mile stretch of the Black in Clarendon, Williamsburg, and Georgetown Counties; and a 70-mile stretch of the Great Pee Dee in Florence and Marion Counties. In 2005 the General Assembly added that portion of the Little Pee Dee River located in Dillon County between the Marlboro County line and the Marion County line. /Act 51 of 2005 H.3782./ Other rivers may be added to the program in the future. For more information look in http://www.dnr.state.sc.us/etc/conservation.html under *Land and Water Stewardship Programs.*
[171] S.C. Code § 51-17-20.
[172] S.C. Code § 51-17-80.

dedication agreement, are filed with the real estate records in the respective county.[173] While PLRs are addressed solely to the taxpayer who requests them and may not be cited as precedent, the IRS has found the program to fulfill the conservation-purposes test.[174]

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 a PLR is 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.

In 2005, the South Carolina General Assembly adopted significant amendments regarding the donative intent requirement. The new legislation prohibits either the state conservation easement tax credit or the flow through of the federal charitable deduction for conservation easements which are given to comply with any state or federal environmental requirement, for the purpose of obtaining road, water or sewer services, or in conjunction with obtaining a subdivision, building, zoning or similar permit, absent extraordinary circumstances.[175]

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

[173] *Id*.
[174] PLR 9052028.
[175] Section 43 of H. 3768 (2005).

any public purpose."[176] Section 1.170A-14 (d)(iv)(A) of the Treasury 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 enjoyment 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:

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

[176] 521 TMP *Charitable Contributions: Income Tax Aspects* at p. A-42.

- Preservation of a unique natural land formation for the enjoyment of the general public;
- 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
- 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.

In PLR 199927014 the IRS held that the property met the "uniqueness" standard because it was an important part of an interconnected series of canals and lakes that flow into the state water management system. The easement also met the "consistency with public programs" (including water and flood programs) standard as preservation of the subject property would further the county's efforts to provide for drainage, protect against flood damage, and protect the water supply. In PLR 200002020 the IRS agreed with the taxpayer that while farmland, woods and streams viewed individually were not unique in the area, the combination of all three on one parcel was unique in the county.

PLR 200002020 also dealt with the "intensity of land development in the area" factor, both in terms of existing development and foreseeable development trends. The IRS noted that the property was located in the most densely developed populated area in the county, with a large subdivision to the north and homes in the south. The IRS agreed that the easement would protect the property from present and foreseeable future trends. Lastly, the easement met the consistent with other governmental programs (including master plans) standard. The county's master plans included preservation of prime farm land, greenways, and river corridors.

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 being furthered by the donation. See Treas. Reg. § 1.170A -14(e)(2) for rules relating to inconsistent use.

e. Relationship of Requirements

Treasury 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 the regulation 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 surroundings 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 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.[177]

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 the regulation.

f. Examples of Qualifying Restrictions

Quoted below are the restrictions contained in several IRS private letter rulings which found the contributions to qualify. (The excerpts quoted are brief, and readers will naturally want to read the entire private letter rulings.)

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[177] Other private letter rulings which dealt with qualifying easements include PLR 8630056; 1 PLR 8638012; PLR 8652013; PLR 8711054; PLR 8713016; PLR 8721017; PLR 8722047; PLR 8810009; and PLR 8810024.

In 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.

4. Historic Sites

The fourth permitted purpose is the preservation of a historically important land area or a certified historic structure. This may include independently significant land areas and historic sites and land areas that contribute to the cultural importance of historic structures or districts. Examples of significant land areas are "an archaeological site or a Civil War

> battlefield with related monuments, bridges, canons, or houses" and any land within or, under certain circumstances, adjacent to a historic district.
>
> If an owner donates her property through a conservation easement for historical preservation, she must provide the public with some visual access. The entire property does not have to be visible, but the public must have enough visual access to realize a benefit. Where the historic property is not visible (*e.g.*, the structure is hidden by a wall or shrubbery, or is too far away from a public road), the terms of the easement must provide that the general public will have access to the property on a regular basis.[178]

(Note: This publication does not further discuss this permitted purpose.)

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.

As stated below, in 2005 the South Carolina General Assembly made important changes in this regard.

2. Donative Intent

i.) Federal Law

"[T]he traditional view [is] that a charitable contribution is one for which the donor has 'no expectation of any quid pro quo.'[179] The sine qua non of a charitable contribution is a transfer of money or property without adequate consideration."[180]

> 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.[181]

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[178] Lipman, 27 Harv. Envtl. L. Rev. 471, 496 (citations omitted).

[179] *Hernandez v. Commissioner*, 480 U.S. 680,690 (1989), *quoting* S. Rept. 1622, 83d Cong. 2d Sess. 196 (1954) (a gift is a payment "made with no expectation of a financial return commensurate with the amount of the gift").

[180] *United States v. American Bar Endowment*, 477 U.S. 105, 116 (1985).

[181] Small, *The Federal Tax Law of Conservation Easements* at p. 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.[182] As stated below, in December of 1996 the IRS issued final regulations dealing with the donative-intent issue.

The IRS has challenged deductions on the grounds that the donor lacked donative intent.[183] 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 to the zoning change, for which the taxpayer subsequently claimed a charitable contribution deduction. The IRS held that a charitable contribution would be properly allowed where (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, that impact this area. First, Treas. Reg. § 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*.[184] 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 Treas. Reg. §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 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.

ii.) State Law

In 2005 in response to numerous published reports that real estate developers were "donating" conservation easements in order to facilitate the development of relatively natural habitats, the General Assembly adopted a special donative intent rule for non-cash charitable

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[182] *See generally* 521 TMP *Charitable Contributions: Income Tax Aspects* at pp. A-18 to A-21.
[183] *See Strotler v. Commissioner*, T.C. Memo 1987-275 (the Tax Court rejected the argument under the facts of this case).
[184] 477 U.S. 105 (1986).

contributions of over $100,000. This donative intent rule must be satisfied in order for a South Carolina taxpayer to either (1) pass through the charitable deduction taken on its federal income tax return;[185] or (b) take the South Carolina conservation easement tax credit.

The special South Carolina statute[186] requires a donor to meet the federal donative intent guidelines imposed under IRC section 170 as well as "be motivated by detached and disinterested generosity benefiting a charitable purpose rather than expected economic benefit." The new Act further provides that a contribution given by a donor to comply with any state or federal environmental or other regulatory requirement, for the purpose of obtaining road, water or sewer services, or in conjunction with obtaining a financial grant, subdivision, building, zoning, environmental, mitigation or similar permits or approvals from any governmental entity will be deemed to not have the requisite donative intent, absent extraordinary circumstances.

In order to hinder taxpayers from planning around the donative intent requirements, for example through the use of intermediaries, the Act authorizes the Department of Revenue to examine the substance, rather than merely the form of the contribution, as well as related and surrounding transactions. The Act also explicitly directs the DOR to use the step transaction, economic reality, quid pro quo, personal benefit and other judicially developed doctrines.

Lastly, the statute provides that the requisite donative intent requirement is not present if property covered by a conservation easement is used for, or associated with, the playing of golf, or is planned to be so used or associated.

3. Quid Pro Quo

> 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. For purposes of this paragraph (h)(3)(i), related person shall have the same meaning as in either section 267(b) [including some corporations and trusts] or section 707(b) [including certain partnerships].[187]

[185] A taxpayer which failed to satisfy the special donative intent test would be required to add back the charitable deduction for purposes of calculating its South Carolina taxable income.
[186] Section 43D of H. 3768 (2005).
[187] Treas. Reg. § 170A-14(h)(3)(i).

A deduction is typically denied where "the donor received or expected to receive a quid pro quo in exchange for the transfer to the recipient."[188] The test objectively looks at the "'external features' of a transaction . . . to determine if a transfer was made with an expectation of a quid pro quo."[189] In the context of conservation easements and other gifts, the *quid pro quo* rule largely applies where a land developer seeks to deduct the value of an easement granted to local authorities in exchange for favorable zoning or other consideration in the development process.[190] The deduction should be denied because "the 'donation' is really a bargained-for exchange, . . . and there is no gift."[191] The general rule on deductibility in the area has been stated thusly, "[r]eceipt of a desired zoning variance from a city which would or might not be available without making a dedication of land [or of an easement] to the city has been held to be a direct economic benefit which would preclude a charitable deduction."[192] Conversely, "a contribution is charitable in nature if the benefits accruing to the donor are only incidental to the benefits accruing to the public."[193]

In *Ackerman Buick*, a *quid pro quo* was found and a deduction denied where the taxpayer dedicated a road it owned to the city to facilitate rezoning of property necessary to operate its business.[194] Similarly, 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.[195] In another case involving the dedication of land to a school district, a deduction was denied because it was found that the taxpayer "knew that the construction of a school and the attendant roads on its property would substantially benefit the surrounding land, that it made the conveyance expecting its remaining property to increase in value, and that the expected receipt of these benefits at least partially prompted [taxpayer] to make the conveyance."[196] In *McConnell v. Commissioner*[197] a developer's dedication of streets and sewers was found to be motivated by his desire to avoid future maintenance responsibilities and to enhance the value of his remaining property. Similarly, in *Stubbs v. United States,*[198] the Ninth Circuit Court of Appeals held the taxpayer, which deeded property for a public road, was motivated by the expectation it would receive favorable zoning and therefore would have public access and public street footage.

It is important to note, as the Tax Management Portfolio points out:

> Many cases raising the donative intent [quid pro quo] issue are factually unique. Moreover, when similar fact patterns do arise, the cases

[188] *Tax Management Portfolios*, 521 2d, at A-20 (Tax Management Inc. 2004).
[189] *Id*.
[190] Stephen J. Small, *The Federal Tax Law of Conservation Easements*, 17-8 (2002).
[191] *Id*. at 17-9.
[192] *Ackerman Buick*, T.C. Memo 1973-224 (1973) (citations omitted).
[193] *Id*.; *Tax Management Portfolios*, 521 2d, at A-20 (Tax Management Inc. 2004).
[194] *Id*.
[195] *Perlmutten v. Commissioner*., 45 T.C. 311 (1965); *see also Woodside Mills v. United States*, 260 F.2d 935 (4th Cir. 1958) (holding that transfer of land by builder not deductible where required to obtain a zoning change).
[196] *Ottawa Silica*, 49 A.F.T.R. 2d 82-1162, 82-1 USTC P 9308, 1982 WL 19302 (1982).
[197] 55 TCM 1284 (1988).
[198] 428 F.2d 885 (9th Cir. 1970).

may be difficult to reconcile. Courts have reached conflicting decisions in cases involving seemingly comparable facts. As a consequence, it may be problematical at the planning stage to predict with certainty whether a client's transaction will ultimately be treated as a gift or a nondeductible payment. When donative intent [quid pro quo] is a potential issue, the tangible and intangible benefits flowing to the taxpayer in connection with the transaction must be closely examined in the context of the particular payment. Before relying on a case or ruling, an advisor should carefully analyze whether the facts of the case or ruling are sufficiently analogous to the client's situation.[199]

In *Addis v. Commissioner,*[200] the IRS prevailed on its claims that the taxpayer failed to fulfill the substantiation requirements imposed by IRC § 170(f)(8) and the regulations[201] because the contemporaneous written acknowledgement by the charity incorrectly stated that the charity provided no goods or services in exchange for the "donation" and contained no description or good faith estimate of the value of the benefits the taxpayers received.[202] The Ninth Circuit noted that "[t]he regulatory definition of consideration, however, calls for us to view all the benefits the [taxpayers] expected from the ["donation."] The regulatory definition of goods and services to embrace expected future consideration means that anticipated consideration must be disclosed even if not currently taxable as income."[203]

As stated above, in 2005 South Carolina adopted its own quid pro quo rules for state tax purposes.

4. 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."[204] Internal Revenue Code § 170(h)(1)(C) defines "exclusively for conservation purposes" as imposing two requirements: First, the conservation purpose must be protected. A contribution will not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity. Second, surface mining must not be permitted.

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[199] *Tax Management Portfolios*, 521 2d, at A-23 (Tax Management Inc. 2004) (citations omitted), *comparing Ackerman Buick* with *Scheffres v. Commissioner,* 28 T.C.M. 234 (1969) (allowing a deduction where the taxpayer transferred a parcel of land to a school board to facilitate a zoning change because the school board could have otherwise acquired the land) and *Allen v. United States*, 541 F 2d 786 (9th Cir. 1976), *aff'g* 74-1 USTC 9433 (N.D. Cal. 1974) (allowing a deduction for a transfer of 9.2 acres of redwood trees required for approval of a subdivision plan because trial court's finding that taxpayer was motivated to preserve the trees).

[200] 374 F.3d 881 (2004).

[201] Treas. Reg. § 1.170A-13(f)(6).

[202] Taxpayers contributed some $73,000 to a charity which paid a similar amount in premiums on a split-dollar life insurance policy. The charity was entitled to receive 56%, and the taxpayer's family trust 44%, of the death benefits.

[203] 374 F.3d at 886-87.

[204] 521 TMP Charitable Contributions: Income Tax Aspects at p. A-43.

Treasury Regulation § 1.170A-14 provides that in order to meet the requirements of the section, a donation must be exclusively for conservation purposes. Treas. Reg. § 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 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, namely the 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, and
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 the 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 a "State Act" and use best management practices, 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 with no logging allowed within 75 feet. Clear cuts (cut areas on which regeneration averages less than ten feet in height) were restricted to five or fewer acres in size, and clear-cut areas containing trees ten years old or younger could not exceed 2% of the total timberland. Additionally, there could be no more than one clear cut per 100 acres without the consent of the donee. The easement incorporated a forest management plan, developed by the taxpayer and donee, that provided guidelines for the taxpayer's management of the property.

The IRS held under these facts that the "exclusive use" requirement had been satisfied:

> 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.

In IRS PLR 200002020, the taxpayer reserved the right to use the property solely for crop farming and other consistent uses. “Taxpayer reserves no right for future development of the property beyond the construction of structures connected with the permitted agricultural uses.” Such uses were held to be solely for conservation purposes.

In IRS PLR 199927014, the taxpayer reserved no right to cultivate or develop the area under easement (a lake). It affirmatively covenanted that the lake would be used in a way consistent with conservation purposes. In addition, the taxpayer agreed not to use adjacent property that would in any way adversely affect the drainage, flood control or water conservation of the 7.5 acres or adjoining property. This also, along with other factors, met the “exclusive” standard.

5. 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.[205]

In PLR 20020819, the easement permitted construction of eight single-family residences, two ancillary buildings, a barn, a riding ring, and a limited number of grazing animals. However, 80% of the tract was limited to an undeveloped state. "Accordingly, the planned inconsistent use of some of the property is not significant enough to cancel the conservation purpose of the easement."

A use 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 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.

6. 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.

[205] *See* PLR 9537018 (selective timber harvesting), quoted at length above.

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.

7. Enforceable in Perpetuity

Under Section 170(h)(5)(A) of the Internal Revenue Code, a contribution is not exclusively for conservation purposes unless the purposes are protected in perpetuity. Under section 27-8-30(c) 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." Treasury Regulation § 1.170A-14(g)(1) provides that 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, recordation in the register of mesne conveyances (RMC) office in the county 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 for a term of years, can use the property in a manner that diminishes the conservation values intended to be protected by the contribution.

8. Property Subject to a Mortgage

In the case of conservation contributions made after February 13, 1986, no deduction will be permitted under IRC § 170 for an interest in property 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.[206] However, 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* (published by the Land Trust Exchange and the Trust for Public Land).

9. Remote Future Event

A deduction shall not be disallowed merely because the interest that passes to or is vested in the donee organization may be defeated by the performance of some act or the

[206] Treas. Reg. § 1.170A-14(g)(2); *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"); *see also* PLR 9329017.

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.[207] 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*,[208] 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 Tax 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.

Note that the South Carolina Conservation Easement Act explicitly states that "this Chapter does not affect the power of a court to modify or terminate a conservation easement in accordance with principles of law and equity."[209] The Act also states the "A person or entity empowered to condemn may condemn a conservation easement.…Holders of the conservation easement must be parties to the proceedings along with the owner of the land."[210]

10. Establishing the Condition of the Property at the Time of the Gift

Treas. Reg. § 1.17A-14(g)(5) provides that, in the case of a donation made after February 13, 1986, of any qualified real property interest where the donor reserves rights the exercise of which may impair the conservation interests associated with the property, for a deduction to be allowable 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.[211] Such documentation may include:

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[207] *See* paragraph (e) of Treas. Reg. § 1.170A -1.
[208] T.C. Memo. 1987-275.
[209] S.C. Code § 27-8-40 (B) (Supp. 2004).
[210] *Id.* § 27-8-80.
[211] *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").

(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."

In PLR 200208019, the IRS noted:

> Taxpayer represents that it will provide ConOrg 1 with documentation of the condition of The Farm at the time of conveyance of the conservation easement. Items furnished and to be furnished to donee include (1) narrative of the history and current condition of The Farm; (2) a location map and directions to site; (3) written reports with site photographs describing ecological features of the subject property, including its wildlife, its geology and soils, its plant cover types, its aquatic resources; (4) a written report discussing endangered species, wetlands and natural areas of The Farm by Dr. X; (5) an inventory of the natural areas of the River X area; (6) an aerial photograph of site; (7) base map (to include property lines and easement locations; (8) a "topo" [topographical] map (to include any key features manmade or ecological); (9) keyed site photographs with description; (10) a description of buildings, structures and other man-made structures (excluding power lines) included in site photographs and maps; and (11) an acknowledgement of condition in the form of notarized letter.

The property description provides a detailed baseline and a common reference point to judge if violations of the easement conditions have occurred. Therefore, the description should define any terms used with enough detail to provide meaningful future comparison. Only the resources that the easement intends to protect must be documented. The level of specificity depends upon how delicate the resource is. For example, if the grantor intends to protect water or air quality, the description should contain a quantitative standard of protection.

The original deed, which transferred the property to the current landowner, should contain a legal description of the property. If the property has not been surveyed in over thirty years, a new survey will need to be completed. Also if the boundaries have more than one foot of error for every 500 feet, a new survey and legal description will need to be done. A computer plot can accurately show the property boundary, and obtaining an accurate boundary plot and legal description will avoid future boundary disputes. Any mapping completed should be attached to the conservation easement document. Moreover, a statement attesting to the validity of the description signed by the grantor and grantee should accompany the document.[212]

In the recent IRS PLR 200403044, the IRS noted approvingly that :

> The baseline documentation includes: (1) a narrative description of the Subject Tract and its current uses, (2) a narrative description of the ecological features of the Subject Tract, (3) a listing of vascular plants found on the Subject Tract, (4) a location map, (5) an infrared aerial map, (6) a vicinity map, (7) an ecological features map, (8) a photostations map, (9) a map showing current roads, structures and debris fields on the Subject Tract, (10) a map showing nearby protected properties, (11) wetland certification letters and maps, (12) a threatened and endangered species report for the Subject Tract, and (13) photographs of the Subject Tract.

The Land Trust Alliance's Standards state in part:

> B. Baseline Documentation Report. For every easement, the land trust has a baseline documentation report (that includes a baseline map) prepared prior to closing and signed by the landowner at closing. The report documents the important conservation values protected by the easement and the relevant conditions of the property as necessary to monitor and enforce the easement. In the event that seasonal conditions prevent the completion of a full baseline documentation report by closing, a schedule for finalizing the full report and an acknowledgement of interim data [that for donations and bargain sales meets Treasury Regulations § 1.170A-14 (g)(5)(i)] are signed by the landowner at closing.[213]

11. Changed Conditions

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[212] 4 Great Plains Nat. Resources J., *supra*, at pp. 152-53 (citations omitted).

[213] Land Trust Standards and Practices, Standard 11 Conservation Easement Stewardship (Land Trust Alliance) (rev'd 2004).

"Although a conservation purpose must be protected in perpetuity, the regulations recognize that changed conditions may frustrate the conservation purpose of a particular gift."[214]

> In general, easements may be extinguished by private mutual agreement between the parties to the easement. However, Congress provided in the Treasury Regulations that conservation easements are extinguishable only by a judicial proceeding. The circumstances that might justify extinguishments include a "change in conditions surrounding the property" that makes the conservation purpose "impossible or impractical." The terminology of the regulation is confusing at best. The traditional rule under property law is that easements can be terminated only if their purposes become "impossible" to accomplish. The regulations refer to the "changed conditions" doctrine, which sets a lower threshold for extinguishment. This doctrine foreseeably could be used to terminate a conservation easement on the grounds of economic hardship. Increased economic development and rising property values surrounding the property could result in extinguishment of the easement. This result would be contrary to the landowner's original goal of preservation. To correct the ambiguity of the regulations, the Land Trust Alliance has provided a Model Conservation Easement that "assumes the impossibility standard is the correct one to apply to conservation easements."[215]

If a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation 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.[216] For purposes of 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.

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[214] 521 TMP *Charitable Contributions: Income Tax Aspects* at pg. A-44.
[215] 35 Land & Water L. Rev., *supra*, at 204.
[216] *See* Treas. Reg. § 1.170A -14(h)(3)(iii) relating to the allocation of basis.

In PLR 200208019, the IRS noted, with approval:

> In the present case, the easement provides for extinguishment only pursuant to judicial proceedings, limits the use of proceeds received by the donee as a result of extinguishment to consistent conservation purposes, and gives the donee a property right that satisfies the percentage values requirement of the regulation, which are to remain constant with respect to such property rights. In this connection, paragraph 16(b) of the conservation easement provides the following: "For the purposes of this paragraph, the ratio of the value of the Easement to the value of the Protected Property unencumbered by the easement shall remain constant."

Similarly, in recent PLR 200403044, the IRS noted:

> In the present case, the Easement provides for no means to extinguish the Easement other than by judicial proceeding (§ 5.11) or by condemnation (§ 5.13). Sections 5.11 and 5.13 further provide that all of the Donee's proceeds from the subsequent sale or exchange (or condemnation) of the Subject Tract shall be used for conservation purposes. The portion of the proceeds of any subsequent sale or exchange (or condemnation) of the Subject Tract payable to the Donee equals an amount that is determined by dividing the fair market value of the Easement donation by the fair market value of the Subject Tract (at the time of the Easement).

Note that the South Carolina Conservation Easement Act explicitly states that "this Chapter does not affect the power of a court to modify or terminate a conservation easement in accordance with principles of law and equity."[217] The Act also states the "A person or entity empowered to condemn may condemn a conservation easement.…Holders of the conservation easement must be parties to the proceedings along with the owner of the land."[218]

12. Restrictions on Transfer by the Donee

The donor must prohibit transfers of the easement by the donee, unless, subsequent to the transfer, the donee requires that the conservation purpose continues to be carried out and the subsequent transferee qualifies as an eligible donee. The deed of easement must require any transferee to assume the donee's responsibilities under the easement. Additionally, the transferee must be a qualified organization under §170(h) of the Code and be eligible under state statutes to hold the easement.

In PLR 200208019 the IRS stated:

[217] S.C. Code § 27-8-40 (B) (Supp. 2004).
[218] *Id.* § 27-8-80.

> In the present case, all statutory and regulatory requirements as to eligibility of transferees of donees are satisfied by the provisions of paragraphs 17 and 18 of the instrument granting the conservation easement. Specifically, paragraph 17 provides that the rights and obligations under the conservation easement are assignable only to any organization that is qualified under § 170 (h) of the Code and the applicable regulations promulgated thereunder, and authorized to acquire and hold conservation easements under State X law. Paragraph 17 further provides that as a further condition for assigning the easement, the grantee "shall require that the conservation purposes that the grant is intended to advance continue to be carried out." Under paragraph 18 the grantor of the conservation easement must incorporate the terms of the easement in any deed or other legal instrument by which there is any transfer or divestment of any interest or portion of the protected property. Accordingly, the proposed contribution of the conservation easement will be made to a qualified organization.
>
> However, under § 1.170A-14(c)(2) of the regulations, the donor must prohibit transfers of the easement by the donee, unless, subsequent to the transfer, the donee requires that the conservation purpose continue to be carried out, and the subsequent transferee qualifies as an eligible donee under § 1.170A-14(c)(1). The deed of easement must require any transferee to assume the responsibilities of Donee under the easement. Additionally, the transferee must be a qualified organization under § 170(h) of the Code and be eligible under State's statute to hold the easement.

Similarly, in recent IRS PLR 200418005, the IRS noted that "the deed provides that any transferee or assignee must: (1) assume the responsibilities of the conservation fund; (2) be a 'qualified organization' . . .; (3) be eligible to hold the easement under State Law; and (4) have the resources to enforce the restrictions."

CHAPTER VII. DONEE'S RIGHT TO INSPECT AND ENFORCE

As stated below, the easement must explicitly give the donee (*e.g.*, a land trust) the right of inspection as well as legal remedies. The donor must also agree to notify the donee in writing before implementing any reserved right which may have an adverse impact on the conservation interests protected by the easement (*e.g.*, mining). The terms of the donation must give the donee the right to enter the property at reasonable times for the purpose of inspection to determine if there has been compliance with the terms of the easement. Additionally the terms of the donation must provide a right of the donee to enforce the conservation restrictions by appropriate legal proceedings, including the right to require the restoration of the property to its condition at the time of the donation.

> The essential factor, in insuring the continued existence of the easement, is effective monitoring. Guarding against violations substantially

> burdens the holder in terms of human and financial resources. Most land trusts prospectively guard against violations by working with the landowner. When the landowner grants the easement, he or she agrees to abide by the terms of the agreement. Occasionally, a land trust may have to bring an enforcement action against a landowner for non-compliance.
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> * * * *
>
> Preventing violations by second-generation purchasers is often a concern since the second owner usually does not have the attachment to the land that the previous owner had. The best way to prevent violations is to educate potential land buyers concerning the obligations of the conservation easement. The burden of the conservation easement on the property will reflect in the purchase price thereby giving the second owner notice of the encumbrance. In other words, the easement will remain enforceable against the second owner. The original owner can help ensure the validity of the easement by providing for assignability in the document.
>
> The threshold issue regarding enforcement of a conservation easement is whether the party bringing suit has standing. The Uniform Conservation Easement Act [See South Carolina Conservation Easement Act of 1991, S.C. Code §§ 27-8-10 *et seq.*] allows for four possible types of petitioners in an enforcement action. The holder of the easement, the owner of the property, a person having third party enforcement rights and any other persons authorized by law have standing to sue. However, automatic litigation of a non-compliance violation involves expensive and time-consuming transaction costs. Enforcement can also be achieved through arbitration, mediation or the property's restoration. The document should specify the preferred alternative but not provide for an exclusive method of enforcement.[219]

Section 27-8-40 of the South Carolina Conservation Easement Act of 1991 provides that a legal action to enforce, or otherwise affect, a conservation easement, may be brought by:

> (1) an owner of an interest in the real property burdened by the easement;
> (2) a holder of the easement;
> (3) a person having a third-party right of enforcement (see below); or
> (4) a person otherwise authorized by law.

Section 27-8-20 (4) defines "third-party right of enforcement" as "a right provided by the grantor of the conservation easement to enforce selected terms of the conservation easement which is granted to a governmental body, a charitable, not-for-profit, or

[219] 4 Great Plains Nat. Resources J., *supra*, at p. 159 (citations omitted).

educational corporation, association, or trust, which though no the holder of the easement, is eligible to be the holder of such easement." Section 27-8-30 (B) goes on to state, however, that no right in favor of a person having a third-party right of enforcement arises under a conservation easement before its acceptance by the holder and a recordation of the acceptance in the office of the register of deeds for each county where the land burdened by the conservation easement lies.

The Land Trust Alliance's Standards state in relevant part:

> E. Enforcement of Easements. The land trust has a written policy and/or procedure detailing how it will respond to a potential violation of an easement, including the role of all parties involved (such as board members, volunteers, staff and partners) in any enforcement action. The land trust takes necessary and consistent steps to see that violations are resolved and has available, or has a strategy to secure, the financial and legal resources for enforcement and defense.[220]

In order to properly enforce the easement, the land trust will need adequate baseline materials as well as an adequate monitoring program. With reference to the latter, the Land Trust Alliance's Standards notes: "C. Easement Monitoring. The land trust monitors its easement properties regularly, at least annually, in a manner appropriate to the size and restrictions of each property, and keeps documentation (such as reports, updated photographs and maps) of each monitoring activity."[221]

In 2004, the Land Trust Alliance updated a study of conservation easement violations. The study showed a violation rate of about 5 percent which was consistent with a study conducted five years earlier. One writer has suggested the following guidelines to reduce the potential for violations:

> 1. Craft carefully designed conservation easements that are clear in meaning and intent to all parties;
> 2. Establish and maintain good relations/communication with the landowners, including subsequent landowners;
> 3. Create solid, detailed baseline documentation;
> 4. Write a violations policy and update it when necessary; and
> 5. Monitor regularly and consistently.

The earlier a violation is discovered, the greater the chance for a quick resolution.[222]

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[220] Land Trust Standards and Practices, Standard 11: Conservation Easement Stewardship (Land Trust Alliance) (rev'd 2004).
[221] *Id.*
[222] Jason B. van Doren, *Summary of the 2004 Conservation Easement Violations & Amendments Study*, Exchange (Land Trust Alliance Vol. 24 No. 2).

Chapter VIII. Valuation

A. General

The value of the donated conservation easement is the fair market value of the perpetual conservation restriction at the time of the contribution. The Tax Court has approved charitable contribution deductions for conservation easements ranging from sixteen to ninety-one percent of the value of the protected property. Because the fair market value of the donated easement is subjective, the government provides strict rules for its determination. The Treasury Regulations stipulate: "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 sales is available to use as a meaningful or valid comparison (which is most likely the case), the fair market value of the easement is equal to the difference between the fair market value of the property before the easement and the fair market value of the property after the easement.

These market values must be substantiated by a qualified appraisal made not more than sixty days before the date of the grant of the easement and not later than the due date for the return in which the deduction is claimed. The property values before and after the easement must reflect the property's potential highest and best uses. A property's potential highest and best use can be derived from comparable sales of existing or potential future uses for the property that yield the greatest value. The appraisals must include an objective assessment considering "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." [223]

If the grant of the easement has the effect of increasing the value of any other property owned by the landowner or a related person, the value of the contribution must be reduced by the amount of any increase. In addition, if the landowner receives in exchange for the easement either a cash payment or some other service or property, including a zoning change or development right approval, the deduction will be reduced by the value of the benefit received or completely disallowed if any significant conservation purposes are undermined.[224]

[223] Lipman, 27 Harv. Envtl. L. Rev. 471, 498-99 (citations omitted).
[224] Lipman, 27 Harv. Envtl. L. Rev. 471, 498-99 (citations omitted).

B. Definition of "Fair Market Value" for Property Tax Purposes

As previously indicated, Chief Administrative Law Judge Marvin Kittrell has ruled:

> 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.
>
> * * * *
>
> Fair Market value is the measure of true value for taxation purposes. There is no valid distinction between market value for sales purposes and market value for taxation purposes. . . .[225]

Similarly, in *Harris v. Georgetown County Assessor*[226] the court stated:

> The proper measure of value for taxation purposes is the fair market value. Fair market value is defined as: ". . .the price which the property would bring following reasonable exposure to the market, where both the seller and the buyer are willing, are not 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."
>
> The property's highest and best use must be considered in calculating the property's value. "Highest and best use" may be defined as "the reasonable, probable and legal use of vacant land or improved property, which is physically possible, appropriately supported, financially feasible, and that results in the highest value." The Appraisal of Real Estate, Appraisal Institute, p. 45 (10th ed. 1992).
>
> To determine a fair market price for the subject property, comparisons of the sale price of other properties of the same character may be utilized.
>
> While not conclusive, market sales of comparable properties present probative evidence of the fair market value of similar property.

C. Definition of "Fair Market Value" of Easements

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 Treasury Regulation § 1.170A-1(c)(2) as "the price at which the property would

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[225] *Spartanburg Co. Assessor v. River Falls Plantation Golf*, 1999 WL1016066 (S.C. Admin. Law Judge Div.) (citations omitted).
[226] 2003 WL 1542789 (S.C. Admin. Law Judge Div.) (citations omitted).

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* (12th Ed.) at p. 22 defines "market value" as:

> The most probable price, as of a specified date, in cash, or in terms equivalent to cash, or in other precisely revealed terms, for which the specified property rights should sell after reasonable exposure 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 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.

The IRS has issued two revenue rulings which indicate that the "before and after" method is the correct method for appraising conservation easements.[227]

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."[228]

The before-and-after test essentially boils down to 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 Internal Revenue Code 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

[227] *See* Rev. Ruls. 77-339 and 76-376.
[228] Small, *The Federal Tax Law of Conservation Easements* at 254 (1986).

> (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*,[229] 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.[230] Granting an easement may increase, rather than reduce, the value of property, and in such a situation no deduction would be allowed.[231]
>
> 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

[229] http://www.irs.gov/pub/irs-pdf/p561.pdf

[230] *See Griffin v. Commissioner*, 56 TCM 1560 (1989) (development restrictions in the French Quarter of New Orleans limited the value of easement); *Garrison v. Commissioner*, 51 TCM 1273 (1986) (the "before" value of the contributed property, which was located in wetlands, was significantly lower than the value claimed by the donor).

[231] *See Strasburg v Commissioner*, T.C. Memo 2000-94 (2000); *Osborne v. Commissioner*, 87 T.C. 575 (1986) (charitable deduction for the grant of a drainage easement to city was reduced by the value added to the donor's property by the city's construction of a drainage facility); Ltr. Rul. 20002020 (1999).

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 to 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. [232]

In some of the more recent PLRs (*e.g.*, PLR 200208019), the IRS has stated the following:

[232] Vermont Land Trust, *Tax Benefits of Donating a Conservation Easement*, http://www.vlt.org/taxbenease.html (Jan. 30, 2004).

> As a general rule, the amount allowed as a deduction for a conservation easement is the difference between the value of the burdened property before and after the donation. See *Symington v. Commissioner*, 87 T. C. 892 (1986.) It is possible that the value of a taxpayer's retained property may increase as a result of the easement. The contribution is deductible only to the extent that its value exceeds the value of the benefits received.

In Notice 2004-41, the IRS stated as follows:

> If the donor (or related person) reasonably can expect to receive financial or economic benefits greater than those that will inure to the general public as a result of the donation of a conservation easement, no deduction is allowable. If the donation of a conservation easement has no material effect on the value of the real property, or enhances rather than reduced the values of the real property, no deduction is allowable.[233]

D. Regulation 1.170A-14

On January 14, 1986, the IRS published final regulations on gifts of conservation easements. The regulations were codified at Treas. Reg. § 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.[234] 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 IRC § 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. Treas. Reg. § 1.170A-14(h) (3)(I) states 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 that section. However, if

[233] The notice cites Treas. Reg. § 1.170A-14 (h)(3)(i) and (ii).
[234] See Treas. Reg. 1.170A-7(c).

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 the 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 1.170A014(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.

E. Fair Market Value Before and After Restriction

Treasury 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 the 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.[235]

[235] *Valuation of Wetlands* (Appraisal Institute at p. 24). Similarly in the article, *Assessing Land Under Conservation Restrictions*, Assessment Journal (Vol. 1, No.4 July/Aug. 1994 at p. 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 has no material effect on the value of the property or, in fact, serves 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, 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 will 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.[236]

F. 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--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*,[237] 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 40 lots derived from the property, and then used an anticipated use valuation technique to treat the parcel as a 40-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 the 40 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* sided with the taxpayer, concluding, based largely on the taxpayer's expert's report, that the value of the conservation easement was $703,000.

[236] See Treas. Reg. § 1.170A -14 (c)(3).
[237] T.C. Memo 1992-436.

In *Schapiro v. Commissioner,*[238] 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 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 with 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 Action on Decision (AOD) on *Schapiro*, indicating that while it felt the Tax Court erred, it did not 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,*[239] the 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 60-acre parcel on the Potomac River in Fairfax County, Virginia. The major disagreement between the parties' appraisal experts was over the highest and best use of the farm 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

[238] T.C. Memo 1991-128.
[239] 36 T.C.M. 1504 (1977).

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 % and 33%, although the Tax Court has also approved reductions of 75% [240] and 90%. *Strasburg v. Commissioner*[241] is one of the more recent cases. The judge in that case reviewed the comparable sales data used by the expert for both sides and determined that five were comparable to the taxpayer's property. The diminution in value on the five comparables ranged from zero to 50%. The court averaged the five figures, resulting in a reduction in value of 32% or $800,000.[242]

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.

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[240] *Stanley Works and Subsidiaries v. Commissioner*, 87 T.C. 389 (1986).
[241] T.C. Memo 2000-94, 79 T.C.M. 1697 (CCH).
[242] Other cases dealing with the proper value of conservation easements include *Johnston v. Commissioner*, T.C. Memo, 1997-475, 74 T.C.M. 968 (CCH); *Schwab v. Commissioner*, T. C. Memo, 1994-232, 67 T.C.M. 3004 (CCH); *Griffin v. Commissioner*, T.C. Memo, 1989-130, 56 T.C.M. 1560 (CCH); and *Losch v. Commissioner*, T.C. Memo 1988-230, 55 T.C.M. 909 (CCH).

- 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 judgment. 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 judgment it is appropriate to do so.

G. Appraisal Guidelines

> [T]reasury 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.[243]

The publication, *Appraising Easements*, is one of the most comprehensive discussion of appraising conservation easements[244]. 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* (frequently referred to as the "yellow book."[245]) 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

[243] *See* Land Trust Alliance, *Appraising Easements* at 9.
[244] Appraising Easements (3d. Ed.), Land Trust Alliance and National Trust for Historic Preservation (1999), see lta.org/publications/apprea.htm.
[245] http://www.usdoj.gov/enrd/land-ack/toc.htm

> 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,*[246] contains the general requirements for qualified appraisals. This publication is quoted at length below.

Lastly, the Uniform Standards of Professional Appraisal Practice (USPAP)[247] was promulgated to establish ethical and technical standards for appraisers. The federal OMB requires many federal land acquisitions to conform with USPAP standards. Real estate appraisals done by appraisers licensed in South Carolina are subject to USPAP.

H. Allocation of Basis

Treasury 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 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.

I. Examples

Treasury 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 Treas. Reg. § 1.170A -4, with respect to reduction in amount of charitable contributions of certain appreciated property, and Treas. Reg. § 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

[246] http://www.irs.gov/pub/irs-pdf/p561.pdf
[247] *See* http://www.appraisalfoundation.org

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 x .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 x .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 x $15,000=$120,000) minus the fair market value of the encumbered land after the granting of the easement (8 x $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 x $1,000)+(2 x $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 x $3,000) x ($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.

J. Cautionary Note on Valuations

Recent perceived abuses of the valuation of conservation easements has generated considerable scrutiny by the IRS,[248] the U.S. Senate Finance Committee,[249] the media[250] and the South Carolina Department of Revenue. A desk audit of some 55 land trusts doing business in South Carolina has disclosed breathtaking valuations of conservation easements, some on property which was recently purchased for a fraction of the claimed value of the easement, and many claim a "before" value far in excess of the appraised value for property tax purposes.[251]

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[248] In a recent speech on October 17, 2005 to the Land Trust Alliance (http://www.irs.gov/pub/irs-tege/land_trust_alliance_final_oct_17_20051.pdf), Steven T. Miller, Commissioner, Tax Exempt and Government Entities at the IRS, outlined (1) forthcoming guidance on easements, (2) the design and implementation of a comprehensive compliance program, and (3) the IRS emphasis on appraisal abuses relating to conservation easements. On November 30, 2005 the IRS announced in IRS 2005-80 a settlement initiative for taxpayers to resolve their disputes with the IRS over certain abusive tax avoidance transactions. Certain conservation and façade easements were included in the list of abusive transactions.

[249] *See* Options to Improve Tax Compliance and Reform Tax Expenditures, Joint Committee on Taxation, Jan. 27, 2005.

[250] See J. Stephens and D. Ottaway, *Developers Find Payoff in Preservation*, Washington Post, p. A01 (Dec. 21, 2003); John P. McDermott, *Tax Auditors Scrutinize Land Dealings*, Post and Courier, p. A1 (Jan. 16, 2005); John O'Connor and Gina Smith, *Conservation Easements Face Scrutiny*, The State, p. B1 (Feb. 20, 2005); Paul Alongi, *Fraudulent Preserves Costing Taxpayers*, The Greenville News, http://greenvilleonline.com/news/2005/02/27/2005022759517.htm (Feb. 28, 2005); and Noelle Phillips, *More tax cheats targeted*, The State, p. A1 (December 4, 2005).

[251] *See Wortmann v. CIR*, 2005 WL 2387487 (U.S. Tax Ct. 2005) in which the taxpayers claimed a charitable contribution of $475,000 for a donation of real property which they had purchased for $75,000 just 17 months before the date of donation. The Tax Court, which affirmed the IRS's valuation of $76,000, stated: "We note that evidence of what property sold for within a reasonable time before the valuation date generally is competent, substantial, and persuasive evidence of its fair market value on the valuation date. Actual sales

> Inflation or ignorance of the valuation rules can lead to enormous and potentially unwarranted tax deductions. Using a transaction described in the national press, suppose a developer purchases a piece of property for $10 million, places some conservation easements on unbuildable ground, e.g. protected wetlands, subdivides the remainder, promotes the protected areas as part of the marketing of the housing project, and then claims tax deductions of over $20 million for the purported reduction in value. This transaction raises several red flags, in my view. First of all, adding an additional layer of protection to the wetlands is unlikely to diminish the value of the property. Second, if the protected areas increased the value of the remaining land, the amount of the charitable deduction must be reduced by the amount of that increase. Finally, if the property was purchased for $10 million, there are only a few scenarios under which the easements could be worth double that, none of which appear likely. First, the purchase could have been from an unsophisticated seller ignorant of the market value of the property. Second, the developer could have purchased property zoned for uses other than a housing subdivision, and obtained favorable zoning variances that resulted in an increase in property values. Although below-market purchases and rezones occur with regularity, the figures in the example strongly suggest an exaggeration of the value of the conservation easement.[252]

In particular, use of the subdivision development analysis can produce aggressive or abusive easement values.

> The subdivision development analysis appears to be gaining in popularity as the rigueur method of determining the before-easement value of land in conservation easement appraisal. That is troubling for a number of reasons. First, the subdivision development analysis can produce unrealistically high values if the appraiser overestimates the gross proceeds realizable from the imagined development, or, more importantly, fails to account for all of the

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between a willing buyer and a willing seller are generally more reliable than estimates and approximations and indicate what a hypothetical buyer and seller may agree on. Windows of time between the valuation date and the sale date have been found to be reasonable under some circumstances, even when they are as long as 15 months or 2 years. As fair market value is a factual determination and necessarily inexact, evidence of the price contained at a recent arm's-length sale may be extremely probative. The weight given to an actual sale price is greatly diminished, however, where a material change in circumstances occurs between the valuation date and the date of sale." 2005 WL 2387487 at pg.5 (citations omitted.) See also *Brea City School District v. Cuyahoga*, 834 N.E. 2d 782 (2005) ("The best evidence of the 'true value in money' of real property is an actual, recent sale of the property in an arm's length transaction"); and *Nhuss Trust v. Commissioner*, TC Memo 2005-236 (2005). (Generally, the best evidence of fair market value is an actual sale of the property in an arm's length transaction within a reasonable time before or after the valuation date.") The Tax Court also held in *Wortman* that "The assessed valuation of property [for property tax purposes] is also evidence of the property's value where, as in the case of Nebraska, the assessed value if defined as the property's fair market value. Assessed valuation may be used to corroborate fair market value determined under the three traditional approaches [of comparable sales, income and cost.]" (Citations omitted.)

[252] H. Barton Thomas, *Conservation Easements: Tax Facts and Fictions*, 47-Mar Advocate (Idaho) 13 (2004). The example is taken from a Washington Post article, *supra*.

> costs and risks associated with the development in a detailed and realistic manner. Even minor errors in the discount rate applied to the estimated gross proceeds from the imagined development can create large variances in the ultimate value determined. Second, no matter how much care and skill is employed in preparing a subdivision development analysis, its estimate of fair market value will almost always be more speculative that the estimate obtained using a more traditional appraisal method, such as the sales comparison approach. Third, many, if not most easement appraisers who employ the subdivision development analysis to determine the before-easement value of land are likely doing so in contravention of established appraisal rules, which dictate that such analysis should be used as the sole or primary appraisal method only in relatively rare circumstances. Generally, two conditions must be present before the subdivision development analysis can be used to establish the value of land: (i) the "highest and best use" of the land must not be available because comparable sales do no exist, or are so few and dissimilar to the subject property that a sales comparison approach would involve unacceptably speculative adjustments and assumptions. Finally, the complexity involved in the subdivision development analysis makes abusive before-easement valuations difficult for the IRS to recognize and refute.[253]

Similarly, A Conservation Easement Appraisal Guide[254] published by the Colorado Coalition of Land Trusts, states on page 24:

> (1) There are six interrelated techniques for valuing land as vacant:
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> (a) Sales Comparison
> (b) Allocation
> (c) Extraction
> (d) Subdivision Development NOTE – This technique results in very misleading indications of property value when it is not used extremely carefully. This technique should not be used unless the highest and best use of a property is for division and development within a reasonably short period of time, when costs of development can be accurately identified, when potential sale prices of resulting parcels can be estimated, and when realistic adsorption rates can be supported by market evidence.
> (e) Land Residual
> (f) Ground Rent Capitalization

The leading appraisal treatise, *The Appraisal of Real Estate,*[255] defines the subdivision development analysis as

[253] 31 Ecology L.Q. 1, 84-85 (footnotes omitted).
[254] http://www.cclt.org/downloads/CCLT_Appraisal_Guide_6_01_04.pdf
[255] *The Appraisal of Real Estate* 343 (12th ed., Appraisal Institute).

> [a] method of estimating land value when subdivision and development are the highest and best use of the parcel of land being appraised. Direct and indirect costs and entrepreneurial profit are deducted from an estimate of the anticipated gross sales price of the finished lots and, the resultant net sales proceeds are then discounted to present value at t market-derived rate over the development and absorption period to indicate the value of the raw land.

The Appraisal Institute notes that the "subdivision development analysis is a complex procedure. When used on its own without an abundance of reliable market data, it can be the least accurate raw land valuation technique."[256] Lastly the Institute states that "the use of subdivision development analysis to value vacant land is most applicable when sales data on vacant lots of land is inadequate," which is generally not the case in South Carolina.

A current or prospective value opinion for property subject to completion of proposed improvements (such as a hypothetical subdivision) can be provided in compliance with USPAP.[257] USPAP Advisory Opinion 17 notes, however, that "[a]n appraisal of real property with proposed improvements presents complex analysis and reporting issues because some portion of the property appraised does not exist at the time of the appraisal. Consequently, an appraiser must use particular care when performing an appraisal of such property to ensure that the results are credible and the appraisal report is not misleading."

The subdivision or lot analysis was at issue in a property tax case, *Spartanburg County Assessor v. River Falls Plantation Golf*.[258] The positions of the parties were reversed in that case, with the assessor arguing for a modified subdivision analysis. The litigation involved the valuation of 4.51 acres located in the River Falls Plantation Golf subdivision. The assessor arrived at his valuation using three comparables, all of which were individual lots sold by the taxpayer. Comparable No. 1 was 0.67 acres, which sold for $62,000 ($92,537/acre); comparable No. 2 was 0.57 acres, which sold for $53,010 ($93,000/acre); and comparable No. 3 was 2.34 acres, which sold for $188,100 ($80,385/acre.) After making various adjustments, the assessor determined the fair market value of the 4.13 acres to be $213,000 or $47,228 per acre. The assessor also relied on a preliminary unrecorded plat. The taxpayer appealed and the Board of Assessment Appeals, apparently rejecting the assessor's use of the subdivision analysis, held that the property was only worth $67,650, or $15,000 per acre. The Administrative Law Judge agreeing with the board, stated as follows:

> Fair market value is the measure of true value for taxation purposes. There is no valid distinction between market value for sales purposes and market value for taxation purposes under S. C. Code Ann. § 12-37-930 (Supp. 1998).
>
> In this case, the subject property is undeveloped raw land. The condition of this property has not changed since its appraisal in tax year

[256] *Id.* at 342.
[257] *See* USPAP Advisory opinion 17 (AO 17).
[258] 1999 WL 1016066 (S.C. Admin. Law Judge Div.)

> 1997. There is no recorded plat which divides this property into lots and the Assessor has assigned this tract of land one tax map number.
>
> Furthermore, even if the taxpayer had recorded the plat of the property, the South Carolina Supreme Court has consistently held that platting, by itself, does not change the value or nature of property.
>
> Therefore, I find that the Assessor's evidence of the fair market value of the property is not persuasive and that the land should be assessed and valued as undeveloped raw land. Furthermore, I find that the value placed on the subject property by the Board is appropriate.[259]

In Announcement 2005-80, the IRS announced a settlement initiative for taxpayers to resolve their tax disputes over certain abusive tax avoidance transactions. Included in the 21 listed transactions was the following:

> 19. Certain abusive charitable contributions and conservation easements (Deductions under § 170) improperly claimed as a result of: (a) open space easements where the easement has no, or de minimis, value; (b) historic land or façade easements that have no, or de minimis, value; and (c) so-called conservation buyer transactions where the charitable organization purchases property, places an easement on it and then "sells" the property with the easement to a buyer at a price substantially less than that paid for it and the buyer also makes a charitable contribution that approximates the price differential. See Notice 2004-41, 2004-28 I.R.B. 31 (5%).

CHAPTER IX. 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 Schedule A, (2) Form 8283 Part B, and (3) an appraisal summary. The donor will also need to have previously obtained a qualified written appraisal. (Note that the requirements applicable to the substantiation of deductions claimed by an individual, closely held corporation, personal service corporation, partnership or S corporation[260] differ than that for C corporations.[261] Certain of these requirements are discussed below.) In recent Notice 2004-41, the IRS noted that

> [a] charitable contribution is allowed as a deduction only if substantiated in accordance with regulations prescribed by the Secretary. . . . In appropriate

[259] 1999 WL 1016066, *supra*, at p. 3 (citations omitted).
[260] Treas. Reg. § 1.170A-13(c).
[261] Treas. Reg. § 1.170A-13(c)(2)(ii).

> cases, the Service will disallow deductions for conservation easement transfers if the taxpayer fails to comply with the substantiation requirements. The Service is considering changes to forms to facilitate compliance with and enforcement of the substantiation requirements.

The American Jobs Creation Act of 2003 (AJCA),[262] codified the substantiation requirements found in the regulations into IRC § 170(f)(11)(B). The AJCA also added a requirement that the *entire* qualified written appraisal, and not just the summary, be attached to returns claiming a deduction of more than $500,000 for contributions made after June 3, 2004.

B. Record Requirements

Treasury 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. IRC §170(f)(8)(A), as amended by RRA 1993 § 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 donee organization (*e.g.*, land trust) has provided goods or services to the donor in exchange for the making of the contributions (*i.e.*, *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 providing additional guidance regarding the substantiation and *quid pro quo* rules.

Under Treas. Reg. § 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 which the taxpayer has contributed to the donee; (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 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 Treas. Reg. § 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

[262] Pub. Law No. 108-357

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 Form 8323, together with an appraisal summary signed by the qualified appraiser (As mentioned earlier, for deductions claimed for contributions after June 3, 2004 greater than $500,000, the entire qualified appraisal must be attached).[263] 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

"An appraisal is a valuation or estimation of value of the property by an impartial, disinterested person of suitable qualifications."[264] "The American Institute of Real Estate Appraisers defines an appraisal as 'a written statement in which is set forth an estimate of the value of an adequately described property as of a specified date . . . supported by the presentation and analysis of relevant data.' "[265]

Appraisers in South Carolina are subject to the South Carolina Real Estate Appraiser License and Certification Act.[266] The Act imposes minimum education and experience requirements. Appraisers are subject to licensing and oversight by the South Carolina Real Estate Appraisers Board under the administration of the Department of Labor, Licensing, and Regulation. Appraisers are also required to conform to the uniform standards of professional appraisal practice as promulgated by the Appraisal Standards Board of the Appraisal Foundation (USPAP). The Act provides that the Board may take disciplinary action for a variety of causes including failing to exercise reasonable diligence in developing an appraisal, and accepting an appraisal assignment when the employment was contingent upon the appraiser's reporting a predetermined valuation, analysis or opinion.

The Internal Revenue Code imposes similar requirements. IRS Publication 561, *Determining the Value of Donated Property*,[267] contains an excellent summary of the appraisal requirements. This publication states in part:

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[263] American Jobs Creation Act of 2003 (AJCA), Pub. Law No. 108-357.
[264] 4 Great Plains Natural Resources J.143, 152 (2000), *quoting* 4A Patrick J. Rohan, *Real Estate Financing* § 2H.01 (1999).
[265] 4 Great Plains Natural Resources J.143, 152 (2000), *quoting* 4A Patrick J. Rohan, *Real Estate Financing* § 2H.01 (1999), *quoting* American Institute of Real Estate Appraisers, *The Appraisal Of Real Estate* 3 (1967).
[266] S.C. Code §§ 40-60-2 to -260 (Supp. 2003).
[267] www.irs.gov/pub/irs-pdf/p561.pdf

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 [for deductions claimed for contributions after June 3, 2004 greater than $500,000, the entire qualified appraisal must be attached[268]]. . . .

A qualified appraisal[269] 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 [unless claiming deductions for contributions after June 3, 2004 that are greater than $500,000[270]], but you should keep a copy as long as it may be relevant under the tax law.

D. Appraisal Summary

As stared above, the taxpayer must obtain an "appraisal summary" (discussed here) as well as a "qualified appraisal" (discussed below). An appraisal summary is a summary of a qualified appraisal that (1) is made on IRS Form 8283; (2) has been signed and dated by the donee; (3) has been signed and dated by the qualified appraiser; and (4) includes the information listed below:

1) The name and taxpayer identification number of the donor (for example, the social security number of an individual),
2) A description of the property in requisite detail,
3) A brief summary of the condition of the property at the time of the gift,

[268] American Jobs Creation Act of 2003 (AJCA), Pub. Law No. 108-357.

[269] "For purposes of this paragraph, the term 'qualified appraisal' means, with respect to any property, an appraisal of such property which is treated for purposes of this paragraph as a qualified appraisal under regulations or other guidance prescribed by the Secretary." IRC § 170(f)(11)(E), as amended by the American Jobs Creation Act of 2003 (AJCA), Pub. Law No. 108-357.

[270] American Jobs Creation Act of 2003 (AJCA), Pub. Law No. 108-357.

4) The manner and date of acquisition of the property by the donor,
5) The cost basis of the property,
6) The name, address, and taxpayer identification number of the charitable donee,
7) The date the donee received the property,
8) A statement explaining whether or not the charitable contribution was made by means of a bargain sale and amount of any consideration received from the donee for the contribution,
9) The name, address, and taxpayer identification number of the qualified appraiser (or appraisers),
10) The appraised fair market value of the property on the date of contribution, and
11) A declaration by the appraiser.[271]

As stated above, the appraisal summary must be signed by the donee land trust. Such person may be either an official authorized to sign the land trust's tax or information returns or a person specifically authorized by the land trust to sign appraisal summaries. The signature by the land trust represents an acknowledgement of receipt of the property described in the appraisal summary and that the land trust understands the donee annual reporting requirements found under Internal Revenue Code § 6050L.[272] The donee's signature does not represent concurrence with the appraised value of the property.[273]

IRS Form 8283, as submitted to the land trust, may, but does not have to, contain all of the material which the donor is required to complete prior to attaching to his or her federal income tax return. "The information set forth in Regs. § 1.170A-13(c)(4)(ii)(D), (E), and (H) through (M) does not have to be included on the appraisal summary when it is signed by the donee or when a copy is furnished to the donee."[274] Information which is not required on IRS Form 8283 *when executed by the land trust* includes:

1) Manner and date of acquisition,
2) Cost or other basis of the property,
3) A statement explaining whether or not the contribution was made by means of bargain sale,
4) The name and address of the qualified appraiser, and
5) The appraised fair market value of the property on the date of the contribution.

The donor is required to attach an appraisal summary to his or her federal income tax return. Where the donor fails to attach it, the IRS may require that the donor submit it within 90 days. If the donor then complies within the 90 days of the request and his failure to attach it was a good faith omission, the deduction will not be disallowed for failure to attach the

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[271] Treas. Reg. § 1.170A-13(c)(4)(ii).
[272] Treas. Reg. § 1.170A-13(c)(4)(iii).
[273] *Id.*
[274] 521-2nd Tax Management Portfolio at n.1248 (BNA 2004).

appraisal summary.[275] Where the donor is a partnership or S corporation, the donor must provide a copy of the appraisal summary, together with a completed copy of Form 8283, to each partner or shareholder receiving an allocation of the contribution deduction.

E. Qualified Appraisal

Publication 561 states 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 number 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.[276]

A qualified appraisal must be performed by a "qualified appraiser," which is defined in Treas. Reg. § 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

[275] Treas. Reg. § 1.170A-13(c)(4)(iv)(H).
[276] Treas. Reg. § 1.170A-13(c)(3); Rev. Proc. 66-49, *modified by* Rev. Proc. 96-15 (setting forth minimal information that should be included for income tax purposes in a competent appraisal report).

- o Understands that an intentionally false or fraudulent overstatement of the value of property may subject him or her to the penalty for aiding and abetting an understatement of tax liability and have appraisals disregarded.

An appraiser must complete Part lll 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.

The IRS is, of course, not required to accept an expert appraisal.[277]

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.

The appraisal must be retained by the donor "for as long as it may be relevant in the administration of any internal revenue law."[278]

[277] Treas. Reg. § 20.2031-6(a).
[278] Treas. Reg. § 1.170A-13(c)(3)(IV)(C)

F. Filing Requirements for Partnerships and S Corps

The Form 8283 imposes the following filing requirements:

> **Partnerships and S Corporations.** A partnership or S corporation that claims a deduction for noncash gifts over $500 must file Form 8283 with Form 1065, 1065-B, or 1120S. If the total deduction of any item or group of similar items exceeds $5,000, the partnership or S corporation must complete Section B of Form 8283 even if the amount allocated to each partner or shareholder does not exceed $5,000.
>
> The partnership or S corporation must give a completed copy of Form 8283 to each partner or shareholder receiving an allocation of the contribution deduction shown in Section B of the partnership's or S corporation's Form 8283.
>
> **Partners and shareholders**. The partnership or S corporation will provide information about your share of the contribution on your schedule K-1 (Form 1065 or 1120S).
>
> In some cases, the partnership or S corporation must give you a copy of its Form 8283. If you received a copy of Form 8283 from the partnership or S corporation, attach a copy to ~~of~~ your tax return. Deduct the amount shown on your Schedule K-1, not the amount shown on the Form 8283.
>
> If the partnership or S corporation is not required to give you a copy of its Form 8283, combine the amount of noncash contributions shown on your schedule K-1 with your other noncash contributions to see if you must file Form 8283. If you need to file Form 8283, you do not have to complete all the information requested in Section A for your share of the partnership's or S corporation's contributions. Complete only column (g) of line 1 with your share of the contribution and enter "From Schedule K-1 (Form 1065 or 1120S)" across columns (c) – (f).

G. Filing Requirements for C Corporations after AJCA

Previously, prior to passage of the American Jobs Creation Act of 2004, when a C Corporation made a charitable donation of an item valued at more than $5,000 (other than certain artwork), it was required to attach Form 8283, Non-Cash Charitable Contributions, to its return but was generally not required to obtain a qualified written appraisal. The AJCA now requires a qualified written appraisal of any non-cash charitable contributions of $5,000 or more. Note that this provision was made retroactively effective for contributions made after June 3, 2004.

H. Appraisals, Valuations and Land Trusts

As stated above, the Form 8283 is not required to contain the appraiser's valuation of the conservation easement at the time it is executed by the donee/land trust. In many cases, however, the 8283 will contain the valuation, and federal law provides that in such cases the execution of the 8283 by the land trust does not represent concurrence with the appraised value.

> As noted above, the Regulations require government agencies and land trusts to sign the appraisal summary for every easement donation they accept, effectively precluding such entities from claiming to be totally ignorant of the values asserted for donated easements. On the other hand, the Regulations do not impose liability on easement donees for abusive or erroneous valuations. Thus, the degree of donee involvement in the valuation process is left to the donees.
>
> The guidebook created by the LTA to help land trusts understand and implement the Standards and Practices (the "LTA Guidebook") discusses an easement donee's responsibility with respect to appraisals at some length. The LTA Guidebook essentially advises donees to walk a fine line: they should be as helpful to the donor and the donor's appraiser as possible without taking on liability by purporting to sanction an appraisal. When an easement donee becomes aware of an apparently abusive easement appraisal, the LTA Guidebook suggests the following responses: (i) simply informing the landowner of the donee's opinion that the appraisal is suspect or abusive, (ii) having the land trust's attorney inform the landowner in writing, with explicit reference to the overvaluation penalties the landowner might face, (iii) suggesting the landowner obtain another appraisal, and (iv) refusing to proceed with the transaction.
>
> The LTA Guidebook cautions that easement donees have an interest in discouraging valuation abuse for the following reasons: easement donees will want to avoid the appearance of being a party to a transaction that unfairly benefits a private individual; easement donees will want to maintain their credibility in the community; and easement donees will want to avoid situations where irate donors blame them when the IRS challenges the donors' easement valuations. In addition, the stakes are high for the land trust community in general. If valuation abuse increases to the point where it creates a public opinion backlash, the credibility of the land trust community with the public and Congress could be damaged, and the tax incentives offered with respect to easement donations could be reduced or eliminated.[279]

The Law Review article quoted above makes reference to policies of the Land Trust Alliance. The Land Trust Standards and Practices reads in part:

> Practices
>
> - A. Tax Code Requirements. The land trust notifies (preferably in writing) potential land or easement donors who may claim a federal or state income tax deduction, or state tax credit, that the project must

[279] 31 Ecology L.Q. at 78-79.

meet the requirements of IRC § 170 and the accompanying Treasury Department regulations and/or any other federal or state requirements. The land trust on its own behalf reviews each transaction for consistency with these requirements.

- B. Appraisals. The land trust informs potential land or easement donors (preferably in writing) of the following: IRC appraisal requirements for a qualified appraisal prepared by a qualified appraiser for gifts of property valued at more than $5,000, including information on the timing of the appraisal; that the donor is responsible for any determination of the value of the donation; that the donor should use a qualified appraiser who follows Uniform Standards of Professional Appraisal Practice; that the land trust will request a copy of the completed appraisal; and that the land trust will not knowingly participate in projects where it has significant concerns about the tax deduction.

- C. No Assurances on Deductibility or Tax Benefits. The land trust does not make assurances as to whether a particular land or easement donation will be deductible, what monetary value of the gift the Internal Revenue Service (IRS) and/or state will accept, what the resulting tax benefits of the deduction will be, or whether the donor's appraisal is accurate.

- D. Donee Responsibilities – IRS Forms 8282 and 8283. The land trust understands and complies with its responsibilities to sign the donor's Appraisal Summary Form 8283 and to file Form 8282 regarding resale of donated property when applicable. The land trust signs Form 8283 only if the information in Section B, Part 1, "Information on Donated Property," and Part 3, "Declaration of Appraiser," is complete. If the land trust believes no gift has been made or the property has not been accurately described, it refuses to the sign the form. If the land trust has significant reservations about the value of the gift, particularly as it may impact the credibility of the land trust, it may seek additional substantiation of value or may disclose its reservations to the donor. (See 5B for other gift substantiation requirements.)[280]

CHAPTER X. ACCURACY RELATED PENALTIES

A donor who values property in excess of its actual fair market value for purposes of the charitable contributions deduction may be subject to an accuracy-related penalty or a fraud penalty. In addition, the donor may have

[280] Land Trust Standards and Practices, Standard 10" Tax Benefits (Land Trust Alliance) (rev'd 2004.)

to pay interest on the tax understatement attributable to the overvaluation as well as on the penalty.[281]

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 6653 (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 accuracy-related penalty applies to any portion of an underpayment attributable to negligence or disregard of rules or regulations. Case law generally defines the term “negligence” as a lack of due care or failure to act as a reasonable and ordinarily prudent person would act under the circumstances. The code and regulations further define negligence to include: (1) any failure to make a reasonable attempt to comply with the tax laws; (2) any failure to keep adequate books and records or to substantiate items properly; and (3) taking a position with respect to an item if the position lacks a reasonable basis. A taxpayer’s failure to make a reasonable attempt to verify a deduction that seems “too good to be true” to a reasonable and prudent person strongly indicates negligence.

In determining whether a taxpayer has shown a disregard of rules or regulations, the term “disregard” includes any careless, reckless, or intentional disregard. The following definitions apply in assessing the nature of a taxpayer’s disregard of rules or regulations:

- Careless – the taxpayer does not exercise reasonable diligence to determine the correctness of a return position that is contrary to the rule or regulation;
- Reckless – the taxpayer makes little or no effort to determine whether a rule or regulation exists, under circumstances that demonstrate a substantial

[281] Kirschten and Freitag, 521-2nd Tax Management Portfolio, *Charitable Contributions: Income Tax Aspects* at pp. 297-98.

deviation from the standard of conduct that a reasonable person would observe;

- Intentional – the taxpayer knows of the rule or regulation that is disregarded.[282]

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 individual taxpayer underpaid his tax by more than $5,000 because of the overstatement ($10,00 for corporations other than S corporations and personal holding corporations).[283] 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.[284]

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 definitions of "qualified appraisal" and "qualified appraiser" were discussed earlier.)

> The accuracy-related penalty also applies to any portion of an underpayment attributable to any substantial valuation misstatement. A

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[282] 521-2nd Tax Management Portfolio at p. 299 (footnotes omitted).
[283] Although the gift at issue in *Frazee v. United States*, No. Civ.A. WMN-02-1816, 2004 WL 1089477 (D. Md. April 14, 2004), was not a conservation easement, but an entire parcel, the case serves as a good example of how valuation of a gift of land to a charity can determine whether a penalty applies under IRC § 6662.
[284] John Wadsworth, *Penalties for the Overvaluation of Easements*, Back Forty Anthology (5.65)

> substantial valuation misstatement occurs when the value of any property claimed on the return is 200% or more of the amount determined to be the correct valuation. The penalty does not apply, however, unless the portion of the underpayment attributable exceeds $5,000.
>
> A stiffer penalty applies when there is a gross valuation misstatement. When applying Section 6662 in the context of the income tax charitable contributions deduction, a "gross valuation misstatement" occurs when the value of any property claimed on the return is 400% or more of the amount determined to be the correct valuation. The penalty is equal to 40% of the underpayment to the extent that the underpayment is attributable to one or more gross valuation misstatements.[285]

In addition, the Revenue Reconciliation Act of 1993 replaced the "not frivolous" standard 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.

The "reasonable cause" exception under Section 6664(c) relieves from penalties a taxpayer who (i) acted in good faith and with reasonable cause, (ii) relied on a "qualified appraisal" prepared by a "qualified appraiser," and (iii) made a good faith investigation of the value of the contributed property.[286] Note, however, that "mere reliance on an appraiser or expert in a matter does not automatically shield a taxpayer from the negligence [penalty;] . . . ; a taxpayer must affirmatively establish that his reliance was reasonable, prudent, and in good faith."[287] The Tax Court in *Van Zelst v. Commissioner*[288] imposed negligence penalties under then IRC § 6653 on a taxpayer who claimed a charitable deduction for land donated to the National Park Service equal to 91 times the amount he paid for the land just two years before the deduction. The court noted that "[m]ere reliance on an appraiser or expert in a matter does not automatically shield a taxpayer from the negligence addition . . . ; a taxpayer must affirmatively establish that his reliance was reasonable, prudent, and in good faith."

IRS Rev. Proc. 97-56 identifies circumstances under which the disclosure on a taxpayer's return of a positions with respect to an item is adequate for the purpose of reducing the substantial understatement of income tax penalty under IRC § 6662(d). The revenue procedure notes that additional disclosure of facts or positions taken with respect to charitable deductions is unnecessary for purposes of reducing any understatement of income tax, provided the forms and attachments listed below are completed in a clear manner and in accordance with their instructions:

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[285] 521-2nd Tax Management Portfolio at p. 301 (citations omitted).

[286] *See Van Zelst v. Commissioner*, 70 T.C.M. 435, *aff'd* 100 F.3d 1259 (7th Cir. 1996), in which penalties were assessed against a taxpayer for valuation of a charitable donation.

[287] *Id.*

[288] 70 T.C.M. 435 (CCH 1995), *aff'd* 100 F.3d 1259 (7th Cir. 1996).

(1) Completing lines 15 through 18 of Form 1040, Schedule A, supplying all required information;
(2) Properly completed Form 8283 attached to the return; and
(3) A contemporaneous written acknowledgement as required by Section 170(f)(8).

The revenue procedure notes that "merely entering the amount of the donation in Schedule A, however, will not constitute adequate disclosure if the taxpayer received a substantial benefit from the donation shown."

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

IRC § 6694 imposes civil penalties on tax return preparers if (1) any understatement was due to a position for which there was not a realistic possibility of being sustained on the merits; (2) the preparer knew or reasonably should have known of such position; and (3) such position was not disclosed or was frivolous, unless it is shown there was a reasonably cause for the understatement and such person acted in good faith.

Lastly, in 2005 South Carolina adopted federal Internal Revenue Code § 6701 which provides penalties for persons who knowingly aid and abet an understatement of tax liability by third parties.[289] "The penalty can be imposed upon any person who aids or assists in, procures, or advises with respect to, the preparation or presentation of any portion of a return, affidavit, claim, or other document while knowing or having reason to know that such portion will be used in connection with any material matter arising under the internal revenue laws and who knows that a taxpayer will use the related information to understate a tax liability…. The penalty is not limited to those who have actually dealt with taxpayers who have planned to understate their tax liabilities, but it extends as well to supervisors, managers, and similar persons who either directs subordinates to aid and abet taxpayers' plan to understate their tax liabilities or does not act to prevent the subordinates from participating in activities that the party knows will produce an understatement of tax liability."[290]

CHAPTER XI. SUMMARY OF SELECTED OTHER STATE STATUTES

The following are selected sections from other state laws.

A. South Carolina Conservation Bank

To improve the quality of life in South Carolina through the conservation of significant natural resource lands, wetlands, historical properties, and archeological sites, the

[289] Section 8 of H.3768.
[290] 14 Mertens, Law of Fed. Income Tax'n § 55:60.

General Assembly created the South Carolina Conservation Bank.[291] Chapter 24 of Title 12 imposes a deed recording fee on transfers of realty, a portion of which is credited to the State's general fund.[292] This law requires that 25 cents of the State portion of the deed recording fee be credited to the South Carolina Conservation Bank Trust Fund, unless the General Assembly provides less appropriations in the annual general appropriations act than what was provided for the previous year to at least one half of the state agencies or departments contained in the budget.[293] This is an ongoing funding source used to acquire interests in land from willing sellers that meet the objectives set out in S.C. Code §§ 48-59-10 to -140. The bank received funding for the first time in the fiscal year commencing July 1, 2004. It is expected to receive approximately $12 million per year.

The Conservation Bank is governed by a twelve-member board which is authorized to award grants to eligible trust fund recipients for the purchase of interests in land. (The qualified entity to which the easement was granted will be the entity that holds the easement as the Act prohibits the bank from owning any land or easement.)[294] The board also has authority to develop additional guidelines and procedures in order to implement the Act.

The Conservation Bank must ensure before granting funds for conservation easements that public access will be provided consistent with the uses permitted by the terms of the conservation easement, as well as recreational uses. Also, the conservation easement will be the controlling document regarding what is and what is not permitted upon the land, how the land will be preserved, and what rights are vested with the eligible trust fund recipient or its assigns that hold the conservation easement.[295]

The Conservation Bank lists as its objectives:

- Protect significant natural resource areas and wildlife habitats.
- Protect water quality.
- Maintain the State's forest lands.
- Protect farmlands, especially family farms.
- Protect and enhance beauty.
- Protect and enhance significant historical and archaeological sites.
- Enhance public access for outdoor recreation and preserve traditional uses such as hunting, fishing, and other types of outdoor recreation.[296]

Interested persons should request an "Application for Funding" from the Bank. The regular application deadlines will be March and July.

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[291] S.C. Code §§ 48-59-10 to -140. For more information on the rate of growth and conversion of forest and agricultural land, as well as the benefits of the Conservation Bank, see Jeffery L. Beacham, *The Wildest Bank Around!*, South Carolina Wildlife 18 (Jan.-Feb. 2004); *see also* South Carolina Conservation Bank, *The South Carolina Conservation Bank Act* at http://sccbank.sc.gov/index.htm (Feb. 19, 2004).
[292] S.C. Code Ann. § 12-24-95 (Supp. 2004).
[293] *Id*; *see also* S.C. Code Ann. § 12-24-90(B)(3) (Supp. 2004).
[294] S.C. Code § 48-59-80.
[295] *Id*.
[296] South Carolina Conservation Bank, *The South Carolina Conservation Bank Act* at http://sccbank.sc.gov/index.htm (Feb. 19, 2004).

For more information, contact:

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S.C. Conservation Bank
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Fax: 803-734-9809
E-mail: DavantM@dnr.sc.gov

B. Credit for Construction, Installation, or Restoration of Water Impoundments, and Water Control Structures

> A taxpayer may claim a credit for twenty-five percent of all expenditures for the construction, installation, or restoration of ponds, lakes, other water impoundments, and water control structures designed for the purposes of water storage for irrigation, water supply, sediment control, erosion control or aquaculture and wildlife management, providing these items are not located in or adjacent to and filled primarily by coastal waters of the State.[297]

To qualify for the credit the taxpayer must obtain a construction permit issued by the South Carolina Department of Health and Environmental Control (DHEC) or proof of exemption from permit requirements issued by the DHEC, the Natural Resources Conservation Service, or a local Soil and Water Conservation District.

The maximum credit that may be claimed is $2,500. In the case of pass-through entities, the credit is determined at the entity level and is limited to $2,500. Any unused credit can be carried forward for five years.

The instructions to the credit form provide that restoration of ponds, lakes, and other water impoundments, and water control structures include all materials and services for:

1. Changing the height of a dam;
2. Increasing the spillway capacity of a dam;
3. Removing sediment from an impoundment;
4. Adjusting the water depth to improve an impoundment for aquaculture or wildlife management;
5. Removing trees greater than 4 inches in diameter from a dam, including removing stumps and replacing with impervious material (Note: FRPP cannot have more than 2% impervious surface);

[297] S.C. Code Ann. § 12-6-3370(A) (West Rev'd 2000). *See* S.C. Dept. of Rev. Comm'n Decision No. 97-49 (August 29, 1991), in which the Department concluded that the homeowners association organized as a not-for-profit corporation to repair a dam was entitled to the credit. The 40 homeowners who owned the lake and dam (and who conveyed the property to the corporation) were not entitled to the credit.

6. Installing a filter or drainage system to control seepage through a dam;
7. Work requiring excavation into the embankment fill or foundation of a dam (*e.g.*, replacing deteriorated pipe);
8. Work requiring removal or replacement of major structural components of a dam (*e.g.*, replacing deteriorated concrete, gates, etc.); and
9. Any other work to improve the capacity, service, or safety of a water impoundment or water control structure, except the items below.

The instructions to the credit form provide that restoration does not include:

1. Routine care (*e.g.*, cutting grass);
2. Reseeding eroded embankment and shore areas;
3. Removing bush and small trees up to 4 inches in diameter from a dam;
4. Replacing stop logs or flash boards with identical components;
5. Sealing cracks in spillway slabs;
6. Replacing trash guards;
7. Replacing or repairing any component of a water supply or irrigation system when the work is done on a component that is not part of the dam, water impoundment, or their appurtenant works; or
8. Any other work that does not improve the capacity, service, or safety of a water impoundment or water control structure.

The credit is claimed on DOR Form TC-3, *Water Resources Credit*.

For more information, contact:

South Carolina Department of Revenue
Columbia Main Office
301 Gervais Street
P.O. Box 125
Columbia, S.C. 29214
Phone: 803-898-5000
Fax: 803-898-5822

C. Habitat Management Credit

A taxpayer may claim an income tax credit equal to 50% of the costs incurred for habitat management, construction and maintenance of improvements on real property made to land described in S.C. Code § 50-15-55(A) as a "certified management area for endangered species or of species in need of management" and which meets the requirements of regulations promulgated by the Department of Natural Resources. S.C. Code Ann. § 12-6-3520(A) (West Group Supp. 2004). (This credit is available only if, in the opinion of the Department, sufficient funding is available to fund the credit.) To qualify for the credit, all costs must be incurred on land that has been designated as a "certified management area for endangered species" provided in S.C. Code § 50-15-40 or for non-game and wildlife species determined to be in need of management under S.C. Code § 50-15-30.

The credit must be claimed in the year that the costs are incurred and may not exceed 50% of the taxpayer's income tax liability. Any credit generated by an S corporation must be used first against any tax liability of the S corporation and any remaining credit passes through to the shareholders. Any unused credit can be carried forward ten years.

Rules exist requiring recapture of the credit. If the landowner voluntarily chooses to leave the agreement made concerning the certified areas after taking the tax credit, then the taxpayer's tax liability for the current tax year must be increased by the full amount of the credit previously claimed.

Note: The Department of Natural Resources is in the process of promulgating regulations concerning this credit. Until regulations are promulgated, the credit is not available.

For more information, contact:

South Carolina Department of Revenue
Columbia Main Office
301 Gervais Street
P.O. Box 125
Columbia, S.C. 29214
Phone: 803-898-5000
Fax: 803-898-5822

D. Conservation Grant Fund

A fund was created in the state treasury to "stimulate the use of conservation easements and fee simple gifts of land for conservation to qualified conservation organizations to improve the capacity of private nonprofit land trusts successfully to accomplish conservation projects and to provide an opportunity to leverage private and public monies for conservation easements."[298] The fund is administered by the board of the Department of Natural Resources, which sets criteria for eligibility of fund monies.[299] Only land eligible for the tax credit under S.C. Code § 12-6-3515 may qualify for a grant from the fund.[300] The South Carolina Department of Natural Resources Board recommends eligible lands to the General Assembly, which must approve the recommendation by concurrent resolution before the board can award the grant.[301]

For more information, contact:

[298] S.C. Code § 50-3-1110 (Supp. 2004).
[299] S.C. Code § 50-3-1160 (Supp. 2004).
[300] S.C. Code § 50-3-1140 (Supp. 2004).
[301] S.C. Code § 50-3-1160 (Supp. 2004).

South Carolina Department of Natural Resources
Post Office Box 167
Columbia, S.C. 29202
Phone: 803-734-4007
Fax: 803-734-9809

E. State Tax Checkoff

Taxpayers required to file an individual income tax return may contribute to the Nongame Wildlife and Natural Areas Program Fund or the South Carolina Conservation Bank Trust Fund by designating the contribution on their income tax return. The contribution may be made by reducing the income tax refund or by remitting additional payment.[302]

CHAPTER XII. SUMMARY OF SELECTED OTHER FEDERAL PROGRAMS

The following are selected federal programs regarding conservation of land.[303]

A. Farm and Ranch Lands Protection Program

Under the Farm and Ranch Lands Protection Program (FRPP),[304] on behalf of the Commodity Credit Corporation, the Natural Resources Conservation Service (NRCS) of the USDA may enter into an agreement with an eligible entity to pay up to 50% of the appraised fair market value for a conservation easement on private land. Eligible entities include tribal, state, local and appropriate non-governmental conservation organizations.[305] Eligible land includes prime, unique, or other productive farm or ranch land, or land containing historical or archaeological resources where a pending offer for purchase of development rights from an eligible entity exists.[306] To be eligible, a landowner must certify that its adjusted gross income for the previous three tax years does not exceed $2,500,000 unless at least 75% of its income comes from agriculture.[307] The program is focused on topsoil conservation through limitation of non-agricultural uses.[308] The NRCS works with the entity and the landowner to develop a conservation plan on any highly erodible lands (HEL), which is enforced by the entity to limit nonagricultural uses of the land and protect any highly erodible land.[309] If the

[302] S.C. Code § 12-6-5060, as amended by H. 3767 (2005).
[303] For additional information on federal assistance in general, and the 2002 Farm Bill Programs specifically, see Lisa Marshall, *2002 Farm Bill Helps Fund Conservation on Private Land*, 3 Wild Life Trends, Issue 7, 5-8 (July 2003); *see also* United States Department of Agriculture, *Natural Resources Conservation Service, Programs: South Carolina* at http://www.sc.nrcs.usda.gov/programs/ (Feb. 12, 2004) (cataloguing and detailing all NRCS programs available in South Carolina).
[304] 16 U.S.C. § 3838(h)-(j) (2002).
[305] 16 U.S.C.A. § 3838(h)(1) (2002).
[306] 16 U.S.C.A. § 3838(h)(2) (2002).
[307] 7 C.F.R. § 1491.4(d)(5) (2002) and Farm Security and Rural Investment Act of 2002 § 1604.
[308] 16 U.S.C.A. § 3838(i)(a) (2002).
[309] 16 U.S.C.A. § 3838(i)(b) (2002); 7 C.F.R. § 1491.22(e) (2004).

entity should fail to enforce the plan, the USDA can exercise its contingent right and take possession of the easement.[310] All easements eligible for funding must be in perpetuity unless prohibited by state law.[311]

For more information, contact:

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http://www.sc.nrcs.usda.gov/programs/

B. Wetlands Reserve Program

The Wetlands Reserve Program (WRP), administered by the USDA Natural Resource Conservation Service (NRCS), is a voluntary program offering eligible landowners the opportunity to protect their lands through permanent easements, 30-year easements, or restoration cost-share agreements.[312] The program requires that the NRCS and the landowner create a plan for the restoration of the area under the easement.[313] The program is aimed at protecting farmed or converted wetlands that were drained for agricultural use prior to December 23, 1985, along with other lands the NRCS might deem appropriate.[314] Acreage protected under the program is limited nationally to 2,275,000 acres[315] and "25 percent of the total cropland in any county."[316]

Payment rates for easements are established by the state conservationist based on the agricultural value of the land.[317] NRCS may pay from 75 to 100% of the cost to restore a wetland on land under a permanent easement, but only 50 to 75% of the cost of restoration on lands under non-permanent easements or cost-share agreements.[318] WRP assistance is capped at $900 per acre in South Carolina. The WRP has been useful in protecting isolated wetlands recently left unprotected, with approximately 200 conservation easements created

[310] 7 C.F.R. § 1491.22(d) (2004).
[311] 7 C.F.R. § 1491.22(b) (2004).
[312] 16 U.S.C.A. § 3837(b)(2) (2002).
[313] 7 C.F.R §§ 1467.4, 1467.10.
[314] 16 U.S.C.A. § 3837(c) (2002). *See also* 7 CFR § 1467.3 (defining "converted wetland" as "a wetland that has been drained, dredged, filled, leveled, or otherwise manipulated (including the removal of woody vegetation, or any activity that results in impairing or reducing the flow, circulation or reach of water) for the purpose, or that has the effect, of making the production of an agricultural commodity possible if such production would not have been possible but for such action").
[315] 16 U.S.C.A. § 2827 (b)(1) (2002). Total annual enrolment is 250,000 acres.
[316] 7 C.F.R. § 1467.4.
[317] 7 C.F.R. § 1467.8. Additionally, payments on non-permanent easements are capped at $50,000 annually, with exceptions.
[318] 7 C.F.R. § 1467.9.

in South Carolina under the program.[319] To date, more than 55,000 acres in South Carolina have been enrolled in WRP.[320]

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C. Farmers Home Administration Programs

Landowners may contract with the FMHA for easements 50-, 30-, or 10-years long to protect "wetland, upland, or highly erodible land" or other lands found suitable for conservation, recreation or wildlife purposes.[321] In exchange for granting the easement, the participating landowner's debt is reduced up to a proportion equal the proportion of the total acreage securing the loan(s) restricted by the easement.[322] To be eligible, the farmland must secure FMHA farmer program loan(s) granted prior to December 23, 1985, and the borrower must not be able to repay the loan(s) without the easement.[323]

To enroll, landowners should contact their local FSA or NRCS office or USDA Service Center and ask about the "Debt for Nature" program (previously the "Conservation Easement Debt Cancellation" program). A contract review team will determine if the land is suitable and propose contract terms including permitted uses and a conservation plan.[324] The contract review team will calculate the amount of debt to be cancelled "by considering the present market value of the farm; the borrower's FSA debt secured by real estate; and the number of acres to be covered by the contract."[325] For owners who are current on their payments, the amount of debt to be cancelled is capped at 33% of the loan principal; however, the amount can be higher for delinquent owners.[326]

For more information, contact:

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[319] Ross B. Plyler, *Protecting South Carolina's Isolated Wetlands in the Wake of Solid Waste Agency*, 53 S.C. L. Rev. 757, 769 (2002).
[320] USDA, Natural Resources Conservation Service, *2003 South Carolina Natural Resource Conservation Activities*, at http://www.sc.nrcs.usda.gov/news/2003screport.pdf (Dec. 1, 2003).
[321] 7 U.S.C.A. § 1997(c) (2002).
[322] 7 U.S.C.A. § 1997(e) (2002). For example, if A grants an easement covering 33% of his land, and A also has qualifying FMHA loans, A's debt could be reduced by up to 33%. In cases where there is no outstanding loan and a new loan is being granted, the proportion of the principal amount of the new loan equal to the proportion of the land restricted is treated as prepaid.
[323] 7 U.S.C.A. § 1997(c) (2002).
[324] USDA, Farm Service Agency, *Debt for Nature Program Fact Sheet* at http://www.fsa.usda.gov/pas/publications/facts/html/dfn01.htm (March 2001).
[325] *Id*.
[326] *Id.*("Conservation contracts can be used in conjunction with other FSA primary loan servicing options available to delinquent and financially distressed borrowers").

South Carolina State FSA Office
1927 Thurmond Mall Suite 100
Columbia, SC 29201-2375
Phone: 803-806-3820
Fax: 803-806-3839
http://www.fsa.usda.gov/sc/

D. Conservation Reserve Program

The Conservation Reserve Program (CRP), administered by the USDA Natural Resource Conservation Service (NRCS), provides technical and financial assistance to eligible farmers and ranchers to address soil, water, and related natural-resource concerns on their lands in an environmentally beneficial and cost-effective manner. The program provides assistance to farmers and ranchers in complying with federal, state, and tribal environmental laws and encourages environmental enhancement. The program is funded through the Commodity Credit Corporation (CCC). CRP is administered by the Farm Service Agency, with NRCS providing technical land-eligibility determinations, conservation planning and practice implementation.[327]

The Conservation Reserve Program reduces soil erosion, protects the Nation's ability to produce food and fiber, reduces sedimentation in streams and lakes, improves water quality, establishes wildlife habitat, and enhances forest and wetland resources.[328] NRCS may pay from up to 50% of the cost to convert highly erodible cropland or other environmentally sensitive acreage to vegetative cover, such as tame or native grasses, wildlife plantings, trees, filterstrips, or riparian buffers. Farmers receive an annual rental payment for the term of the 10- to 15-year contract. [329]

The 2002 Farm Bill authorized a CRP initiative to restore up to 500,000 acres of floodplains by the planting of bottomland hardwood trees on private lands. South Carolina was allocated 2000 acres in the program. Each enrolled site will be restored to an ecologically diverse forest type. Eligible land must be located within a 100 year floodplain, comprised of primarily wetland soils and adjacent to permanent rivers and streams. Program participants will receive 50% of the cost to establish the trees, an annual rental payment for 14-15 years, as well as technical planting assistance. Participants retain the right to sell credits. Sign up for the hardwood initiative may be made at anytime at local Farm Service Agency offices. Additional information on the hardwood initiative (and other CRP programs) maybe found on FSA's website at: www.fsa.usda.gov/dafp/cepd/crpinfo.htm.

For more information on CRP or USDA programs, contact:

Glenn Sandifer

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[327] USDA, SC Natural Resources Conservation Service, *Conservation Reserve Program* at *http://www.nrcs.usda.gov/programs/crp/*
[328] *Id.*
[329] USDA, SC Natural Resources Conservation Service, at *http://www.whmi.nrcs.usda.gov*

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E. Conservation Security Program

The Conservation Security Program (CSP) is a new voluntary program that provides financial and technical assistance to promote the conservation and improvement of soil, water, air, energy, plant and animal life, and other conservation purposes on tribal and private working lands. Working lands include cropland, grassland, prairie land, improved pasture, and range land, as well as forested land that is an incidental part of an agriculture operation. The program provides equitable access to benefits to all producers, regardless of size of operation, crops produced, or geographic location.[330] Annual rental payments are due based on the length of the agreement.[331]

The total estimated area in the three South Carolina watersheds for 2005 is 790,042 acres, encompassing parts of 16 counties. In 2005, conservation stewards in the three South Carolina watersheds will have the opportunity to participate in USDA's Conservation Security Program. Selected watersheds include Black, Lynches, and South Fork Edisto River watersheds. NRCS State Conservationist Walter W. Douglas stated that "[t]he selection of these three watersheds in South Carolina represents a balance of resource needs, historic stewardship, potential producer eligibility, and the technology and adequate staff needed to successfully implement the program."[332] The Great Pee Dee, Little Pee Dee and Lumbar watersheds will be eligible for sign ups starting in January.

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F. Grassland Reserve Program

The Grassland Reserve Program (GRP) is a voluntary program that helps landowners and operators restore and protect grassland, including rangeland, pastureland, shrubland, and certain other lands, while maintaining the areas as grazing lands. Section 2401 of the Farm

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[330] USDA, SC Natural Resources Conservation Service, *Conservation Security Program* at *http://www.nrcs.usda.gov/programs/csp/*
[331] USDA, SC Natural Resources Conservation Service, *http://www.whmi.nrcs.usda.gov*
[332] USDA, SC Natural Resources Conservation Service, *Conservation Security Program* *http://www.nrcs.usda.gov/programs/csp2005.htm/l*. *See also www.sc.nrcs.usda.gov/programs/cs2006.html.*

Security and Rural Investment Act of 2002 (Pub. L. 107-171) amended the Food Security Act of 1985 to authorize this program. The Natural Resources Conservation Service (NRCS), Farm Service Agency (FSA) and the U. S. Forest Service are coordinating implementation of GRP, which helps landowners restore and protect grassland, rangeland, pastureland, shrubland and certain other lands and provides assistance for rehabilitating grasslands.[333] The first grassland easement in the country was in South Carolina; and in fiscal year 2005 NRCS had $851,649 in available Commodity Credit Corporation (CCC) funds to implement the GRP in South Carolina. [334]

To enroll, landowners should contact the South Carolina USDA Service Center. There are four enrollment options:

(1) Permanent easements, where payments are based on the fair market value of the property less the grazing value;
(2) Thirty-year easements;
(3) Rental agreements with 10-, 15-, 20-, and 30-year options available. In this agreement 75% of the grazing value will be paid in annual payments for the length of the agreement; and
(4) A restoration agreement, where up to 90% of the restoration cost on grassland and shrubland that has never been cultivated and not more than 75% on restored grassland or shrubland that has been cultivated.[335]

For more information, contact:

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http://www.sc.nrcs.usda.gov/programs/

G. Environmental Quality Incentives Program (EQIP)

The environmental Quality Incentives Program (EQIP) is a voluntary conservation program from the USDA Natural Resources Conservation Service. It supports production agricultural and environmental quality as compatible goals. Through EQIP, farmers may receive financial and technical help with structural and management conservation practices on agricultural land.

EQIP was reauthorized in the 2002 Bill and is administered by the Natural Resources Conservation Service (NRCS).

333 USDA, SC Natural Resources Conservation Service, *Grassland Reserve Program* at *http://www.nrcs.usda.gov/programs/grp_info.html/*
334 *Id.*
335 *Id.*

In South Carolina, EQIP will pay up to 50 percent of the costs of eligible conservation practiced although small farmers may be eligible for up to 90 percent cost share. EQIP cost-share is limited to $450,000 per person or entity, as well as a $40,000 for incentive payments for the entire Farm Bill. Cost-share payment on irrigation practices are limited to $15,000 per contract and Stacking Sheds with a roof are limited to 50 percent cost-share rate. Incentive payments may be made to encourage a farmer to adopt land management practices, such as nutrient management, manure management, integrated pest management, and wildlife habitat management, and such payments will be made at a flat rate.

Details about signup, eligible practices and cost-share rates are announced each year. NRCS evaluates each application, with higher priorities given to applications that use cost-effective conservation practices, address local priorities and provide the most environmental benefit.

Farmers will develop a conservation plan, if they don't already have one, for the acreage affected by the EQIP practices. Conservation practices must meet NRCS technical standards. Farmers may elect to use an approved third-party provider for technical assistance, if available.

The major resource concerns targeted by EQIP in South Carolina are components of the national priorities and measures outlined by the National NRCS Office. Those national concerns are reduction of nonprofit source pollutants, reduction of emissions, reduction in soil erosion and sedimentation and promotion of the conservation of at risk species. All EQIP contracts should document an existing resource concern.

South Carolina's resource concerns, recommended by the State Technical Committee, are listed here:

- Soil Quality
- Surface Water Quality
- Wetlands Health
- Grazing Lands Health
- Water Quantity
- Air Quality
- Plant Population Health
- At-Risk Species Habitat Quality
- Ground Water Quality

The National Resources Conservation Service, the Local Working Group or the Farm Service Agency determine eligible producers for the EQIP program. Any farmer engaged in livestock or crop production on eligible land may apply for EQIP. EQIP contracts may be for a tract, farm or multiple farms. Eligible land includes cropland; rangeland; pasture; private non-industrial forestland; and other farm or ranch lands, as determined by the Secretary of Agriculture.

For more information view:

www.scnrcs.usda.gov/programs/eqip/eqip2005.html; and
www.sc.nrcs.usda.gov/programs/eqip/howitworks2005.html.

For more information, contact:

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H. Wildlife Habitat Incentives Program (WHIP)

The Wildlife Habitat Incentives Program (WHIP) is a voluntary program for people who want to develop and improve wildlife habitat primarily on private land. Through WHIP, USDA's Natural Resources Conservation Services provides both technical assistance and up to 75 percent cost-share assistance to establish and improve fish and wildlife habitat. WHIP agreements between NRCS and the participant generally last from 5 to 10 years from the date the agreement is signed.

The Wildlife Habitat Incentives Program was established by the 1996 Farm Bill for the purpose of making technical and financial assistance available to landowners to develop, enhance, and restore upland wildlife, wetland wildlife, threatened and endangered species, fish and other types of wildlife habitat. South Carolina's Department of Natural Resources has identified bobwhite quail and other species associated with grassland, and early successional/shrub habitat as being a "Priority Conservation Concern" in the state. The Natural Resources Conservation Service and the State Technical Committee followed in identifying these species and habitat to also be of primary concern, in order to target technical and financial assistance to landowners in South Carolina. Because of the dependence of quail and other edge species on very specific types of early successional habitat, current land use practices (both forestry and farming) eliminate suitable nesting, brood rearing, escape, and winter cover in most instances.

State Objectives:

1. Restore early successional habitat, and riparian areas;
2. Restore historical rice field and marshland habitat for wintering waterfowl and shorebird habitat;
3. Restore Longleaf Pine ecosystem, including wiregrass; and
4. Restore and enhance trout stream habitat in the Upstate of South Carolina.

Highlighted among S.C.'s WHIP projects are a trout preservation project in the upstate and a waterfowl project in the lowcountry. In addition, a partnership with Clemson

University at the Pee Dee Research and Education Center resulted in $50,000 for wildlife habitat restoration research. We enrolled 92 individual contracts with landowners across the state.

For more information download:

> www.nrcs.usda.gov/programs/whip.html; and
> www.sc.nrcs.usda.gov/programs/whip.html.

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