

A Tax Guide to Conservation Easements
Expanded Table of Contents

Chapter One: Definitions and Conservation Tools.....	1
I. Definitions.....	1
A. Common Law.....	1
B. Statutory Law.....	2
C. Regulatory Law.....	2
D. Tax Law.....	2
E. Private Letter Rulings and other IRS Administrative Materials.....	3
F. U.S. Tax Court.....	4
G. Precedent.....	5
H. Fee Interests.....	6
II. Conservation Tools.....	8
A. Conservation Easements.....	8
B. Bargain Sales.....	10
C. Purchase of Development Rights.....	11
D. Transfer of Development Rights.....	12
E. Cluster Development.....	14
F. Conservation Buyer Transactions.....	15
Chapter Two: Basic Tax Law Principles.....	17
I. Introduction.....	17
II. The Code and Regulations.....	18
III. Tax Benefits: A Privilege Not a Right.....	19
IV. The Partial Interest Rule.....	22

A Tax Guide to Conservation Easements
Expanded Table of Contents

V. Donative Intent.....	23
VI. Quid Pro Quo Transactions.....	25
VII. Tax Avoidance and Easement Contributions.....	28
VIII. Sham Transactions and the Economic Substance Requirement.....	28
IX. Abusive Transactions.....	33
VIII. Substantial Compliance.....	33

Chapter Three: Requirements for Qualified

Conservation Contributions Part I: Basic

Requirements.....38

I. Introduction.....	38
II. A Qualified Real Property Interest: Code section 170(h)(2); Regulations section 1.170A-14(b).....	38
A. Donor's Entire Interest Less a Qualified Mineral Interest: Code section 170(h)(2)(A); Regulations section 1.170A-14(b)(1).....	38
B. A "Remainder Interest": Code section 170(h)(2)(B); Regulations sections 1.170A- 7(b)(3) and (4).....	41
C. A "Perpetual Conservation Restriction": Code section 170(h)(2)(C); Regulations section 1.170A-14(b)(2).....	42
1. Easements in general.....	43

A Tax Guide to Conservation Easements
Expanded Table of Contents

2. Appurtenant Easements and Easements in Gross.....	43
3. Conservation Easements.....	44
4. The Uniform Conservation Easement Act (“UCEA”).....	44
5. The Necessity of Compliance with State Law.....	45
III. Qualified Organizations: Code section 170(h)(3); Regulations Section 1.170A-14(c)(1).....	46
A. General Requirements for Qualified Organizations; Regulations section 1.170A- 14(c)(1).....	47
B. Types of Qualified Organizations: Regulations sections 1.170-14(c)(1)(i)-(iv).....	48
1. Governmental Units: Regulations section 1.170A-14(c)(1)(i).....	49
2. Publicly Supported Exempt Organizations Deriving Income From Contributions: Regulations section 1.170A- 14(c)(1)(ii).....	50
a. The Public Support Test: Regulations section 1.170A-9(f).....	51

A Tax Guide to Conservation Easements
Expanded Table of Contents

b. Treatment of Conservation Easement	
Contributions.....	52
c. Unusual Grants: Regulations section	
1.170A-9(f)(3)(E)(6)(ii).....	54
3. Exempt Organizations Deriving Income from	
Operations: Regulations section 1.170A-	
14(c)(1)(iii).....	54
4. Exempt Organizations Controlled or	
Supported by Government Agencies or	
Publicly-Supported Exempt	
Organizations: Regulations section	
1.170A-14(c)(1)(iv).....	55
B. Commitment to Protect the Conservation	
Purposes of the Easement: Regulations	
Section 1.170A-14(c)(1).....	55
1. Organized for Conservation Purposes;	
Regulations 1.170A-14(c)(1).....	56
2. Operated for Conservation Purposes;	
Regulations 1.170A-14(c)(1).....	57
3. Reporting Requirements.....	58
4. Easement Substitution (exchange of one	
easement for another).....	58
5. Accreditation.....	60

A Tax Guide to Conservation Easements
Expanded Table of Contents

C. Necessary Resources: Regulations section	
1.170A-14(c)(1).....	60
IV. Transfers of Easements: Regulations section	
1.170A-14(c)(2).....	62
V. Qualified Conservation Purposes: Code section	
170(h)(4)(A), Regulations section 1.170A-	
14(d).....	62
A. Public Recreation or Education: Code section	
170(h)(4)(A)(i), Regulations section	
1.170A-14(d)(2).....	63
B. Preservation of a Significant, Relatively Natural	
Habitat for Fish, Wildlife, or Plants: Code	
section 170(h)(4)(a)(ii); Regulations section	
1.170A-14(d)(3).....	65
C. Open-Space Preservation: Code section	
170(h)(4)(A)(iii); Regulations section	
1.170A-14(d)(4)(i).....	68
1. Scenic Easements: Code section	
170(h)(4)(A)(iii)(I); Regulations	
section 1.170A-14(d)(4)(ii)(A).....	68
2. Easements Pursuant to a Clearly Delineated	
Governmental Conservation Policy:	
Code Section 170(h)(4)(A)(iii)(II),	

A Tax Guide to Conservation Easements
Expanded Table of Contents

Regulations section 1.170A-14(d)(4)(iii).....	71
3. Open Space Easements Must Yield a Significant Public Benefit: Code section 170(h)(4)(A)(iii), Regulations section 1.170A-14(d)(4)(iv).....	75
4. Prevention of Intrusion or Future Development: Regulations section 1.170-14(d)(4)(v).....	78
5. Public Access: Regulations sections 1.170A-14(d)(4)(iii)(C) and (D).....	82
D. Historic Preservation: Code section 170(h)(4)(A)(iv); Regulations section 1.170A-14(d)(5).....	83
1. Historic Land Areas: Code section 170(h)(4)(A)(iv), Regulations section 1.170A-14(d)(5)(ii).....	83
2. Certified Historic Structures: Code sections 170(h)(4)(A)(iv) and (B); Regulations section 1.170A-14(d)(5)(iii).....	85
3. Public Access: Regulations section 1.170A-14(d)(5)(iv).....	8

Chapter Four: Requirements for Qualified

Conservation Contributions Part II: Other

Requirements	89
I. Introduction.....	89
II. Uses Inconsistent with “Significant Conservation Values” Must Be Prohibited: Regulations section 1.170A-14(e)(2).....	89
A. Inconsistent Uses Must Be Prohibited.....	90
B. The Exception to the Inconsistent Use Prohibition: Regulations section 1.170A-14(e)(3).....	91
C. How to Deal with Inconsistent Uses.....	92
III. The Perpetuity Requirement: Code sections 170(h)(2)(C) and(5)(A); Regulations section 1.170A-14(a) and (b)(2).....	93
A. What Does Perpetuity Mean?.....	93
B. The Two Regulatory Requirements for Perpetuity.....	96
C. Exception for Remote and Future Events: Regulations section 1.170A-14(g)(3).....	98

A Tax Guide to Conservation Easements
Expanded Table of Contents

D. The Rule Against Perpetuities and Perpetual Conservation Easements.....	100
E. Amending Perpetual Conservation Easements.....	100
1. Background.....	100
2. Tax Rules Governing Charities Limit Amendments.....	104
a. Excess benefit transactions: Code section 4958 and Regulations sections 53.4958-1 through 8.....	105
b. “Substantial Contributors”.....	106
c. Assets must be used exclusively for charitable purposes.....	107
d. Paying More Than Fair Market Value.....	108
d. Commitment to Protect the Conservation Purposes of the Donation.....	109
F. Extinguishment: Regulations section 1.170A- 14(g)(6)(i).....	110
G. Subordination of Mortgages: Regulations section 1.170A-14(g)(2).....	112
1. Background.....	112
2. When must the subordination occur?...113	

A Tax Guide to Conservation Easements
Expanded Table of Contents

3. What must the subordination provide?.....	113
H. No Deduction Is Allowed Where Surface Mining Rights Are Retained: Regulations section 1.170A-14(g)(4).....	115
1. Surface Mining: Code section 170(h)(5)(B); Regulations section 1.170A-14(g)(4)(i).....	116
a. Split Estate Issues.....	116
b. The surface mining prohibition: Code section 170(h)(5)(B)(i); Regulations section 1.170A- 14(g)(4)(i).....	117
c. Mining remoteness exception: Code section 170(h)(5)(B)(ii), Regulations section 1.170A- 14(g)(4)(ii).....	118
d. What minerals are affected by the surface mining prohibition?.....	120
2. Subsurface Minerals: Code sections 170(h)(5)(B)(i) and (6), Regulations section 1.170A-14(g)(4)(i).....	121

IV. Other Requirements When Landowner Reserves	
“Certain Rights”	123
A. Natural Resource Inventory: Regulations section	
1.170A-14(g)(5)(i).....	123
B. Notice Requirements: Regulations section	
1.170A-14(g)(5)(ii).....	125
C. Monitoring Requirements: Regulations section	
1.170A-14(g)(5)(ii).....	126
D. Enforcement and Restoration: Regulations	
section 1.170A-14(g)(5)(ii).....	127
1. Restoration.....	127
2. Other Remedies, Damages, and Attorney’s	
Fees.....	129
a. Reciprocal Attorney’s Fee Provisions..	129
b. Replacement Cost Damages.....	130
3. Extinguishment of an Easement: Regulations	
section 1.170A-14(g)(6)(i).....	131
a. Condemnation.....	133
b. Division of Sales Proceeds in the Event of	
Extinguishment: Regulations section	
1.170A-14(g)(6)(ii).....	136
c. Use of Proceeds by the Easement Holder:	
Regulations 1.170A-14(g)(6).....	139

A Tax Guide to Conservation Easements
Expanded Table of Contents

V. The Requirement for “Donative Intent”.....	140
A. Dual-character Contributions.....	142
B. Bargain Sales and Donative Intent.....	145
C. Easements Exchanged for Governmental Approvals.....	146
D. Conservation Buyer Transactions.....	150
1. “Handshake” Conservation Buyer Transactions.....	150
2. "Part Performance" and Conservation Buyer Transactions.....	150
3. Binding Commitments by Conservation Buyers.....	152
4. IRS Notice 2004-41 and Conservation Buyer Transactions.....	154
E. A Conservation Buyer Deal That Works.....	155
F. Reciprocal Easements.....	156
G. Form 8283 Requirements Relating to Donative Intent.....	157
Chapter Five: Tax Benefits.....	159
I. Introduction.....	159
II. Calculation of the Tax Benefit.....	160

A Tax Guide to Conservation Easements
Expanded Table of Contents

A. The Value of the Easement Is Deductible: Code sections 170(a) and (h); Regulations section 1.170A-14(h)(3)(ii).....	161
B. Calculating the Maximum Tax Benefit.....	162
C. Annual Limitation on Easement Deductions: Code section 170(b); Regulations section 1.170A-8(a).....	164
1. The Limitation Applicable to Conservation Easement Contributions: Code sections 170(b)(1)(E)(i) and (ii).....	164
2. Application of Limitation to Other Qualified Conservation Contributions: Code section 170(b)(1)(E)(i).....	165
3. 100 Percent Write-off for Farmers and Ranchers: Code Section 170(b)(1)(E)(iv).....	167
4. Application of Limitations to Limited Liability Companies and Partnerships.....	170
5. Relationship of Deductions for Qualified Conservation Contributions and Other Contributions.....	172

A Tax Guide to Conservation Easements
Expanded Table of Contents

6. Unlimited write-off for Corporations: Code section 170(b)(2)(B).....	172
7. Phasing Easement Contributions to Extend Income Tax Benefits.....	173
D. Other Limitations on Easement	
Deductions.....	175
1. Limitation to Basis for Certain Easement Contributions: Code section 170(e)(1)(A); Regulations section 1.170A-4(a).....	175
2. Calculating basis in a conservation easement: Regulations 1.170A-14(h)(3)(iii).....	176
3. Effect of Other Charitable Deductions on Conservation Easement Deductions; Code section 170(b)(1)(E)(i).....	177
4. Tax Benefits Expire at the Donor's Death.....	179
E. The Alternative Minimum Tax: Code sections 55 and 56(b)(1)(A)(i); Regulations 1.57-1.....	179
II. The Conveyance of a Conservation Easement	
Reduces the Basis of the Easement Property: Regulations section 1.170A-14(h)(3)(iii).....	180

A Tax Guide to Conservation Easements
Expanded Table of Contents

A. The Reason for the Basis	
Adjustment.....	180
B. Basis Adjustments for Sales and Bargain	
Sales.....	180
III. Treatment of Easement Contributions by Real	
Estate Developers.....	182
A. Developer Contributions May Be Limited to	
Basis.....	182
B. Enhancement to the Development.....	183
C. Donative Intent.....	184
IV. Corporations, Partnerships, Limited Liability	
Companies, and Trusts.....	184
A. Corporations.....	185
1. Easement Deductions for C Corporations:	
Code sections 170(b)(2)(A) and	
(b)(2)(B).....	185
2. Easement Deductions for S Corporations:	
Code section 1366; Regulations sections	
1.1366-1 and 2.....	186
3. Conversion of a C corporation to an S	
corporation.....	188

A Tax Guide to Conservation Easements
Expanded Table of Contents

a. Qualifying for Conversion: Code sections 1361(b) and 1362(a)(2); Regulations section 1.1361-1(b).....	188
b. Taxes Applicable to S corporations: Code sections 1374(a) and 1375; Regulations sections 1.1374-2(a) and section 1.1375-1.....	188
c. Treatment of Tax Credits Resulting from S Corporation Contributions.....	189
B. Easement Deductions for Limited Liability Companies.....	190
C. Allocations of Income Items; Special Allocations; Substantial Economic Effect.....	190
C. Easement Deductions for Limited Partnerships.....	193
D. Easement Deductions for Trusts.....	193
1. Grantor Trusts: Code section 671; Regulations section 1.671-3.....	193
2. Personal Residence Trusts and Qualified Personal Residence Trusts: Code section 2702; Regulations 25.2702-5.....	194
3. Simple and Complex Trusts.....	195

A Tax Guide to Conservation Easements
Expanded Table of Contents

V. Tax Deductions Syndications: Potential Challenges..	197
A. Potential IRS Challenges to Syndications.....	200
B. Land Trust Alliance Advisory Regarding Syndications.....	202
VI. Federal Tax Treatment of State Tax Credits for Easement Contributions.....	204
A. Tax Treatment of Credits in the Hands of the Original Recipient.....	204
B. Tax Treatment of Credit Transfers by the Original Recipient.....	205
C. Tax Treatment in the Hands of a Credit Buyer.....	206
D. Do Tax Credits Affect Conservation Easement Deductions?.....	207
VII. Tax Treatment of Expenses Incurred in Contributing a Conservation Easement.....	208
VII. Tax-deferred Exchanges and Easement Sales...	209
Chapter Six: Easement Valuation.....	211
I. Introduction.....	211
II. Basic Concepts.....	211
A. Fair Market Value.....	212
B. Highest and Best.....	212
III. Appraisal Methods.....	215

A Tax Guide to Conservation Easements
Expanded Table of Contents

A. Replacement Method.....	215
B. Discounted Cash Flow Method.....	216
C. Diminution in Value.....	218
D. Comparable Sales Method.....	219
E. Regulatory Requirements Regarding Easement Appraisal Methods; Regulations 1.170A- 4(c)(3)(i).....	220
1. The Direct Comparable Sales Approach.....	221
2. The Before-and-After Valuation Approach: Regulations Section 1.170A-14(h)(3)(i) – Determining Before Value.....	223
IV. Determining the Impact of the Easement on the Value of Other Property: Regulations Section 1.170A-14(h)(3)(i).....	227
A. The Contiguous Property Rule.....	229
B. The Enhancement Rule.....	231
C. Subtracting the Value of Other Benefits.....	233
V. Preliminary Appraisals.....	235
VI. Conclusion.....	237
Chapter Seven: Substantiation Requirements.....	238
I. Introduction.....	238

A Tax Guide to Conservation Easements
Expanded Table of Contents

II. Recent Judicial Actions Regarding	
Substantiation.....	238
III. Qualified Appraisal and Qualified Appraiser: Code sections 170(f)(11)(E); Regulations sections 1.170A-13(c)(3) and (5).....	241
A. Qualified Appraisal.....	241
B. Qualified Appraiser.....	243
III. Other Substantiation Requirements.....	247
A. Form 8283 and the Appraisal Summary: Regulations section 1.170A-13(c)(4).....	247
1. Filling Out the Form.....	247
2. Supplemental Information Required.....	250
3. Signing Form 8283 and Land Trust Responsibilities.....	250
B. Acknowledgment of the Contribution: Code section 170(f)(8); Regulations section 1.170A-13(f)(2).....	255
1. Form of Acknowledgement.....	256
2. Contents of Acknowledgement: Regulations section 1.170A-13(f)(2).....	256
a. Goods or Services: Regulations section 1.170A-13(f)(5).....	257

b. Good Faith Estimate: Regulations section	
1.170A-13(f)(7).....	258
3. Contemporaneous: Regulations section	
1.170A-13(f)(3).....	260

Chapter Eight: Audits, Administrative Appeals and Penalties

I. Introduction.....	262
II. The Audit.....	262
A. How Returns are Selected for Audit.....	263
B. Types of Audits.....	263
C. Statute of Limitations.....	264
D. Conclusion of the Audit.....	264
III. Administrative Appeals... ..	267
IV. Penalties... ..	270
A. Valuation Over-Statement Penalty for	
Appraisers: Code Section 6695A.....	270
B. Penalties for Taxpayers: Code section 6662;	
Regulations sections 1.6662-5(a).....	272
1. Substantial Over-valuation.....	272
2. Substantial Underpayment of Tax.....	274
3. “Good Faith” Exception to the Penalty for	
Taxpayers.....	275
V. Conclusion... ..	277

Chapter Nine: Estate and Gift Taxes and Conservation

Easements.....	278
I. Introduction.....	278
II. The Unified Estate and Gift Tax: Code sections 2001–2801; Regulations sections 20.0-1 through 20.7701-1 and 25.0-1 through 25.7701-1.....	279
III. The Gift Tax: Code sections 2501–2524; Regulations section 25.0-1 through 25.7701-1.....	280
A. The Gift Tax and the Exclusion Amount: Code section 2505; Regulations section 25.2505- 1t.....	280
B. The Annual Exclusion from Gift Tax: Code sections 2503(b) and 2513; Regulations section 25.2503-2(a).....	280
1. Gifts of Land.....	282
2. The Present Interest Requirement: Code section 2503(b)(1); Regulations sections 25.2503-3(a) and (b).....	284
C. Discounting.....	285
D. Other Gift Tax Exemptions.....	288
E. Some Cautions About Gifts.....	289

A Tax Guide to Conservation Easements
Expanded Table of Contents

IV. Estate Tax: Code section 2001–2210; Regulations	
sections 20.0-1 through 20.7701-1...	290
A. The Gross Estate: Code section 2031;	
Regulations sections 20.2031-0 –	
20.2046-1.....	290
B. The Taxable Estate: Code section 2051;	
Regulations section 20.2010-1t.....	291
C. The Unified Exclusion Amount and Portability:	
Code section 2010; Regulations section	
20.2010-1t.....	292
D. The Marital Deduction: Code section 2056;	
Regulations section 20.2056a-1.....	294
1. Bypass Trusts.....	295
2. The Marital Deduction and Qualified	
Terminable Interest Property Trusts:	
Code section 2056(b)(7)(B).....	296
3. Don't Forget to Be Practical.....	298
E. Credit for Prior Transfers: Code section 2013;	
Regulations section 20.2013-1.....	298
F. Special Valuation for Qualified Real Property:	
Code section 2032A; Regulations sections	
20.2032a-3, a-4, and a-8.....	298

A Tax Guide to Conservation Easements
Expanded Table of Contents

G. Generation-skipping Transfer Tax: Code sections 2601–2664; Regulations sections 26.2600-1 - 26.7701-1.....	300
H. Installment Payment of Tax: Code section 6166; Regulations section 20.6166a-2.....	301
I. Conservation Easement Estate Tax Benefits:	
Code sections 2055(f) and 2031(c).....	303
1. Two Types of Estate Tax Benefits for Conservation Easements.....	303
2. The Post-Mortem Election: Code sections 2031(c)(8)(A)(iii) and (C) and section 2031(c)(9).....	308
3. Tax Requirements and Limitations.....	310
J. The Use of Conservation Easements in Estate Plans.....	310
1. Use with the Annual \$14,000 Gift Tax Exclusion.....	311
2. Use with section 2032A Special Valuation.....	314
3. Use with the Unified Exclusion Amount...	315
4. Conservation Easements and Value Replacement.....	315

A Tax Guide to Conservation Easements
Expanded Table of Contents

K. Other Restrictions Affecting the Value of Land in a Decedent's Estate.....	317
L. Stepped-Up Basis for Estate Assets: Code section 1014.....	317
M. Estate Tax Returns and Tax Payment: Regulations sections 20.6075-1 and 20.6081-1.....	319
N. Life Insurance: Code section 2042; Regulations section 20.2042-1.....	320
O. Charitable Giving and Estate Taxes.....	321
1. Charitable bequests: Code section 2106(a)(2).....	321
2. Charitable Remainder Trusts: Code section 664; Regulations section 1.664-1.....	321
3. Contributions of Remainder Interests in a Farm or Residence; Regulations sections 1.170A-7(b)(3) and (4).....	323
V. The Use of Trusts.....	324
VII. State Estate or Inheritance Tax.....	325
VIII. Conclusion.....	326