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UT Extension
SP646

Farm and Forest Land Preservation with Conservation Easements

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This publication is intended to provide basic information on conservation easements for landowners, community leaders, students and other interested individuals. It is not intended, and should not be used, to provide information to guide a particular conservation easement transaction or to substitute for the legal, financial and/or property appraisal planning or assistance that is needed for such transactions.

I. Introduction

A conservation easement is a legal instrument that allows landowners to voluntarily restrict the ways in which a designated parcel of land can be used. Conservation easements are an increasingly popular way for landowners to control the future use of their property and for the public to ensure that privately owned lands are used in publicly desirable ways. Conservation easements are created through either a voluntary sale or donation from a landowner to a governmental agency or other qualified organization. The agency or organization that receives the easement obtains the right and obligation to enforce the easement's restrictions on both current and future owners of the property. Typically, the restrictions limit the type and amount of "development" that may occur on the parcel, although the restrictions may vary from one conservation easement to another and are determined by the agreement between the landowner and the agency or organization receiving the easement. Since the restrictions are often in the public's interest and typically diminish the value of the land, landowners can often receive property, income and estate tax benefits from granting the easement. The extent of the tax benefits depends on both the details of the conservation easement and the landowner's specific circumstances.

This publication provides a general introduction to conservation easements. It begins with an overview of both conservation easements and private land conservation. After that overview, the following two sections explore the legal and tax implications of granting a conservation easement in more detail. Following these is a summary of the steps involved in granting a conservation easement. Finally, there is a list of additional resources where the interested reader can obtain more detailed information.

II. An Overview

Land conservation has historically occurred through government acquisition or retention of property. National and state forests and park systems are prime examples. However, private organizations, commonly referred to as land trusts, have also been active in the conservation and/or preservation of privately owned lands. Land trusts

are non-profit organizations that hold property or interests in property, in trust, for the public good. The first land trusts were formed in the 1890s in the northeastern United States in response to the rapid urbanization that accompanied the industrial revolution. These trusts initially operated much like private park commissions, acquiring lands in or near urban areas for the public to use and enjoy. During the first half of the 20th century, land trusts and the types of lands protected grew more diverse, although the actual number of land trusts and the amount of land protected grew somewhat slowly. By 1950, there were only about 50 land trusts operating in the United States; most of which were located in either the Northeast or along the Pacific Coast.

The environmental movement of the 1960s and 1970s brought a newfound interest in conservation and the number of land trusts began to grow at a more rapid pace. However, at that time, land trusts were protecting lands primarily through outright ownership, acquiring property either by donation or purchase. This method of land conservation requires either well-funded land trusts or conservation-minded and generous landowners. To better leverage their limited resources, land trusts began to use a particular type of easement called, fittingly enough, a conservation easement.

An easement is a commonly used legal instrument that grants a right over a particular parcel of real property to someone other than the owner of the property.[1] Easements are based on the idea that property ownership is not a single indivisible right, but instead a collection of individual, often separable, rights. These individual rights include, for example, the right to erect structures, reside, grow crops and exclude others from the property. This collection of rights has often been compared to a bundle of sticks, with each stick representing a different right. Just as a single stick can be removed from a bundle, so can an individual right be severed from the collection of rights that a landowner enjoys. The severance of a right often occurs by voluntary transfer, as in a lease where the right to temporary occupancy of a property is granted to a tenant. However, the severance can also occur involuntarily, as when a public utility exercises the power of eminent domain to obtain an easement to install and maintain a pipe or line over or under privately owned property.

The advantage of easements over ownership for land trusts is that they allow trusts to protect lands, not by acquiring the entire bundle of landowner rights, but by acquiring only those specific rights that are relevant to the trusts' conservation goals. In general, these rights are the rights to "develop" the land in the future, or the rights to convert the land to a more intensive use, such as from a farm to a residential neighborhood, shopping mall or industrial park. Since landowners are generally more willing to sacrifice the right to develop their land than all of their rights to the land, conservation easements allow land trusts to preserve more lands with fewer resources. As a result, the increased use of conservation easements has helped to fuel a substantial increase in the rate at which lands are being protected across the country.

The use of conservation easements to conserve private lands has also been encouraged by amendments to state and federal laws to solidify the legal basis for this particular type of easement and to increase the tax benefits available to landowners who grant conservation easements. In Tennessee, conservation easements are primarily governed by the Conservation Easement Act of 1981, which authorizes state governmental agencies to acquire conservation easements and specifies how conservation easements are to be enforced and how they are to be assessed for property taxes. At the federal level, the tax code has been amended, most recently by the Taxpayer Relief Act of 1997, to increase the incentives for conservation easements. The legal implications of conservation easements, including the effects of the Tennessee statutes, are discussed in the next section. An overview of potential tax benefits follows.

III. The Legal Implications

Conservation easements are designed to preserve existing, or limit future, uses of land. They are legally binding, voluntary agreements between landowners and government agencies or other qualified organizations designed to restrict the type and amount of development that can occur on a parcel of land. The landowner forgoes these development rights and the agency or organization acquires the right and obligation to monitor and enforce the restrictions. These restrictions apply to both current and future owners, as conservation easements are publicly recorded and "run with the land."

Thus, instead of transferring property rights as other easements do, conservation easements actually "extinguish" these rights. Exactly which rights are extinguished

[1] For more information on easements, see *An Introduction to Easements*, available online at http://economics.ag.utk.edu/pubs/policy/easement.pdf.

varies from one conservation easement to another but, in general, the landowner retains all rights not explicitly transferred or extinguished by the easement. Conservation easements do not require public access or use of the land by the agency or organization that receives the easement, unless specifically stated in the easement. However, under current Tennessee law, there is some ambiguity over who may sue to enforce the terms of an easement, as the wording of the statute appears to open the door to parties other than the holder of the easement.[2] As a result, the question of who, in addition to the easement holder, may sue to enforce a conservation easement will likely be answered by judicial decree or future legislative action.

One of the most important advantages of conservation easements is their flexibility. For example, landowners and the receiving agency or organization have a great deal of freedom in choosing exactly which rights are extinguished by the easement. This allows conservation easements to be tailored to the particular circumstances of individual landowners. For example, landowners may transfer "development" rights while retaining the right to continue using their land. Thus, landowners can use conservation easements to achieve conservation and possibly tax and estate planning goals, while retaining the right to use their lands for agriculture or forestry. Also, these rights may be transferred to future owners of the property, such as the landowner's heirs or beneficiaries. Conservation easements designed to protect "working lands" are often referred to as agricultural easements or agricultural conservation easements. In addition to rights to continue to work the land, a landowner can also retain limited development rights, such as the right to erect one or more houses or other structures on the property.

Conservation easements are also flexible in terms of their coverage and duration. For example, landowners may restrict all or any portion of their property with an easement. The conservation easement can either be permanent or last only for a specific period of time.

However, this flexibility is limited by two factors. First, the tax incentives available to landowners may be affected by the structure of the easement. Although tax incentives will be discussed in more detail in the next section, in general, the less restrictive the easement or the more rights the landowner retains, the less likely the easement will qualify for tax incentives. Along similar lines, the less restrictive the easement or the more rights the landowner retains, the less likely that a governmental agency or qualifying organization will be interested in participating in the easement. Monitoring and enforcing easements requires resources, and agencies or other organizations will be less willing to devote these resources to easements that offer little public benefit.

While conservation easements need not grant public access to the property, Tennessee law does provide that the agency or organization holding the easement shall have "the right of entry at reasonable times for inspection whether or not the easement specifically permits such rights of entry" TCA § 66-9-304(c). Similarly, while conservation easements may lower the amount of property taxes due, they do not absolve the property owner from the payment of such taxes. In general, the granting of a conservation easement does not absolve the landowner from traditional owner responsibilities, such as any applicable duty of care the landowner may owe in regard to the upkeep and maintenance of the property. Landowners may generally still be held liable for a breach of that duty resulting in property damage or injury to persons on or near the property. However, Tennessee landowners who grant conservation easements to governmental units are absolved from this responsibility by statute TCA §11-10-105.

Finally, it is important to understand that a properly executed and recorded conservation easement will govern the use of the property it encumbers for the life of the easement, absent a court order invalidating all or part of the easement. What conditions, if any, would be required for a court to modify or invalidate the terms of a conservation easement are difficult to predict. Thus, if an easement restricts the use of a parcel of land to "agricultural pursuits," and such pursuits become untenable because of a change in local land uses or market conditions, it is not clear what alternative uses would be acceptable to a court. Would the land necessarily revert to its "natural state"? Might the conservation easement be construed to allow another use with obvious public benefits, such as a park or school? Or, might a court simply recognize the impossibility of continuing agricultural operations and invalidate the easement? At this point, conservation easements remain a relatively new, untested legal instrument and there are no clear answers to these questions. As a result, landowners who wish to preserve an ongoing use

[2] TCA § 66-9-303(1)(A)(i) defines a conservation easement as an easement that is "held for the benefit of the people of Tennessee," and TCA § 66-9-307 provides that conservation easements may be enforced by "the holders and/or beneficiaries of the easement."

of the property, such as farming or forestry, should ensure that the easement not only explicitly retains the right to continue these operations, but also allows for both changes in these operations to meet changing market or land use conditions and changes in use if these operations become unsustainable.

IV. The Tax Benefits

A conservation easement can have significant property, income and estate tax benefits for the landowner. Conservation easements lower property tax payments by decreasing the assessed value of the land for which the easement is granted. Under Tennessee law, property taxes are based upon the assessed value of the property, which is meant to represent the property's fair market value, or "its sound, intrinsic and immediate value, for purposes of sale between a willing seller and a willing buyer" TCA § 67-5-601. For farm or forest land located in or near developing or urban areas, the market value of the land for development may exceed that for its current use, and the property tax assessment is, in general, based on the higher value. By granting a conservation easement, the landowner forecloses the possibility of the land being converted into this alternative use and, by law, the assessed value is the fair market value less "such reduction in value as may result from the granting of the conservation easements" TCA § 66-9-308.

Thus, the property tax savings from a conservation easement will be greater for lands that are in or near urban or developing areas and for lands that are burdened by more restrictive easements. What the law does is simply require that assessors consider the effect of the easement when assessing the value of the property – the greater the diminution in value, the greater the property tax savings. However, these tax savings may be reduced or even eliminated if the property already qualifies for differential assessment. Differential assessment programs, commonly referred to as "greenbelt laws," direct local tax assessors to assess land that qualifies as agricultural, forest or open space land at its current use value, rather than its fair market value TCA § 67-5-1001, *et seq*. These laws are intended to protect farm and other "green belts" of land, particularly in urban areas, from the pressures that increasing property taxes can create in favor of their development for other uses.[3]

The donation or "bargain sale" of a conservation easement that meets the criteria of Section 170(h) of the Internal Revenue Code can qualify as a charitable donation for federal income tax purposes. (See Inset: Qualifying Easements under Section 170 of the Internal Revenue Code). A bargain sale is the sale of property for less than its fair market value. Thus, in the event of a bargain sale, the amount of the charitable deduction is the difference between the easement's fair market value and the amount at which the easement is sold.[4] In addition, to qualify as a charitable deduction under the Internal Revenue Code, the donor/seller must establish intent to make a charitable gift prior to the transaction.[5] Currently, the Internal Revenue Code limits the amount of a charitable deduction that can be taken in any one year to 30 percent of an individual's adjusted gross income (10 percent in the case of corporations).[6] However, any donation in excess of the annual

A Simple Example of Possible Estate Tax Savings

Ms. Smith owns a large farm in Williamson County, Tennessee. Her farm is worth $4 million and is adjacent to land that is rapidly being developed. Ms. Smith donates the development rights in perpetuity to the local land trust. According to a qualified appraisal, the land's value is reduced by $2 million. Ms. Smith is eligible for a charitable deduction of this amount. She also notifies the local tax assessor for reduced property taxes. Following Mrs. Smith's death, the estate tax value of the farm encumbered by the conservation easement is $2 million, rather than the $4 million at which it was originally appraised. Since the conservation easement qualifies for the Section 2031 exclusion, the value of the taxable estate is further reduced by $500,000, which is the maximum amount allowed under Section 2031.

[3] For more information on differential assessment in Tennessee, see *Summary: The Agricultural, Forestry and Open Space Land Act (or "The Greenbelt Law")* available online at http://economics.ag.utk.edu/pubs/policy/greenbelt.pdf.

[4] Internal Revenue Service Publication 561, *Determining the Value of Donated Property*, provides rules for the appraisal of a charitable donation of a conservation easement. The preferred method compares properties subject to similar easements. Where comparable properties are lacking, the value of the easement is the difference in a pre-easement valuation and a post-easement valuation, or a "value before minus the value after" rule.

[5] Rules governing the tax treatment of bargain sales are discussed in Internal Revenue Service Publication 526, *Charitable Contributions*.

[6] These annual limits may be increased under certain scenarios.

limit may be applied toward federal income taxes for up to five additional years subject to the same stipulations.

Finally, the donation or sale of a conservation easement can have estate tax benefits. A properly constructed conservation easement will have two effects. First, the conservation easement will decrease the value of the taxable estate to the same extent that the easement reduces the value of the property. Second, the easement may also qualify for an additional reduction in the taxable estate under Section 2031 of the Internal Revenue Code. This Section, enacted as part of the Taxpayer Relief Act of 1997, allows an exclusion from the taxable estate equal to 40 percent of the residual value of the land subject to the easement, up to a maximum of $500,000, provided the easement reduces the fair market value of the property by at least 30 percent. Smaller deductions are available for easements that reduce the value of the property by an amount less than 30 percent. Section 2031 also enhances estate-planning flexibility with a "post-mortem" option for granting an easement.

It is important to note that "tax breaks" are not assured with a conservation easement. The Internal Revenue Service requires that the easement have several characteristics to qualify for the deduction(s). The most restrictive characteristics are that the easement must be *in perpetuity* (or unending) and must be for *conservation purposes yielding significant public benefits*. (Again, see Inset: Qualifying Easements under Section 170 of the Internal Revenue Code). All conservation easements are not required to be in perpetuity, but they must be to qualify for a "charitable deduction" on federal estate and income taxes. Tax incentives for establishing conservation easements can mean significant savings for taxpayers during their lives and can result in reduced estate taxes after their death. However, for many landowners, these savings are minor relative to the knowledge that the farm they "loved" won't be paved over.

V. The Mechanics

The following is a brief outline of the steps involved in granting a conservation easement. This process can be both time-consuming and expensive. An important consideration for many landowners will be the availability of financial assistance for these expenses.

- **Obtain Competent Professional Guidance**. It is highly recommended that any landowner contemplat-

Qualifying Easements under Section 170(h) of the Internal Revenue Code

To qualify under Section 170(h) of the Internal Revenue Code, a "qualified real property interest" must be donated or transferred to a "qualified organization" for "conservation purposes." The rules allow for considerable flexibility, but are clear in many areas and have been tested in courts in a variety of circumstances.

A qualified real property interest can be any one of the following three:

(i) An entire interest in the property (not necessarily including mineral rights),
(ii) A remainder interest, and/or
(iii) A restriction (in perpetuity) on the use that may be made of the real property (i.e., a conservation easement)

Qualified organizations include governmental units, such as municipalities and state and federal agencies and non-profit organizations. Most organizations qualified to accept charitable contributions are non-profit organizations and are generally organized as trusts for the management of conservation easements and properties. These organizations would typically be described as 50% Limit Organizations in IRS Publication 78, Cumulative List of Organizations.

Conservation purposes are defined as the:

(i) preservation of land areas for outdoor recreation by, or the education of, the general public (this is the only conservation purpose that would necessarily require public access);
(ii) protection of a relatively natural habitat of fish, wildlife or plants, or similar ecosystem;
(iii) preservation of open space (including farmland and forest land) where such preservation yields a significant public benefit and is either
(a) for the scenic enjoyment of the general public, or
(b) pursuant to a clearly delineated federal, state or local governmental conservation policy; or
(iv) preservation of an historically important land area or a certified historic structure. A certified historic structure is any building, structure or land area listed in the National Register, or which is located in a registered historic district and is certified by the Secretary of the Interior as being of historic significance to the district.

ing entering into a conservation easement seek qualified professional assistance to help him or her sort through all of the financial and legal issues.

- **Choose the Receiving Entity.** The landowner will need to choose or find a governmental agency or other qualified organization willing to purchase or accept a donation of the conservation easement. Differences in missions and resources among governmental agencies and conservation organizations result in different priorities for protecting lands. As a result, not all organizations are likely to be interested in protecting a particular parcel of land. Typical factors considered by these agencies and organizations are the current use, size and location of the property and whether the preservation of the property would benefit the general public by preserving natural scenic views, wildlife habitat, timber, farmland and/or cultural or historical values. While there are a variety of qualified organizations capable of and willing to accept easements, there is no guarantee that landowners will always be able to find an interested agency or organization.

- **Compile a Baseline Inventory.** The baseline inventory includes a title search, and possibly a survey of the property, as well as a description of both the current uses of the property and the resources that the conservation easement is to protect. The baseline inventory helps to establish a reference point for determining compliance with the terms of the easement.

- **Negotiate and Draft the Conservation Easement.** The landowner and agency or organization accepting the easement will need to agree upon which uses of the property are to be allowed and which uses are to be disallowed. Even though the general principle is that all rights not explicitly transferred by the conservation easement are retained by the landowner, landowners interested in continuing to use their lands should make sure that the easement contains explicit exclusions that are broad enough to allow them to use the land in accordance with their desires. An example of a form conservation easement can be found at http://www.epa.gov/owow/nps/ordinance/documents/A2e-ModelLand.pdf.

- **Execute and Record the Documents.** To be enforceable and to qualify for tax incentives, a conservation easement must be executed by all current owners of the property to which it applies. It must also be recorded in the county in which the property is located. If the property is subject to a mortgage or deed of trust, the holders of the mortgage or deed of trust must consent in writing to the granting of the easement and such consent must also be recorded.

- **Obtain an Appraisal of the Property.** To qualify for certain tax benefits, the effect of the conservation easement on the value of the property must be established by an appraisal.

VI. Possible Sources of Funding

Most conservation easements are either donated or transferred via a "bargain sale" at a price below the value of the development rights that are extinguished. The ability or willingness to pay for a conservation easement, or to incur the costs associated with transferring or monitoring and enforcing the easement, will vary both from one agency or qualifying organization to another and from one parcel to another.

The United States Department of Agriculture provides funds for the purchase of conservation easements through the Farm and Ranch Lands Protection Program and the Forest Legacy Program. Information on the Farm and Ranch Lands Protection Program is available from the Natural Resources Conservation Service ("NRCS"), while information on the Forest Legacy Program is available from the United States Forest Service and/or the Tennessee Department of Agriculture, Division of Forestry.

Conservation easements should not be confused with other conservation programs funded by the 2002 Farm Bill, such as the Conservation Reserve or Conservation Security Programs. An agricultural producer enrolling land in the Conservation Reserve Program enters into a contract with the NRCS through which the producer agrees to take lands out of production and establish a vegetative cover for a specified period of time, in return for an annual rental payment and cost-sharing for establishing the vegetative cover. Information on the Conservation Reserve Program and other conservation programs is available from the NRCS.

VII. Conclusion

Conservation easements allow landowners to preserve or limit current and future uses of their farms and forests. Under certain circumstances, they can provide substantial tax benefits for landowners and/or allow landowners to convert some of their equity into cash. They provide an attractive option for landowners and land trusts because they allow landowners to retain ownership while foregoing the rights to future development. Thus, through conservation easements, landowners can achieve conservation or preservation aims while retaining limited rights to continued use of their property for themselves and for future generations. To do so, conservation easements should be carefully tailored to fit individual circumstances and should be made flexible enough to accommodate changes in farm and forest practices and conditions. In addition, tax incentives are contingent both upon individual landowner circumstances and a properly structured easement. Landowners are strongly encouraged to retain competent professionals to assist them through the process.

Additional Sources of Information

Publications

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Organizations

American Farmland Trust
1920 N St. NW, Suite 400
Washington, DC 20036
(202) 659-5170
www.farmland.org

Land Trust Alliance
1319 F St. NW, Suite 501
Washington, DC 20004
(202) 638-4725
www.lta.org

Trust for Public Land
116 New Montgomery St., 4th Floor
San Francisco, CA 94105
(415) 495-4014
www.tpl.org

Internet Links

Tennessee Department of Environment and Conservation: Land Trusts 101
http://www.state.tn.us/environment/tn_consv/archive/landtrusts.htm

Land Trust Alliance: Land Trusts Operating in Tennessee
http://www.lta.org/findlandtrust/TN.htm

Natural Resources Conservation Service: Farm and Ranch Lands Preservation Program
http://www.nrcs.usda.gov/programs/frpp/

Division of Forestry, Tennessee Department of Agriculture: Forest Legacy Program
http://www.state.tn.us/agriculture/forestry/index.html

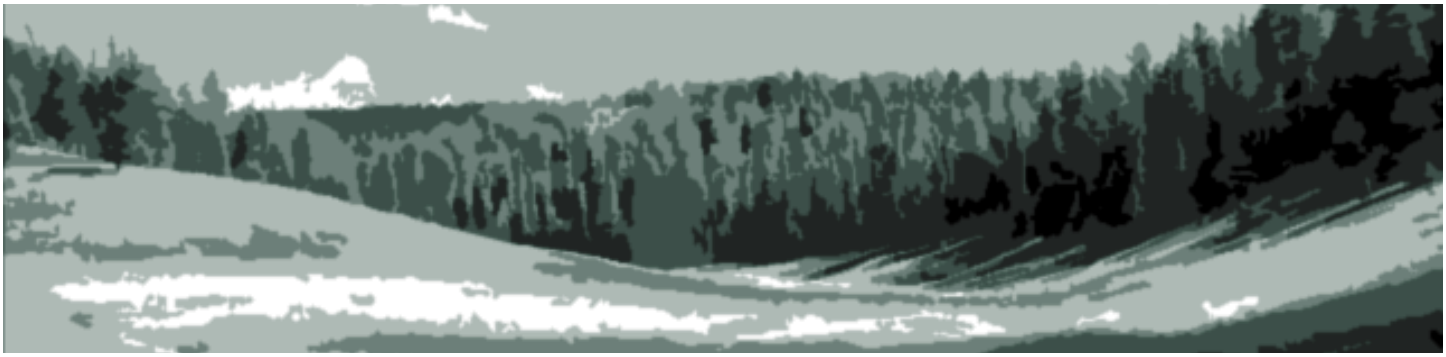
United States Forest Service
http://www.fs.fed.us/spf/coop/programs/loa/flp.shtml

Natural Resources Conservation Service: Conservation Security Program
http://www.nrcs.usda.gov/programs/csp/

Natural Resources Conservation Service: 2002 Farm Bill Conservation Programs
http://www.nrcs.usda.gov/programs/farmbill/2002/products.html

National Timber Tax Web site
http://www.timbertax.org

Examples of Conservation Easements
http://www.epa.gov/owow/nps/ordinance/documents/A2e-ModelLand.pdf
http://www.dnr.state.md.us/met/model.html



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