



## Conservation Easements: Donor Beware

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Conservation easements have garnered significant attention and gained popularity over the last few years due in part to the availability of federal tax deductions and Virginia state tax credits associated with conservation easements. Conservation easements are granted in perpetuity should not be entered into lightly or without the advice of qualified legal counsel who can help navigate and identify the potential benefits and risks of granting conservation easements. This article will provide a brief overview of the statutory requirements for granting a qualified conservation easement as well as the potential pitfalls that may jeopardize the tax benefits received by the taxpayer.

Generally, a taxpayer cannot deduct as a charitable contribution the donation of a portion of an interest in real property, except a donation of a "qualified conservation easement." The Internal Revenue Code provisions require the satisfaction of its requirements and substantiation of the value to claim such a donation qualifies as a charitable contribution. Further, the Virginia Conservation Easement Act and the Virginia Land Conservation Incentives Act of 1999 provide the requirements necessary to qualify for a state income tax credit for a donation in perpetuity of a "fee interest" or a "less-than-fee interest" in real property.

Without parsing the technical definitions of the Internal Revenue Code, the basic terms commonly used in connection with a conservation easement are as follows:

1. A "fee interest" is the donor's entire interest (i.e., a complete conveyance of property, such as the transfer of an entire parcel of property to a third party), whereas a "less-than-fee interest" is something less than the entire interest (i.e., the conveyance of certain rights with respect to property, such as easement rights).
2. A "qualified conservation contribution" is the contribution of a "qualified real property interest" to a qualified organization exclusively for a "qualified conservation purpose."
3. A "qualified real property interest" can be a donor's entire fee interest (other than a qualified mineral interest), a remainder interest, or a restriction (granted in perpetuity) on the use which may be made of the real property.
4. A "qualified conservation purpose" can be one or more of the following purposes: (i) the preservation of land for outdoor recreation by, or education of, the general public,

(ii) the protection of a relatively natural habitat of fish, wildlife, plants or similar ecosystem, (iii) the preservation of open space (including farmland and forest land) where such preservation is for the scenic enjoyment of the general public, or 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.

Once the taxpayer has identified that he or she has a qualified real property interest to be contributed for a qualified conservation purpose, the taxpayer must then substantiate the value of a contribution in excess of \$5,000 through the use of a qualified appraisal. The tax benefits of a conservation easement are only as valuable to the donor as his or her ability to properly substantiate the value of the contribution. Without proper substantiation, the tax benefits related to the conservation easement may be denied by the Internal Revenue Service and/or the Virginia Department of Taxation.

Substantiation of the value of a conservation easement has been the subject of recent Notices, Letter opinions and Publications from the Internal Revenue Service to provide guidance to taxpayers related to valuation. In addition, the Internal Revenue Service has increased its scrutiny of the value assigned to the conservation easement with increased audits, and ultimately reductions in the value or a finding that the conservation easement has no value. The heightened scrutiny of conservation easement valuations and recent court cases highlight the technical and practical implications to be considered with a conservation easement.

The Internal Revenue Code requires a "qualified appraisal" be conducted by a "qualified appraiser" in accordance with the Treasury Regulations regarding timing, form and fee structure. The "qualified appraisal" must address particular information required by the Treasury Regulations and be conducted by a qualified appraiser in accordance with the Uniform Standards of Professional Appraisal Practice. The Internal Revenue Code and the Treasury Regulations enumerate the qualifications required of a "qualified appraiser." These qualifications include the requirement that the appraiser demonstrates verifiable education and experience in valuing the type of property subject to the appraisal. The Virginia Code also requires the qualified appraiser hold a real estate appraiser's license from the Commonwealth of Virginia.

The determination as to whether an appraiser is properly licensed is simple and objective; however, the determination as to whether an appraiser "demonstrates verifiable education and experience valuing the type of property subject to the appraisal" is more complex and subjective. Just as every property has its own unique characteristics and value, every conservation easement does as well. Therefore, the qualified appraiser needs significant experience appraising properties in a particular geographic area to meet the standards required by the Internal Revenue Code. It is important to remember, appraisers are subject to civil penalties for false or fraudulent overstatement of values.

The value of a conservation easement is equal to the fair market value of the perpetual conservation restriction at the time of the contribution. If there are comparable sales records for

the type of donated easement, then the value of the qualified conservation easement is based upon such comparables. If, however, these records are not available, then the value is generally determined as the difference between the fair market value of the property to be encumbered before the granting of the restriction and the fair market value of the property after the granting of the restriction. This use of comparable sales records underscores the importance of a local appraiser with knowledge of the local market and the particular type of property for which the restriction is being granted.

Careful compliance with all requirements set forth in the Internal Revenue Code and the Virginia Code is critical to properly identify a qualified conservation easement and then to adequately substantiate the value of the Federal tax deduction or Virginia tax credit for the contributed easement. While the Internal Revenue Service and the Virginia Department of Taxation will continue to audit deductions and credits claimed for the donation of qualified conservation easements, using a local appraiser who regularly appraises property of a similar type for the purpose of substantiating value to the Internal Revenue Service and/or the Virginia Department of Taxation is a key component to obtaining the intended tax benefits of granting the easement.

*For more information about this topic, please contact the author at 804.420.6462 or or any member of the firm's Financial Services & Real Estate Team.*

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