



Conservation Easements

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Note – the original article published last fall has been updated to reflect the year-end legislation that made changes to charitable contribution limits and carryforward.

By Don Deans, CPA, PFS

The gift that keeps on giving...or your worst nightmare?

What is a conservation easement, and how does it affect your high-income clients? Keep reading, even if your clients don't own any land!



A conservation easement is a voluntary encumbrance on land that creates a permanent and legally enforceable land preservation agreement between a landowner and a qualified conservation organization.

The landowner transfers the voluntary encumbrance to a qualified conservation organization, either a 501(c) (3) charity or a government agency, enabling a claim for a deduction for such transfer. The landowner is giving away land rights that may restrict real estate development, commercial or industrial uses or other activities to a mutually agreed upon level. Accordingly, the value of the land is reduced by the amount of the deduction. That is, the amount of the value of the encumbrance given to the charity is a charitable contribution.

Thus, a conservation easement is a donation of a qualified property interest to a qualified conservation organization for conservation purposes.

Characteristics of a conservation easement

First, a conservation easement is characterized by each of these requirements and qualities.

- Voluntarily granted by the owner of real property.
- All future property owners are bound to comply with the terms of the easement.
- Held and enforced by a qualified conservation organization.
- The owner of the real property maintains ownership of the underlying property and all permitted uses of the property, other than that which has been donated.

Contrary to a common misperception, it is important to note that the underlying property does not become publicly owned.

The Donation

We can now address how the donation of a conservation easement is made, and more importantly, how it is valued. Conservation easements were added to the Internal Revenue Code in 1980, with the addition of code section 170. This code section, along with Treasury Regulation 1.170A-14, governs charitable contributions of conservation easements.



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The valuation of the conservation easement is dependent upon an independent appraisal of the property and is governed by Treasury Regulation 1.170A-13. The valuation of the conservation easement is measured as the difference between the appraisal value of the property at its highest and best use, before it is encumbered with an easement, and the appraised value of the property after it is encumbered. The appraisal methodology is referred to as “the before and after” method.

There are certain nuances relating to the appraisal process. Though not meant to be all inclusive, key ones are:

- The unrestricted highest and best use value is reduced by the second calculation and the resulting number is the figure allowed as a Charitable Contribution.
- The final appraisal must be completed within sixty days of the date of the donation.
- The property needs to be owned for at least one year in order to perfect the fair market value of the easement, as determined by the before and after appraisal methodology.

The donation is made in the form of a non-cash contribution using IRS Form 8283. When the deduction is taken, it is limited to a percentage of adjusted gross income. Since 2006, the limit on the deduction for charitable contributions had been increased from 30% to 50% of AGI, and the carry-forward had been increased to 15 years annually with what was referred to as "tax extenders." Year-end legislation signed by President Obama makes the change to the limit on deductions to 50% of AGI with a 15 year carry-forward permanent.

Finally, the non-cash contribution is not a preference item and is not subject to alternative minimum tax (AMT).

The Interests

We have discussed the characteristics of a conservation easement and how it is donated. Now we will discuss what a “real property” interest is. All real property has numerous property rights, or interests. Based upon where the property is located, these rights have different values, as to what are the highest and best uses.

Consider certain property interests of real property: development rights, water rights, air rights, and mineral rights, to name a few. Each of these has different highest and best uses, based upon location. Think of the value of development rights in suburban Atlanta or Philadelphia! Think of mineral rights in West Virginia or Texas!

The Organization

Next, we will address the qualified conservation organization. To qualify for a deduction, the real property interest has to be donated to a qualified conservation organization. This organization must be either a 501(c) (3), or a government entity. The organization must have a commitment to protect the conservation purpose of this donation. It also has to have the resources to enforce the terms of this easement in perpetuity.



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The Purpose

The last item we will address is the “conservation purpose” of the donation. The regulations require that the conservation easement comply with at least one of the following conservation purposes:

- Preservation of land areas for outdoor recreation or education of the public
- Protection of natural habitat of fish, wildlife, plants, or ecosystem
- Preservation of open space
- Protection of historically important land or historical structures

Non-Land Owner

Now, for the non-land owner. You may ask, “Wonder why this is important to me? I live in an apartment in Atlanta and own no real property.”

The reality is there are owners of real property who want to protect land and natural resources but who personally cannot use all the tax benefits of conservation easements. Accordingly, these landowners have structured transactions to sell part of their property to enable high income individuals to potentially benefit from the donation of a conservation easement. These transactions are Regulation D securities and should be treated as such.

Opportunity for CPAs

Done correctly, donating or investing in conservation easements can be an excellent strategy for high-income clients to mute their federal and state income taxes. Especially of interest to CPAs is that high income financial advisors and their clients have limited or no access to conservation easements, and for those advisors, even discussing conservation easements with their clients could make them in violation of “selling away” and thus utilizing a broker dealer who specializes in Regulation D placements is recommended.

The Nightmares

The IRS has a 68 page audit guide for conservation easements. Additionally, the appraisal referred to above has to be a “qualified appraisal,” performed by a “qualified appraiser.”

There are continual cases brought by the IRS against taxpayers who have claimed conservation easements on their tax returns. I have reviewed a large number of these cases and have yet to see the IRS prevail when the taxpayer has followed the rules. It is very important to consider who is sponsoring and preparing the documentation and analysis of any proposed easement.

Remember: If not properly prepared, this could become a nightmare. However, if all i’s are dotted and t’s are crossed, it can be a very viable and excellent option!



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Conclusion

If someone is considering a conservation easement, they must understand that it is a complex transaction. If you have a client with significant real property and tax obligations, I would recommend retaining a competent team of professionals to ensure that the transaction is compliant with all requirements of the Internal Revenue Code and if applicable, requirements of SEC and FINRA. Similarly, if you have high-income clients who have not yet considered conservation easements, we will be glad to work with you so that you and your clients are comfortable. Certainly, the time is now to develop your working knowledge so you can best meet your client's needs.

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About GSCPA

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