TAX ANALYSTS SPECIAL REPORT

NEW ESTATE TAX RELIEF FOR LAND UNDER CONSERVATION EASEMENT

by C. Timothy Lindstrom and Stephen J. Small

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The Taxpayer Relief Act of 1997 contained provisions for relief from federal estate taxes. Lindstrom and Small believe that one of the most significant but least mentioned of these provisions is an expansion of relief for conservation easement. While section 2031(c) of the Internal Revenue Code is somewhat complex, the authors believe that the tax benefits can be significant. They think section 2031(c) also offers some new tax planning opportunities for landowners, at least one of which breaks entirely new ground for estate planners. Finally, the authors argue that estate tax relief under section 2031(c) may be considerably easier to qualify for than the other federal estate tax provisions aimed at family farms and businesses. Theis special report provides an in-depth analysis of the federal tax law on the donation of conservation easements, in particular new section 2031(c), many of the provisions of which are without precedent in current law, according to the authors.

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Section 508 of the Taxpayer Relief Act of 1997, P.L. 105-34 (TRA '97), contains an important new incentive for voluntary private land conservation in America. The provision, formerly known as the American Farm and Ranch Protection Act, was introduced by Sens. John Chafee, R-R.I., and Max Baucus, D-Mont., and Reps. Amo Houghton, R-N.Y., and Ben Cardin, D-Md. It adds section 2031(c) to the Internal Revenue Code (the code). Section 2031(c) provides an "exclusion" from federal estate taxes for a portion of the value of land subject to a permanent, donated conservation easement. Unlike the family-owned business exclusion created by section 502 of TRA '97 (section 2033A, discussed in the October 13, 1997 issue of *Tax Notes* by Professor Kasner at p. 209), section 2031(c) is not based on any existing provision of tax law (section 2033A is based on section 2032A). Some of the concepts are entirely new and there is little or nothing in the case law, regulations, letter rulings, or committee reports to illuminate this new provision. The recently published Joint Committee on Taxation's "General Explanation of Tax Legislation Enacted in 1997" adds very little to an understanding of the section. What follows is a summary description and analysis based on the authors' experience with conservation easements in income tax and estate tax planning and participation in the seven-year history and evolution of section 2031(c).

I. The Law Prior to TRA '97

Under law as it existed prior to August 5, 1997, the donor of a conservation easement was entitled to two types of federal tax benefits, provided that the easement met the requirements of section 170(h) and the accompanying regulations. If the gift was made during the donor's lifetime, the donor of such an easement was entitled to an income tax deduction for the value of the easement (generally, the difference between the value of real property subject to the easement before and after the easement was put into place).[1] In addition, in the case of either a lifetime gift or a testamentary gift, the donor's estate was entitled to take into account the effect of the easement on the fair market value of real property in the decedent's estate in valuing that property for estate tax purposes. (The code does not provide a formal "deduction" for the value of an *inter vivos* easement in calculating estate taxes, although the estate tax appraisal of easement restricted real property by reflecting the effect of the easement has essentially the same effect. This article will refer to that estate tax benefit as a "subtraction.") Section 2031(c) does not change the old law. Section 2031(c) adds an additional benefit for the donors of easements that meet the requirements of both section 170(h) and section 2031(c).

II. What Is a Conservation Easement?

Conservation easements are voluntary restrictions on the use of land negotiated by the landowner and the organization[2] chosen by the landowner to "hold" (enforce) the easement. The purpose of a conservation easement is to protect some aspect of the land that has a conservation value.[3]

The terms of conservation easements are entirely up to the landowner and prospective easement holder to negotiate. However, section 170(h) and the regulations under section 170(h) establish standards for easements that, if met, qualify the *donation* of the easement for income and estate tax deductions.[4]

The protection of farmland, ranch land, and forest land, particularly where such land is under development pressure and where local planning identifies the continuation of current use as valuable to the community, are typical goals of conservation easements.[5] In addition, the protection of wetlands, floodplains, historic properties, areas providing habitat to important wildlife, and land possessing unusual beauty are also appropriate uses of easements.[6] Easements which are permanent, donated (rather than sold) by the landowner, and which conserve for the public benefit one or more of the foregoing characteristics of land typically qualify for the tax benefits offered by the code. Generally (although not always)[7] public access to the encumbered property is not required to qualify for federal tax benefits.

Easements normally permit the continuation of the uses being enjoyed by the landowner at the time of the donation of the easement.[8] In addition, land subject to a conservation easement may be freely sold, donated, passed on to heirs, and transferred in every normal fashion, so long as the land remains subject to the restrictions of the easement. It is even possible to retain rights to limited development of land, including limited residential construction, so long as the retention of such rights does not conflict with the conservation purpose of the easement.[9]

To qualify for a tax deduction, easements must be donated either to a federal, state, or local government agency, or to a "publicly supported" charitable organization that has the capacity to enforce the terms of the easement.[10] The organization generally must be in the conservation or historic preservation field, however it need not necessarily be an environmental organization.[11] For example, an association of farmers established for the purpose of protecting farmland, if the association qualifies as a public charitable organization (qualifying under section 501(c)(3)), and has the capacity to enforce the easement, would be qualified to hold easements on farmland.

Conservation easements are generally easements *in gross*;[12] they were often not recognized as common law

[1] Treas. reg. section 170(h)(3). The "before and after" test is a long-standing rule. *See* Rev. Rul. 73-339, 1973-2 C.B. 68, and *Thayer v. Commissioner*, T.C. Memo. 1977-370.

[2] The donee must be a "qualified organization" under section 170(h)(3). A so-called "private foundation" is not an eligible easement donee under section 170(h)(3). The donee generally must be in the conservation or historic preservation field.

[3] Section 170(h)(4).

[4] In general, the easement must be a "qualified real property interest" under section 170(h)(2), it must go to a "qualified organization" under section 170(h)(3), and the gift must meet one of the "conservation purposes" tests under section 170(h)(4). The terms of the easement must be enforceable in perpetuity under section 170(h)(5)(A).

[5] *See, e.g.*, LTRs 8711054, *87 TNT 52-30* (preservation of farmland), 8713016, *87 TNT 60-35* (preservation of farmland), 8721017, *87 TNT 102-16* (preservation of ranch land), and 9537018 (preservation of forest land).

[6] *See, e.g.*, LTRs 8247024 (preservation of significant habitat), 8652013, *86 TNT 256-75* (preservation of a scenic view), 9052028, *90 TNT 264-34* (preservation of habitat), and 9318017, *93 TNT 100-61* (preservation of habitat and "buffer zone" for adjoining state park).

[7] Treas. reg. section 1.170A-14(d).

[8] *See, e.g.*, LTRs 9537018, *95 TNT 182-47* (continuation of timber harvesting and management according to certain standards), and 9632003, *Doc 96-22543 (13 pages)* (ranching).

[9] LTRs 8233025 (reservation of two additional homesites) and 9603018, *Doc 96-2107 (10 pages)* (reservation of additional homesites and the right to carry on agriculture, forestry, and equestrian activities).

[10] *Supra*, note 2.

[11] Treas. reg. section 1.170A-14(c).

[12] *See* Browne & Van Dorn, "Charitable Gifts of Partial Interests in Real Property for Conservation Purposes," 29 *Tax Law.* 69 (1975); Small, "The Tax Benefits of Donating Easements in Scenic and Historic Property," 7 *Real Estate L.J.* 304 (1979).

and often are enabled by statute. A majority of states have adopted some form of the Uniform Conservation Easement Act (12 U.L.A. 64). As of 1994 over 750,000 acres of land in the United States were subject to conservation easements held by land trusts.[13]

III. The Nature of the Exclusion

Section 2031(c) provides a partial exclusion from the federal estate tax for the value of land subject to a donated, permanent conservation easement meeting the requirements of section 2031(c). The benefit is an "exclusion" rather than a "deduction" because it does not relate directly to the amount of any expense or the value of any gift as a deduction does. An additional factor distinguishing the exclusion from a deduction is that the exclusion affects the basis of land to which it is subject (see discussion below), while a deduction generally has no effect on basis.

From a taxation standpoint, there are three reasons for a landowner not to try to minimize the value of the easement to maximize the value of the exclusion.

The total value that can be excluded under the provision is $500,000 per estate. The benefit is phased in by $100,000 increments over five years, beginning in 1998. The exclusion allowed is equal to 40 percent of the value of land (not structures) remaining after taking into account the value of the easement. There is no policy reason for the 40 percent rule. It is simply an arbitrarily negotiated number, a political compromise somewhere between 100 percent and zero. The exclusion is calculated quite simply.

Example 1.

Assume that Mr. Smith owns land worth $1 million. During his lifetime he donates an easement that reduces the value of the land to $700,000; assume at his death the land is still worth $700,000. The exclusion under section 2031(c) is $280,000 (40 percent of $700,000); the value of the land subject to estate tax is $420,000 ($700,000 less the section 2031(c) exclusion of $280,000).

As noted, the exclusion is not directly tied to the value of the easement, but to the remaining value of land subject to an easement after subtracting the value of the easement. In fact, it is arguable that on certain sets of numbers the greater the value of the easement, the smaller the benefit that will be derived from the exclusion because the easement will reduce the base against which the 40 percent exclusion applies. In a great many cases, of course, the $500,000 cap on the exclusion (or, over the next four years, the phase-in of the cap) may tend to be a more significant limiting factor.

However, from a taxation standpoint, there are three reasons for a landowner not to try to minimize the value of the easement to maximize the value of the exclusion. First, as is discussed below, the easement must reduce the value of the land by at least 30 percent for the full benefit of the exclusion to be available.[14] Second, the entire value of the easement can be "subtracted" from the value of the land whereas section 2031(c) allows exclusion of only a portion of the value of the land remaining after subtracting the value of the easement. Third, a very restrictive easement is likely to generate a larger income tax deduction under section 170(h).[15] In other words, greater aggregate tax savings can be realized by donating stronger easements rather than weaker ones. Obviously, the determination of the strength of the easement must be based on a complex balancing of tax benefits, financial goals, family circumstances, and the preference of the prospective donor for land protection.

Section 2031(c) benefits are to be phased in by $100,000 increments, beginning in 1998.[16] Estates of decedents dying in 1998 would be eligible for a $100,000 exclusion, in 1999 for a $200,000 exclusion, and so on until 2002 when the full $500,000 is available. Due to the effect of the phase-in of benefits and the cap on the total amount that can be excluded the potential estate tax savings from section 2031(c) by itself ranges from less than $37,000 for a decedent dying in 1998 whose estate is taxed at a marginal rate of 37 percent (37% x $100,000) up to $275,000 for a decedent dying in 2003 whose estate is taxed at a marginal rate of 55 percent (55% x $500,000).

The exclusion applies to easements meeting the requirements of section 2031(c) regardless of when they were donated. Land already under easement is eligible for the exclusion, provided that it is still held by the original donor or a member of the original donor's family and other requirements of section 2031(c) are met (a more detailed discussion follows). However, section 2031(c) did not become effective until January 1, 1998, so the estates of landowners dying in 1997 are not eligible for the exclusion.

The exclusion available under section 2031(c) by its terms applies only to the federal estate tax and not the gift tax. Accordingly, a landowner who makes *inter vivos* gifts of land (or interests in land) under easement may not take the section 2031(c) exclusion into account for purposes of valuing these gifts.

IV. Existing Tax Benefits Available

The exclusion provided by section 2031(c) is in addition to the existing federal income and estate tax

[13]The Land Trust Alliance. This number excludes easements held by government agencies.

[14]Section 2031(c)(2).

[15]*See, e.g., Stotler v. Commissioner*, T.C. Memo. 1987-275, 87 TNT 110-28 (value of land before easement was $1,165,000; value of land after easement was $100,000; income tax deduction was $1,065,000).

[16]Section 2031(c)(3).

benefits for easement donations: the deduction from federal income tax and the subtraction of the value of the easement from land subject to easement which is included in a decedent's estate for federal estate tax purposes. In Example 1 we assumed that the easement was worth $300,000. This $300,000 can be deducted from the donor's income tax under the existing provisions of section 170(h). Because the easement is considered a gift of appreciated property the deduction is generally limited to 30 percent of the donor's adjusted gross income.[17] Any unused portion can be carried forward for five years.[18] When added together the total value "removed" from land included in the decedent's estate due to the easement in this example is $580,000 ($300,000 because of the easement itself and $280,000 under section 2031(c)). In addition, the donor has the benefit of a $300,000 income tax deduction.

V. Doubling the Exclusion

Section 2031(c)(1) states that if the executor elects the exclusion then there shall be excluded "from the gross estate" the lesser of the exclusion amount or "the exclusion limitation." In other words, the exclusion limitation is applied *per estate*, not per property. Furthermore, section 2031(c)(8)(C) provides that the easement that gives rise to the exclusion need not be donated by the decedent, but may be donated by a member of the decedent's family. Therefore, a husband and wife using a simple estate plan that ensures that the estate of each spouse maximizes the use of the section 2031(c) exclusion can take advantage of the exclusion twice. Accordingly, with proper planning, a husband and wife could exclude up to $1 million in the value of land subject to a qualified easement if both die after the exclusion is fully phased in in 2002. Doubling the exclusion in this manner would allow combined estate tax savings under section 2031(c) of $550,000 for couples with estates taxed at the 55 percent marginal rate.

VI. The 'Post-Mortem Election'

During the final hours of the conference on TRA '97 a small but important change was made to section 2031(c). It is found in section 2031(c)(8)(B), which defines "land subject to a qualified conservation easement" as land with respect to which a qualified conservation easement has been made by "an individual described in subparagraph (C), as of the date of the election described in paragraph (6)." Subparagraph (C) provides that an individual includes the decedent, a member of the decedent's family, *the executor of the decedent's estate, or the trustee of a trust the corpus of which includes land to be subject to the qualified conservation easement*" (emphasis supplied). Through this provision section 2031(c) allows a "post-mortem election" by making it possible for an easement donated by the executor of a decedent's estate, or the trustee of a trust holding land that would be included in a decedent's estate, to qualify for the exclusion provided by section 2031(c).

This provision was sponsored by Sen. Judd Gregg, R-N.H. While conversations with Hill staff suggest that the intent of the section was that a post-mortem election would make both the exclusion provided by section 2031(c) *and* the subtraction of the value of the easement (essentially through a deduction under section 2055(f)) from the land available to the estate, it appears that the language of section 2031(c)(8) does not accomplish this. Section 2031(c)(8), which provides the definition of "individual" giving rise to the post-mortem easement possibility, clearly limits the use of the definition to section 2031(c). The only estate tax benefit conferred by section 2031(c) is the exclusion, which suggests that a post-mortem easement will qualify the estate for the benefits of the exclusion only. No language in either the Finance Committee or Conference Committee reports deals with this provision.

The Joint Committee on Taxation's "General Explanation" says only that "In order to qualify for the exclusion, a qualifying easement must have been granted by the decedent, a member of the decedent's family, *the executor of the decedent's estate, or the trustee of a trust holding the land* . . ." (emphasis supplied). Because the exclusion applies to the value of land coming into the decedent's estate, and because the value of land with respect to which no *inter vivos* easement was granted will be the value of land unrestricted by easement, the exclusion will apply to a larger value than in the case of land encumbered by an *inter vivos* easement. It is understood that members of the staff of the Joint Committee on Taxation agree with this position.

Example 2.

Assume the same facts as in Example 1, except that Mr. Smith did not donate an easement during his lifetime and made no provision for an easement donation in his will. Instead, Mr. Smith's executor donates an easement that lowers the value of the land by $300,000. There is no deduction from the taxable estate under section 2055(f), but under section 2031(c) the executor may elect to exclude 40 percent of $1,000,000 (the value of the land on the date of Mr. Smith's death) from Mr. Smith's estate.

It should be possible to cure defects in an existing easement through post-mortem action, at least for purposes of qualifying for the exclusion. For example, subparagraph 2031(c)(8)(B) requires that for the easement to qualify for the exclusion it must "include a prohibition on more than a *de minimis* use for a commercial recreational activity" (see discussion below). Few existing easements include such explicit prohibitions. It seems clear that failure of an *inter vivos* easement to prohibit commercial recreational activity can be cured

[17] If the donor's basis and the fair market value of property at the time of donation are the same or nearly the same (e.g., on the date of closing of purchase) the donor may want to elect to take the deduction based on the basis of the property, allowed by section 170(b)(1)(C)(iii), rather than based on fair market value. Such an election would allow the donor to take the deduction up to 50 percent of adjusted gross income. There may be other situations where for tax-planning purposes this election might make sense.

[18] Section 170(d)(1).

by a post-mortem easement amendment; it is understood that Joint Committee staffers agree with this interpretation of the statute.

The only trusts affected by the post-mortem provisions of section 2031(c) would appear to be trusts established by a landowner's will to which qualifying land is transferred by will, or trusts established during the landowner's lifetime taxable as part of his estate.

The post-mortem election provision provides important new estate planning and land conservation opportunities. It also raises many questions and possibly the need for supplemental legislation at the state level. In many states title to real property vests in the heirs as of the date of the decedent's death so the executor would have no authority over the property to grant a post-mortem easement. In those states where the executor does have authority over the decedent's real property, it may not be clear whether an executor or trustee can make a post-mortem charitable gift without specific authority provided in the landowner's will or trust document, or granted by probate court. Taking full advantage of this new tool will certainly require fast action by the family, which means even faster analysis and informed advice by the family's advisors.

VII. The Carryover Basis

Section 508(b) of TRA '97 also amends section 1014(a) of the code to provide that, to the extent of the section 2031(c) exclusion, land will have a carryover basis rather than a stepped-up basis. The "General Explanation" states "To the extent that the value of such land [land under easement] is excluded from the taxable estate, the basis of such land acquired at death is a carryover basis. . . ." This means that in some cases it will not be in the best financial interests of heirs for an estate to take advantage of the exclusion. Generally, the rationale for section 1014(a) is that Congress continues to believe that it is unfair to expose heirs to two taxes: the capital gains tax on the appreciation in the value of such assets over what the decedent had paid for them and the estate tax on assets passing through a decedent's estate. Following this logic Congress continues to believe that if an asset is not subject to estate tax it should not receive a stepped-up basis. For this reason section 1014(a) was amended to provide that "to the extent of the applicability of the exclusion described in section 2031(c)" land will have the basis it had in the hands of the decedent (i.e., the decedent's basis will be "carried over"). Note that the logic of Congress in imposing a carryover basis for the exclusion under section 2031(c) appears to be flawed by congressional inconsistency in allowing an exclusion from federal estate taxes for family-owned business assets under section 2033A and not imposing a carryover basis. Section 1014(a) was not amended in response to section 2033A's exclusion.

Example 3.

Assume that Mr. Smith made a qualifying easement donation prior to his death on land valued before the easement at $750,000. Assume that the easement reduced the value of the land he owned at his death by 30 percent and was therefore worth $225,000. Also assume that, at Mr. Smith's death, the land was still worth $750,000 and the improvements $250,000. As indicated above, normally the basis in the hands of Mr. Smith's heirs would be stepped up to $1 million. However, his executor elects to take the exclusion provided by section 2031(c). The exclusion applies to 40 percent of the value of the land remaining after subtracting the value of the easement. In this case the remainder value of the land would be $525,000 ($750,000 - $225,000). The exclusion allowed is $210,000 (40% x $525,000). This is 28 percent of the total value of the land ($210,000/$750,000). Mr. Smith's basis in the land (the carryover basis) is $5,000. Therefore, the portion of that basis applicable to the exclusion amount would be $1,400 (28% x $5,000). That portion of the land not subject to the exclusion would still receive a stepped-up basis of $540,000 ($750,000 x 72%). The total adjusted basis for the land is therefore $541,400 ($1,400 + $540,000). The improvements, which are not subject to the exclusion, receive a stepped-up basis of $250,000. Therefore, the total adjusted basis of the entire property (both land and improvements) is $791,000 ($541,000 + $250,000).

In this example, if the heirs choose to sell the property for $1 million they will pay capital gains tax on $208,600 ($1 million sales price - $791,400 basis). It is probable that the gain will be taxed at 20 percent under the new capital gains rate established by TRA '97, resulting in a total capital gains tax of $41,720. On the other hand, assume that Mr. Smith's estate was subject to a 37 percent estate tax rate (the lowest effective taxable rate). The additional estate tax, had Mr. Smith's executor not elected to take the exclusion, would have been $77,700 (37% x $210,000, the amount which could have been excluded). The savings to the heirs resulting from election of the section 2031(c) exclusion, even considering the carryover basis requirement, would be $35,980 ($77,700 - $41,720). If the estate tax rate applicable to the land were higher, the savings from electing the exclusion would be greater.

Except in a case where the estate owes no tax it will almost always make sense to elect the exclusion because the minimum effective estate tax rate is 37 percent while, with proper planning, the capital gains rate is likely to be 20 percent (and it could be lower for some taxpayers). However, because many estates holding land under easement may not be taxable, an executor has a choice under section 2031(c)(6) (see discussion of the election below) whether or not to elect the exclusion.

VIII. Enjoyment of Exclusion by Descendants

Section 2031(c)(8) provides that for an estate to take advantage of the exclusion the easement must have been donated by the decedent; a member of the decedent's family; the executor of the decedent's estate; or the trustee of a trust that holds the land. "Member of the decedent's family" is defined in subparagraph

2031(c)(8)(D) by reference to section 2032A(e)(2). This section defines "member of the family" as a decedent's spouse, ancestors, and lineal descendants of the decedent and spouse, and spouses of such lineal descendants. Because the easement may have been donated by an ancestor of the decedent, and because the limitation on the exclusion applies per estate rather than per property, it appears that the benefits of the exclusion may be passed from one generation to another.

Example 4.

Assume that Mr. Smith donates an easement that qualifies under sections 170(h) and 2031(c) and passes his land on to his daughter, Anne. Anne keeps the land and subsequently marries and has children and bequeaths the land to her children. They keep the land and pass it on to their children (Mr. Smith's great-grandchildren). The exclusion will be available to Mr. Smith's estate; to Anne's estate; to her children's estates; and to their children's estates. It does not matter whether the preceding estate took advantage of the exclusion, as long as the land remains in the family of the donor, the exclusion remains an option. In addition, each succeeding generation of owners may "subtract" the value of the easement from the land in valuing the estate for tax purposes (or, put another way, in each generation the appraisal of the land in the estate of the deceased landowner will properly take into account the restrictions imposed by the easement). However, if Anne were to sell the land to Mrs. Jones, only Mr. Smith's estate would get the benefit of the exclusion because Mrs. Jones is not a member of Mr. Smith's family (however, Mrs. Jones' executor could still "subtract" — take into account — the value of the easement in determining the value of the land for estate tax purposes).

The reason for allowing the exclusion to be passed from one generation to the next was to minimize pressure on heirs to sell off open space land. When the original version of what was to become section 2031(c) was first introduced in 1990, this point was addressed in testimony to the House Ways and Means Committee. As stated in the "General Explanation," "The Congress believed that a reduction in estate taxes for land subject to a qualified conservation easement would ease existing pressures to develop or sell off open spaces in order to raise funds to pay estate taxes, and would thereby help to preserve environmentally significant land."

IX. Retained Development Rights

Section 2031(c)(5) provides that the exclusion shall not apply to the value of any development rights retained under the easement agreement. Subparagraph 2031(c)(5)(D) defines development rights "as any right to use the land subject to the qualified conservation easement in which the right is retained for any commercial purpose not subordinate to and directly supportive of the use of such land as a farm for farming purposes within the meaning of section 2032A(e)(5) of the Internal Revenue Code." Section 2032A(e)(5) provides a broad definition of farming which includes growing crops (including fruit and vegetables); raising livestock; forestry and preparing timber for market (except for milling); the training and management of animals; as well as the "handling, drying, packing, or storing" of commodities at least 50 percent of which were produced on the farm.

Under this definition it would appear that retaining the right to maintain, or establish, a residence to be used by the landowner and associated improvements such as garages, barns, and guest houses (for the use of nonpaying guests), would not be considered development rights (the value of such structures are not eligible for the exclusion anyway because the exclusion applies only to land) since the mere right to live on the land would not be considered a commercial purpose. It would also appear that the right to establish housing for workers on the farm would be "subordinate to and directly supportive of the use of such land as a farm." Rights retained in the easement to sell portions of the land for development purposes, or to establish residential structures for rent or sale separately would, in all likelihood, be considered development rights.

Whether the retained right to divide land into farm-sized parcels (200 acres, for example), when the resulting parcels are restricted to farm use, would be considered a retained development right is not clear from the language of section 2031(c). Until regulations providing specific examples are adopted, or court decisions provide more elaboration, easement donors not intending to retain development rights would be wise to be conservative in drafting their easements.

Example 5.

Assume that Mr. Smith donates an easement on land valued at $1 million. Subject to the restrictions of the easement the land is worth $700,000. In the easement agreement Mr. Smith retains the right to create three new house sites which can be divided off from the land. These sites are considered "retained development rights" and have a value of $50,000 each. After Mr. Smith's death (assume no change in values from the date of donation of the easement), his executor calculates the exclusion by subtracting $150,000 (the value of the three retained development rights) from the $700,000 remainder value of the land. The resulting $550,000 is the base against which the exclusion is applied, resulting in an exclusion of $220,000 (40% x $550,000). The total value attributable to the easement and removed from the estate in this case is $520,000 ($300,000 + $220,000).

A. Termination of Retained Development Rights

Section 2031(c)(5)(B) allows heirs to save estate tax that would otherwise be due on retained development rights by agreeing to "terminate" some or all such rights within nine months of the decedent's death. This provision states that "if every person in being who has an interest (whether or not in possession) in the land" executes an agreement within nine months of the date of the decedent's death to terminate some or all of any retained development rights then the estate tax shall be "reduced accordingly." The agreement must be implemented (presumably by an amendment to the easement or a new easement) within two years of the decedent's death or an "additional tax" will be imposed. The ability to terminate development rights provides heirs of a landowner who chooses to retain some development rights with a second look at the desirability of keeping those rights. It also provides an easement donor with the opportunity to donate an easement which gives heirs important post-mortem estate planning opportunities.

Section 2031(c)(5)(B) provides that if an agreement is made permanently to extinguish retained development rights "then any tax imposed by section 2001 shall be reduced accordingly." This provision appears to allow the estate to recalculate the estate tax as though such rights had never been retained in the easement agreement. This would increase the value of the easement and therefore the tax savings resulting from subtracting the increased easement value from the land included in the estate.

Example 6.

In the previous example, where Mr. Smith retained three development rights in his easement, the total value removed from the estate was \$520,000. If Mr. Smith's heirs terminate the rights retained in the easement the value of the easement will increase to \$450,000 (\$300,000, the value of the original easement, plus \$150,000, the value of the development rights terminated by the heirs) resulting in a remainder value of \$550,000 and an exclusion of \$220,000. The total value removed from the estate due to the easement in such a case would be \$670,000 (\$450,000 plus the exclusion amount of \$220,000).[19]

Were the phrase "reduced accordingly" to be interpreted to mean that, for purposes of calculating estate taxes, only the value of the exclusion is affected by terminating retained development rights rather than the value of the land subject to the easement, the exclusion would be calculated on the unadjusted remainder value of \$700,000, resulting in an exclusion of \$280,000. The total value removed from the estate under such an interpretation would be \$580,000. This approach, however, would provide a less compelling incentive for the termination of retained development rights.

Section 2031(c)(5)(C) provides that failure to implement the agreement within two years of the decedent's death or the sale of the property, whichever occurs first, triggers an additional tax equal to the amount of tax which would have been due on the retained development rights had there been no agreement. The tax is payable six months following such date.

No reference is made to payment of interest on the additional tax. Because the provision treats the amount due as an "additional tax" rather than recapture of tax already due, it is arguable that no interest will be collectible, provided that the additional tax is paid in a timely fashion.

Strangely, neither the Finance and Conference Committee reports nor the "General Explanation" discuss the termination of retained development rights. All three reports merely point out that the provision allows a deferral of tax on retained development rights. The "General Explanation" states "The exclusion from estate taxes does not extend to the value of any development rights retained by the decedent or donor, although payment for estate taxes on retained development rights may be deferred for up to two years, or until the disposition of the property, whichever is earlier."

State law will determine who is included in the phrase "every person in being who has an interest (whether or not in possession) in the land." Presumably all heirs of the land must agree, and possibly creditors where it is not clear whether the land must be sold to pay debts of the estate.

A caution about the retention of development rights is necessary. Because heirs have an opportunity to terminate retained development rights landowners may be tempted to retain substantial development rights in an easement to maximize their heirs' flexibility in post-mortem planning. This tactic runs three significant risks from a taxation standpoint. First (as discussed below), the easement must comply with the terms of section 170(h), which prohibits the retention of substantial development potential in the easement. This is not a valuation issue but a qualification issue. If the rights retained in the easement are so substantial as to conflict with the conservation purpose of the easement the easement may not qualify for any tax benefits, although the donor (and succeeding owners) will still have to comply with the restrictions of the easement. Termination of retained development rights will probably not cure this threshold issue as failure to meet section 170(h) requirements at the time the easement was donated would probably keep the door closed to any tax benefits.

Second, the greater the value of the rights retained in the easement the smaller the value of the easement and, correspondingly, the value of the subtraction from the estate attributable thereto.

Third, if the retained rights reduce the value of the easement so that it fails to meet the 30 percent threshold (discussed below), the value of the exclusion will be reduced. It is not clear that extinguishing retained rights after the landowner dies will cure the problem, or that a post-mortem easement amendment by the executor will cure the problem.

A separate issue is whether the termination of retained development rights by heirs gives the heirs an income tax deduction for the value of the rights terminated. The answer may turn on two points. First, is the termination of retained development rights the conveyance of a "qualified conservation contribution" as defined in section 170(h); specifically, does the ter-

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[19]Technically, the value of the easement may not actually increase by the full \$50,000 per-lot value. If a buildable house lot is worth, say, \$50,000, that same lot without building rights may be worth, say, \$5,000. Put another way, extinguishing a "development right" may not eliminate all land value from the estate.

mination meet one of the conservation purposes identified in this section? This is a factual question that will depend on the individual circumstances of the easement and land to which it pertains. The second point depends on ownership of the land at the time the retained rights are terminated. If title in the land is held by the decedent's estate it is doubtful that heirs could claim an income tax deduction, although the estate may take a deduction against its own income. If title has actually vested in the heirs (as automatically happens on a landowner's death under the laws of some states), then it would seem that the heirs would be eligible to take individual income tax deductions for the value of the rights terminated.

X. Retained Commercial Recreational Use Rights

Section 2031(c)(8)(B) provides that to qualify for the exclusion a conservation easement "... shall include a prohibition on more than a *de minimis* use for a commercial recreational activity." This provision was intended to prevent easements allowing the establishment of major commercial recreational uses such as public golf courses or ski resorts from qualifying for section 2031(c) benefits.[20] However, the exception for *de minimis* uses provides little guidance as to what commercial recreational uses are permitted.

> ***Given the current state of the law, it would be advisable in drafting easements to include a provision prohibiting all but de minimis commercial recreational activity.***

The parent legislation to section 2031(c) (S. 499 and H.R. 195) expressly provided that retaining the right to lease land for hunting and fishing was a permitted exception to the prohibition against commercial recreational activity. Hunting and fishing leases are a very important addition to many farming and ranching operations, particularly in the South and the West. Such leases encourage habitat protection and wildlife management which are beneficial to both land and wildlife. Therefore, the deletion of the exception and substitution of the phrase "*de minimis*" is of considerable concern.

The Conference Committee report and the "General Explanation" both attempt to reinstate the exception provided in the parent legislation for hunting and fishing leases as being within the meaning of *de minimis*. Both contain identical statements: "*de minimis* commercial recreational activity that is consistent with the conservation purpose, such as the granting of hunting and fishing licenses, will not cause the property to fail to qualify" for the exclusion. Both reports state that it is anticipated that the Secretary of the Treasury will provide further guidance as to the definition of *de minimis* activities.

Early clarification of the meaning of this provision is needed to guide those drafting new easements. This could take the form of a regulatory clarification or legislative amendment (which may provide an earlier opportunity) that the granting, sale, or leasing of hunting and fishing licenses or rights will not cause the land to fail to qualify for the exclusion so long as recreational hunting and fishing is not inconsistent with the conservation purpose of the easement.

Given the current state of the law, it would be advisable in drafting easements to include a provision prohibiting all but *de minimis* commercial recreational activity.

Clarification is also needed because thousands of existing easements were drafted with no knowledge that an express prohibition of this nature could be necessary some day, even though the easement, when taking all of its provisions together, may not allow commercial recreational activity. Guidance is needed as to whether these easements must all be amended to include this express prohibition. It would be reasonable to construe this provision to allow existing easements that do not by their terms expressly allow more than *de minimis* commercial recreational activity to qualify for the exclusion.

An alternative would be to clarify that a post-mortem easement (or easement amendment) permitted by the legislation can supply the requisite prohibition. As noted above, although it is reasonable to assume this is permitted by section 2031(c) (and it is understood that the Joint Committee staff agrees) because local law may not clearly provide for charitable gifts by executors, the "post-mortem cure" may be difficult to obtain.

XI. The 30 Percent Threshold

Section 2031(c)(2) provides that to enjoy the full benefit of the exclusion, the easement must reduce the value of the land by at least 30 percent. For every percentage point by which the easement falls short of that threshold the exclusion is reduced by 2 percentage points. Thus, an easement reducing the value of land by 25 percent would support only a 30 percent exclusion under section 2031(c). Easements resulting in more than a 30 percent reduction in value will not increase the amount of the exclusion beyond 40 percent, however.

There is no reported legislative history behind the 30 percent threshold. It appeared in none of the legislative proposals that ultimately led to section 2031(c). The provision appeared as part of the Balanced Budget Act of 1995 after the Finance Committee approved what ultimately became section 2031(c) in 1997, but before final congressional action on the Balanced Budget Act. It was not included in either the House or Senate versions of the American Farm and Ranch Protection Act introduced in 1997, nor in any of the predecessors to this act. It appears that the intent was

[20] *See* section 170(h)(4)(A)(i), under which an easement "for the preservation of land areas for outdoor recreation by, or the education of, the general public" may meet one of the "conservation purposes" tests.

to ensure that only "meaningful easements" would qualify for the exclusion. This was an issue raised by Treasury officials (during Finance Committee mark-up of the 1995 Balanced Budget Act) who were concerned that easements might be donated that only minimally affected property values but still qualified the donor's estate for the section 2031(c) exclusion. Long-standing provisions of section 170(h) and the underlying regulations requiring that easements confer a significant public benefit to qualify for tax benefits already appear to address this concern adequately. Furthermore, Treasury's ability to scrutinize estate returns would appear to provide amply for the policing of abuses. Nevertheless, the threshold requirement was included.

> ***The 30 percent threshold may penalize the owners of land having wetlands regulated under section 404 of the Clean Water Act or providing habitat to endangered species under the Endangered Species Act.***

The 30 percent threshold may actually penalize the owners of land having wetlands regulated under section 404 of the Clean Water Act or providing habitat to endangered species under the provisions of the Endangered Species Act. This is because the existence of those conditions triggers federal regulation that may reduce the value of land to such an extent that a conservation easement will have only a negligible effect on its value. If that occurs it is likely that the requirement that the easement reduce the value of the land by at least 30 percent for the donor to enjoy the full 40 percent exclusion may deny the donor of an easement on federally regulated land any meaningful benefit under the new law. For the same reason an easement on such land may not result in any other significant tax benefits.

This problem was addressed in general terms by legislation introduced during negotiations on TRA '97 by Sen. Dirk Kempthorne, R-Idaho. The proposal, S. 949, would have allowed donors of easements on regulated wetlands or endangered species habitat an "enhanced deduction based upon the full market value of their property" (description of the proposal by Sen. Kempthorne during Senate debate on TRA '97). While the floor manager (Sen. William V. Roth Jr., R-Del.) agreed to work with Sen. Kempthorne on the issue during the negotiations of the Conference Committee nothing appears to have resulted.

Valuing easements for purposes of determining compliance with the 30 percent threshold may be problematic. The exact language of section 2031(c)(2) requires that the 40 percent exclusion be "reduced by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land (determined without regard to the value of the easement) and reduced by the value of any retained development right. . . ."

This language would appear to require the following valuation process. First, the value of the easement is determined by the appraiser. This requires the standard determination of the value of the land before the easement and after the easement.[21] The difference is the value of the easement. Second, the value of development rights retained in the easement is determined by the appraiser. Third, the appraiser subtracts the value of retained development rights from the pre-easement value of the land (already determined). Finally, the value of the easement as determined in step one is divided by the adjusted value of the land as determined in step three. For each percentage point by which this percentage fails to meet the 30 percent threshold, two percentage points are deducted from the 40 percent exclusion.

To avoid imposing a double penalty upon retained development rights (which are fully taxed as discussed above), section 2031(c)(2) requires that the value of retained rights be subtracted from the value of the land before calculating the percentage of the land's value represented by the easement. However, some have argued that subtracting the value of retained development rights in this calculation makes it easier to meet the 30 percent threshold and therefore creates an incentive for easement donors to maximize the number of retained development rights in the easement.

Example 7.

Mrs. Green donates an easement on her farmland. In step one her appraiser determines that the fair market value of the land before the easement is in place is $1 million. The appraiser also determines that the after-easement value of the land is $800,000. If the analysis stopped here, the section 2031(c) exclusion would be 20 percent of $800,000 (40% reduced by 10 times 2). However, Mrs. Green has retained the right to sell two house lots. In the second step the appraiser determines the value of the house lots (which are deemed retained development rights) to be $50,000 each. In the third step the appraiser subtracts the value of the retained development rights from the pre-easement value of the land resulting in a value of $900,000 ($1 million - $100,000). In the final step, the appraiser divides the value of the easement by the original value of the land reduced by the value of the retained development rights ($200,000/$900,000). This yields an adjusted percentage value of the easement of 22.22 percent for purposes of determining compliance with the 30 percent threshold. In fact, the percentage reduction in the value of the land thus determined falls below the 30 percent threshold by 7.78 percentage points (which the statute requires be rounded to 8). The section 2031(c) exclusion available therefore is only 24 percent (40% - (2 x 8%)).

In this example, the retained development rights added 2 percentage points to the adjusted percentage

[21] *Supra* note 1.

value of the easement increasing the exclusion available by 4 percent from 20 to 24 percent. This adjustment allows the exclusion of an additional $32,000 (worth $17,600 in tax savings for a 55 percent bracket estate). However, these retained development rights also reduced the value of the easement for all other tax purposes and added $100,000 in taxable wealth to the decedent's estate. These consequences significantly outweigh the additional 4 percentage points added to the exclusion.

The fact that land has historic value does not disqualify it from the benefits of the exclusion if it meets one of the other 'conservation purposes' tests of section 170(h).

Several questions must be answered before the calculation required in section 2031(c)(2) can be made. First, are the values to be those determined as of the date of the donation of the easement, or as of the date of the decedent's death (or on the alternate valuation date)? The language of section 2031(c)(2) suggests that the valuation is to be done at date of the decedent's death as opposed to the date of donation. The section provides that the exclusion shall be reduced in response to the amount "by which the value of the qualified conservation easement *is* less than 30 percent of the value of the land" (emphasis supplied). "Is" strongly suggests that determination of compliance with the threshold be contemporaneous with valuation of the land in the estate, not the date of donation. This means that a determination of compliance with the 30 percent threshold will have to be undertaken repeatedly if the land passes from one generation to another (remember that the exclusion is available to each succeeding generation in the line of descent from the original donor).

The requirement for repeated determinations of compliance with the 30 percent threshold will complicate the task of executors and increase administrative costs (both for decedents' estates and for the IRS) compared to making the determination only once on the date of the donation of the easement. In addition, requiring a redetermination of compliance with the 30 percent threshold in each successive estate makes the estate tax benefits less certain for donors, a factor that may decrease the incentive intended by Congress. The point at which a determination of compliance with the 30 percent threshold would be most likely to effectuate the intent of the provision (ensuring that only meaningful easements will be eligible for the exclusion) is when the easement is being negotiated by the donor. Valuations determined at this point will give the donor the greatest incentive to write the kind of meaningful easement Congress intended. Determining compliance with the 30 percent threshold long after the donation will serve only to penalize heirs rather than furthering the incentive to donate meaningful easements.

A second question relating to compliance with the 30 percent threshold is whether provisions of section 2031(c)(5)(B) permitting termination of retained development rights, with a resulting increase in the value of the easement is to be taken into account in determining compliance with the 30 percent threshold. Section 2031(c)(5)(B) provides that if retained development rights are terminated "any tax imposed by section 2001 shall be reduced accordingly." This language suggests that in determining the tax on the estate the executor should calculate the tax as though terminated development rights had never been retained in the easement. This would lead to the conclusion that the easement should be valued for purposes of the 30 percent threshold as though the terminated rights had not been retained by the donor. Supporting the position that the termination of retained rights should affect both the value of the easement and the amount of the exclusion for computing estate tax due is the fact that Congress could have drafted section 2031(c)(5)(B) to state that "the exclusion shall be determined as though such development rights had not been retained" or some equally narrow formulation. Instead Congress chose very comprehensive language: "*any tax imposed by section 2001*" (emphasis supplied).

XII. Geographic Limitations

Section 2031(c)(8)(A)(i) provides that for land to be eligible for the exclusion on the date of the decedent's death it must be in or within a 25 mile radius of a metropolitan statistical area (MSA), national park, national wilderness area, or in or within 10 miles of an "urban national forest" as designated by the U.S. Forest Service. The Office of Management and Budget, in conjunction with the Department of Commerce, maintains maps of MSAs. MSAs are based on urbanized areas with a population of 50,000 people or more. However, in most parts of the country MSAs encompass the entire county (or counties, or in some states town or towns) within which the urbanized area lies, even though much of the county is well outside the urbanized area. Section 2031(c) covers all such land, plus land lying within 25 miles of the outside boundary of the MSA. In addition, as urbanized areas continue to emerge and grow MSA maps are updated to reflect this change so that areas not now covered by section 2031(c) may be in the future as urban development continues.

Section 2031(c)(8)(A)(i)(II) provides that if land is qualified because of its proximity to a national park or wilderness area the Secretary of the Treasury may disqualify the land from eligibility for the exclusion by making a determination that the land is not under "significant development pressure." It seems clear that until such a determination is made land remains eligible for the exclusion. It is not clear by what process a determination will be made, and once made, how it will apply.

This analysis leads to the following question: if a conservation easement that would otherwise qualify is donated before a determination is made that the land is not under significant development pressure, does a subsequent determination disqualify the estate from electing the exclusion? It would make the consequences of easement donation much more predictable if the disqualification only operated if the determination was in place at the time of the donation. Predictability will strengthen the incentive for easement donation and better promote the intention of Congress to enhance the incentive for voluntary land conservation.

Determining the qualification of easements as of the date of the donation would also protect the family of the donor more effectively. As discussed above, one of the provisions of the new law is specifically intended to ensure that each succeeding generation in the family of the donor will be entitled to the benefits of the exclusion so that the donation of an easement will not disadvantage their heirs in the payment of estate taxes on easement restricted land. Allowing a determination by the Secretary to disqualify land from the benefit of the exclusion after the easement has been donated would thwart this intention.

It would be simple, fair, and in furtherance of congressional intent for the Secretary of the Treasury to make such determinations subject to notice and hearing and to provide that such determinations only apply to easements donated after the date of such notice. Given the spread of urban development in the United States it is logical to presume that determinations that land is not under significant development pressure may be rescinded in the future. Such rescissions should be effective when made, both for easements donated thereafter and for the estates of decedents dying thereafter.

Early versions of the legislation (e.g., S. 2957, the Open Space Preservation Act introduced by Sen. Chafee during the 102d Congress) contained no geographic limitations. S. 1013 (another Chafee bill, the Rural Land Conservation Act introduced in the 103d Congress) provided coverage only for land in or within 50 miles of a metropolitan statistical area or national park. S. 910, the American Farm and Ranch Protection Act introduced first in the 104th Congress, added coverage for wilderness areas designated as part of the National Wilderness Preservation System. It is understood that the reference to the National Wilderness Preservation System resulted from congressional staff concern that a mere reference to wilderness areas could be interpreted to include wilderness areas designated by states.

The reference in section 2031(c)(8)(A)(i)(II) to "national parks" would appear, in light of the provisions of 16 U.S.C. 1c, to include all units within the national park system. 16 U.S.C. 1c provides, in pertinent part "... the various authorities relating to the administration and protection of areas under the administration of the Secretary of the Interior through the National Park Service, including but not limited to the Act of August 25, 1916 ..., shall, to the extent such provisions are not in conflict with any such specific provision, be applicable to all areas within the national park system and any reference in such Act to national parks, monuments, recreation areas, historic monuments or parkways shall hereinafter not be construed as limiting such Acts to those areas."

If 16 U.S.C. 1c governs section 2031(c), then areas designated as national parks, national monuments, national preserves, national historic sites, national historic parks, national memorials, national battlefields, national cemeteries, national recreation areas, national seashores, national lakeshores, national rivers, national parkways, national trails, and other units of the park system should all be eligible for the section 2031(c) exclusion. Notwithstanding this provision, however, it is understood that the estimate of the revenue impact of the exclusion assumed that only those units of the national park system designated as "national parks" were eligible for the new benefit.

Urban forests are, in most cases, already included within areas covered due to proximity to an MSA. Urban forests are confined to those named on a specific list maintained by the U.S. Forest Service, and there are only a few forests listed.[22] Land eligible for the section 2031(c) exclusion is limited to that lying in or within 10 miles of a designated forest. However, such land is not subject to the proviso that it may be disqualified if the Secretary of the Treasury determines that it is not under significant development pressure. There appear to be no policy reasons for the distinctions between the different categories of land areas qualified for the exclusion.

XIII. Compliance With Section 170(h)

As noted above, section 2031(c)(8)(B) defines "qualified conservation easement" in terms of a "qualified conservation contribution" of a "qualified real property interest" the donation of which meets a "conservation purposes test" as those terms are defined in section 170(h). This means that the easement must be permanent; it must be donated; and it must be held by a qualified land conservation organization or governmental agency. In addition, land protected must have publicly significant environmental or scenic value; provide important wildlife habitat; or be open space the conservation of which furthers a "clearly delineated governmental policy."

Section 2031(c)(8)(B) provides, however, that "clause (iv) of section 170(h)(4)(A) shall not apply" in determining whether land is a "qualified real property interest." This means that land which meets a "conservation purposes" test solely because it is historic will not be eligible for the exclusion provided by section 2031(c). While there was an intention to disqualify historic structures for the exclusion (the exclusion is sup-

[22]Urban forests included, as of August 1997, the following: the Arapaho and Roosevelt National Forest near Fort Collins, Colo.; the Pike & San Isabel National Forest near Pueblo, Colo.; the Wasatch-Cache National Forest near Salt Lake City, Utah; the Uinta National Forest near Provo, Utah; the White Mountain National Forest near Laconia, N.H.; the Tonto National Forest near Phoenix, Ariz.; the Angeles National Forest near Arcadia, Calif.; the Cleveland National Forest near San Diego, Calif.; the Los Padres National Forest near Goleta, Calif.; the San Bernardino National Forest near San Bernardino, Calif.; the Chattahoochee-Oconee National Forest near Gainesville, Ga.; the Mount Baker-Snoqualmie National Forest near Mountlake Terrace, Wash.; the Mount Hood National Forest near Gresham, Ore.; and the Gifford Pinchot National Forest near Vancouver, Wash.

posed to apply to land only), dropping the entire category of real property, both land and structures, covered by clause (iv) was simply a drafting error in the 1995 legislation that became part of the Balanced Budget Act of 1995 and that was carried over by Finance Committee action into TRA '97. Once this language became part of the revenue estimate for the proposal it could not be corrected without deferring consideration beyond action on the TRA '97. However, the fact that land has historic value does not disqualify it from the benefits of the exclusion if it meets one of the other "conservation purposes" tests of section 170(h).

Conservation easements that apply to structures, as opposed to land only, may generate income tax deductions under section 170(h) and the value of such a restriction may be subtracted from a decedent's estate in computing estate taxes. However, section 2031(c)(1)(A) limits the exclusion to the value of land only, not structures.

For example, the owner of a 500-acre farm on which is located an historically significant manor house can donate an *inter vivos* easement protecting the house as historically significant under section 170(h), and a separate easement on the land. Assuming that both easements comply with section 170(h), the landowner would be able to take an income tax deduction for the value of both easements; the estate would be subject to tax on the reduced value resulting from easements on both the land and the house; and, assuming that the easement on the land complies with the other provisions of section 2031(c), the estate would be able take advantage of the 40 percent exclusion on the remainder value of the land under easement. The easement on the house would be disqualified from the exclusion. This is both because the house is a structure, and because, on these facts, the easement qualifies under section 170(h) solely because it protects an historic structure. In this example the landowner has provided separate easements for the house and the land. This may be prudent planning, not only because the objectives of the two easements are quite different, but also to clarify that the land easement stands on its own for purposes of qualifying for the exclusion of section 2031(c). However, there is nothing in the new law that dictates that separate easements be used for this type of situation.

XIV. Miscellaneous Provisions

A. Three-Year Holding Period

Section 2031(c)(8)(A)(ii) requires that the decedent, or a member of the decedent's immediate family, own the land with respect to which an exclusion is elected "at all times during the three year period ending on the date of the decedent's death." This provision would appear to allow periods of ownership of less than three years by the decedent and family members to be tacked together in order to make up the requisite three-year period.

Section 2031(c)(9) allows the exclusion to apply to interests in land held by partnerships, corporations, or trusts provided that at least 30 percent of such entity is owned by the decedent at his death. The combined effect of the three-year holding provision and the provisions regarding interests in partnerships, corporations, and trusts would appear to be that if ownership for the requisite three-year period is through the vehicle of such an entity it will qualify for the exclusion. Disqualifying land because it was held by such an entity prior to the decedent's death would clearly frustrate the purpose of section 2031(c)(9). The "General Explanation" supports this view by characterizing the provision qualifying land held by such entities as a "look-through" provision.

B. Acquisition Indebtedness Limitation

Section 2031(c)(4) provides that the exclusion shall not apply to the extent that the land is "debt-financed property." Debt-financed property is any property with respect to which there is "acquisition indebtedness" outstanding at the time of decedent's death. Acquisition indebtedness is debt incurred by the donor in acquiring the property; debt incurred before the acquisition of the property if such debt would not have been incurred but for such acquisition; debt incurred after the property was acquired if such debt would not have been incurred but for the acquisition "and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition; and the extension, renewal or refinancing of such debt." Because such debt is deductible from the estate Congress wanted to avoid the "double-dipping" that could occur if an exclusion were allowed on land acquired with the proceeds of a loan outstanding at the time of the decedent's death.

Example 8.

Assume that Mr. Smith borrows $500,000 to acquire 500 acres of land. He pays down the debt by $50,000 over the next four years and dies after placing a qualifying easement on the land. At his death the value of the land unrestricted is $1 million, the easement value is $300,000, and the restricted value is $700,000. There are no retained development rights. To determine the amount of exclusion available the executor would deduct the outstanding debt of $450,000 from the restricted value of $700,000. The resulting $250,000 is eligible for the exclusion. In this example the exclusion amount would be $100,000 (40% x $250,000).

C. Land Held by P'ships, Corporations, and Trusts

As discussed above, section 2031(c)(9) provides that the exclusion is available for land held by partnerships, corporations, or trusts, provided that the decedent owned at least a 30 percent interest (directly or indirectly) in such entity at his death. This provision incorporates the new "Rules Regarding Ownership" of section 2033A(e)(3), the family-owned business exclusion, which describes how ownership in corporations, partnerships, and "tiered entities" shall be determined. Section 2031(c)(9) is important because a growing number of family landholdings are held through such entities for tax and estate planning purposes. While the land itself would not be an asset of the estate in such cases, the value of the interest in the entity holding the land would be. This provision ensures that if the entity donates a qualifying easement (or acquires land already subject to a qualifying easement), the benefit of the exclusion (to the extent of the decedent's ownership interest in the entity) will be available to his estate.

In dealing with the kinds of long-term gifting programs that frequently utilize family partnerships, etc., it is important to remember that the exclusion provided by section 2031(c) does not apply to the gift tax.

D. Exclusion Must Be Elected

The exclusion is not automatic. The executor may elect to claim the exclusion; section 2031(c)(6) provides that the election is made on the estate tax return. Because of the carryover basis rule (see discussion above) it may not be advantageous for every estate to take the exclusion. Of course, an election opens the door for mistakes where executors or their advisors are ignorant of the availability of the exclusion and fail to make the election, or make it improperly.

XV. Unrelated Provisions

In addition to the exclusion, section 508 of TRA '97 provides two additional benefits related to easement donation.

A. Special Farm Valuation Under Section 2032A

The Internal Revenue Service has ruled that when an election to value a family farm under section 2032A had been made the subsequent donation of a conservation easement constituted a "disposition" within the meaning of the section triggering liability for payment of additional estate taxes.[23] Although as a policy matter the donation of an easement was perfectly consistent with the intent of section 2032A (in part the preservation of family farms), the IRS had asserted that the technical definition of the term "disposition" in section 2032A included an easement donation. Section 508(c) of TRA '97 cures this problem by amending section 2032A so that it is clear that an easement donation is not a disposition.

B. Separation of Surface and Mineral Rights

Section 170(h)(5)(B)(ii) generally denied income tax deductions for the donation of easements on land where the mineral rights had been separated from the surface rights so as to allow surface mining, unless the severance of the mineral rights had occurred prior to June 13, 1976, and the probability of surface mining on the property was "so remote as to be negligible."[24] Section 508(d) of TRA '97 deletes the reference to 1976 so that the date on which the mineral rights were severed is no longer relevant to the deductibility of the easement. It is still necessary that the probability of surface mining on the property be so remote as to be negligible, however.

XVI. Relationship to Other New Provisions

TRA '97 includes two other provisions of particular significance for rural landowners. One is the increase in the unified credit against the estate tax that, until last year, sheltered the first $600,000 of estate assets from tax. Section 501 of TRA '97 amends section 2010 to increase the unified credit over seven years so that by 2006 it will shelter a total of $1 million in estate assets.

In addition, section 502 of TRA '97 adds new section 2033A to the code. Section 2033A provides a new exclusion for family-owned businesses, including family farms (see the discussion by Professor Kasner in the October 13, 1997 edition of *Tax Notes* on page 209). The exclusion amounts to $700,000 in 1998; however, it is phased down over the next seven years to $300,000, coordinated with the phase-in of the increase in the unified credit. The net effect is that by combining the unified credit and the new family-owned business exclusion owners of qualified businesses will be able to shelter $1.3 million in assets beginning in 1998. However, the effect of combining these two benefits will remain level rather than increasing with the phase-in of the unified credit. A provision of the technical corrections bill to TRA '97 ensures that estates qualifying for the family-owned business exclusion will not suffer an increase in estate tax as the unified credit (which provides a benefit at the estate's lowest tax brackets) is increased while the family-owned business exclusion (which provides a benefit at the estate's highest tax brackets) is reduced.

Section 2031(c) provides an important new opportunity for landowners and for the permanent conservation of land.

The requirements to qualify for the new exclusion provided by section 2033A are virtually identical to the requirements to qualify for special use valuation for farms under section 2032A. The most important of these requirements are that more than 50 percent of the decedent's assets must be made up of the qualifying business; the decedent or immediate family must have actively operated the business for five of the preceding eight years; and a member of the immediate family must agree to continue to operate the business for at least 10 years after the decedent's death.

What is particularly important is that these three new benefits, the increased unified credit, the family-owned business exclusion, and the exclusion for the value of land subject to a qualified conservation easement, can be layered on top of one another. In addition, the use value provisions of section 2032A can also be added, and because the criteria for qualifying for the family-owned business exclusion are essentially the same as those for qualifying for section 2032A use valuation, most family farms qualifying for one can qualify for both.

In comparing the provisions of sections 2033A and 2031(c) it is clear that the owners of substantial rural land who live within the geographic coverage of section 2031(c) will find it easier to qualify for the estate tax benefits associated with conservation easements than will the owners of substantial rural land trying to qualify for the estate tax benefits provided by the new family-owned business exclusion of section 2033A. In addition, when fully phased in, the tax benefits provided by section 2031(c) will be much more substantial than those available under section 2033A.

[23] LTR 8731001, *87 TNT 149-67*.

[24] LTR 9632003.

XVII. Conclusion

Section 2031(c) provides an important new opportunity for landowners and for the permanent conservation of land. There is much not yet known about these new rules and how Treasury will interpret them. While it is still arguable that no one should donate a conservation easement for the simple joy of the federal tax relief, for the families of easement donors willing to travel the straight and somewhat narrow road laid out by section 2031(c), the federal tax benefits can be substantial.

Document 1 of 12

Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS

ARTICLE 30.5
CONSERVATION EASEMENTS

Law reviews: For article, "Conservation Easements: A General Practitioner's Overview", see 19 Colo. Law. 221 (1990); for comment, "Open Space Procurement Under Colorado's Scenic Easement Law", see 60 U. Colo. L. Rev. 383 (1989).

Section

Document 2 of 12

Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS/38-30.5-101. Legislative intent.

38-30.5-101. Legislative intent.

The general assembly finds and declares that it is in the public interest to define conservation easements in gross, since such easements have not been defined by the judiciary. Further, the general assembly finds and declares that it is in the public interest to determine who may receive such easements and for what purpose such easements may be received.

Source: L. 76: Entire article added, p. 750, § 1, effective July 1.

Document 3 of 12

Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS/38-30.5-102. Conservation easement in gross.

38-30.5-102. Conservation easement in gross.

"Conservation easement in gross", for the purposes of this article, means a right in the owner of the easement to prohibit or require a limitation upon or an obligation to perform acts on or with respect to a land or water area, airspace above the land or water, or water rights beneficially used upon that land or water area, owned by the grantor appropriate to the retaining or maintaining of such land, water, airspace, or water rights, including improvements, predominantly in a natural, scenic, or open condition, or for wildlife habitat, or for agricultural, horticultural, wetlands, recreational, forest, or other use or condition consistent with the protection of open land, environmental quality or life-sustaining ecological diversity, or appropriate to the conservation and preservation of buildings, sites, or structures having historical, architectural, or cultural interest or value.

Source: L. 76: Entire article added, p. 750, § 1, effective July 1. **L. 2003:** Entire section amended, p. 990, § 1, effective August 6.

Editor's note: This section was contained in a 2003 act that was passed without a safety clause. For further explanation concerning the effective date, see page vii of this volume.

ANNOTATION

Law reviews. For article, "Protecting Open Space and Wildlife Habitat Under Colorado Law", see 24 Colo. Law. 2729 (1995).

Document 4 of 12

Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS/38-30.5-103. Nature of conservation easements in gross.

38-30.5-103. Nature of conservation easements in gross.

(1) A conservation easement in gross is an interest in real property freely transferable in whole or in part for the purposes stated in section 38-30.5-102 and transferable by any lawful method for the transfer of interests in real property in this state.

(2) A conservation easement in gross shall not be deemed personal in nature and shall constitute interest in real property notwithstanding that it may be negative in character.

(3) A conservation easement in gross shall be perpetual unless otherwise stated in the instrument creating it.

(4) The particular characteristics of a conservation easement in gross shall be those granted or specified in the instrument creating the easement.

(5) A conservation easement in gross that encumbers water or a water right as permitted by section 38-30.5-104 (1) may be created only by the voluntary act of the owner of the water or water right and may be made revocable by the instrument creating it.

Source: L. 76: Entire article added, p. 751, § 1, effective July 1. **L. 2003:** (5) added, p. 990, § 2, effective August 6.

Editor's note: Subsection (5) was contained in a 2003 act that was passed without a safety clause. For further explanation concerning the effective date, see page vii of this volume.

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Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS/38-30.5-104. Creation of conservation easements in gross.

38-30.5-104. Creation of conservation easements in gross.

(1) A conservation easement in gross may only be created by the record owners of the surface of the land and, if applicable, owners of the water or water rights beneficially used thereon by a deed or other instrument of conveyance specifically stating the intention of the grantor to create such an easement under this article.

(2) A conservation easement in gross may only be created through a grant to or a reservation by a governmental entity or a grant to or a reservation by a charitable organization exempt under section 501 (c) (3) of the federal "Internal Revenue Code of 1986", as amended, which organization was created at least two years prior to receipt of the conservation easement.

(3) Repealed.

(4) Conservation easements relating to historical, architectural, or cultural significance may only be applied to buildings, sites, or structures which have been listed in the national register of historic places or the state register of historic properties, which have been designated as a landmark by a local government or landmarks commission under the provisions of the ordinances of the locality involved, or which are listed as contributing building sites or structures within a national, state, or locally designated historic district.

(5) If a water right is represented by shares in a mutual ditch or reservoir company, a conservation

easement in gross that encumbers the water right may be created or revoked only after sixty days' notice and in accordance with the applicable requirements of the mutual ditch or reservoir company, including, but not limited to, its articles of incorporation and bylaws as amended from time to time.

Source: L. 76: Entire article added, p. 751, § 1, effective July 1. **L. 85:** (3) repealed and (4) amended, p. 1203, §§ 3, 1, effective July 1. **L. 99:** (2) amended, p. 632, § 49, effective August 4. **L. 2003:** (1) amended and (5) added, p. 991, § 3, effective August 6; (2) amended, p. 1022, § 1, effective August 6.

Editor's note: (1) Subsections (1) and (5) were contained in a 2003 act that was passed without a safety clause. For further explanation concerning the effective date, see page vii of this volume.

(2) Section 2 of chapter 142, Session Laws of Colorado 2003, provides that the act amending subsection (2) applies to conservation easements created prior to, on, or after August 6, 2003. The act was passed without a safety clause. For an explanation concerning the effective date, see page vii of this volume.

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Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS/38-30.5-105. Residual estate.

38-30.5-105. Residual estate.

All interests not transferred and conveyed by the instrument creating the easement shall remain in the grantor of the easement, including the right to engage in all uses of the lands or water or water rights affected by the easement that are not inconsistent with the easement or prohibited by the easement or by law.

Source: L. 76: Entire article added, p. 751, § 1, effective July 1. **L. 2003:** Entire section amended, p. 991, § 4, effective August 6.

Editor's note: This section was contained in a 2003 act that was passed without a safety clause. For further explanation concerning the effective date, see page vii of this volume.

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Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS/38-30.5-106. Recordation upon public records.

38-30.5-106. Recordation upon public records.

Instruments creating, assigning, or otherwise transferring conservation easements in gross must be recorded upon the public records affecting the ownership of real property in order to be valid and shall be subject in all respects to the laws relating to such recordation.

Source: L. 76: Entire article added, p. 751, § 1, effective July 1.

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Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS/38-30.5-107. Release - termination.

38-30.5-107. Release - termination.

Conservation easements in gross may, in whole or in part, be released, terminated, extinguished, or abandoned by merger with the underlying fee interest in the servient land or water rights or in any other manner in which easements may be lawfully terminated, released, extinguished, or abandoned.

Source: L. 76: Entire article added, p. 751, § 1, effective July 1. **L. 2003:** Entire section amended. p. 991, § 5, effective August 6.

Editor's note: This section was contained in a 2003 act that was passed without a safety clause. For further explanation concerning the effective date, see page vii of this volume.

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Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS/38-30.5-108. Enforcement - remedies.

38-30.5-108. Enforcement - remedies.

(1) No conservation easement in gross shall be unenforceable by reason of lack of privity of contract or lack of benefit to particular land or because not expressed as running with the land.

(2) Actual or threatened injury to or impairment of a conservation easement in gross or the interest intended for protection by such easement may be prohibited or restrained by injunctive relief granted by any court of competent jurisdiction in a proceeding initiated by the grantor or by an owner of the easement.

(3) In addition to the remedy of injunctive relief, the holder of a conservation easement in gross shall be entitled to recover money damages for injury thereto or to the interest to be protected thereby. In assessing such damages, there may be taken into account, in addition to the cost of restoration and other usual rules of the law of damages, the loss of scenic, aesthetic, and environmental values.

Source: L. 76: Entire article added, p. 752, § 1, effective July 1.

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Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS/38-30.5-109. Taxation.

38-30.5-109. Taxation.

Conservation easements in gross shall be subject to assessment, taxation, or exemption from taxation in accordance with general laws applicable to the assessment and taxation of interests in real property. Real property subject to one or more conservation easements in gross shall be assessed, however, with due regard to the restricted uses to which the property may be devoted. The valuation for assessment of a conservation easement which is subject to assessment and taxation, plus the valuation for assessment of lands subject to such easement, shall equal the valuation for assessment which would have been determined as to such lands if there were no conservation easement.

Source: L. 76: Entire article added, p. 752, § 1, effective July 1.

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Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS/38-30.5-110. Other interests not impaired.

38-30.5-110. Other interests not impaired.

No interest in real property cognizable under the statutes, common law, or custom in effect in this state prior to July 1, 1976, nor any lease or sublease thereof at any time, nor any transfer of a water right or any change of a point of diversion decreed prior to the recordation of any conservation easement in gross restricting a transfer or change shall be impaired, invalidated, or in any way adversely affected by reason of any provision of this article. No provision of this article shall be construed to mean that conservation easements in gross were not lawful estates in land prior to July 1, 1976. Nothing in this article shall be construed so as to impair the rights of a public utility, as that term is defined by section 40-1-103, C.R.S., with respect to rights-of-way, easements, or other property rights upon which facilities, plants, or systems of a public utility are located or are to be located. Any conservation easement in gross concerning water or water rights shall be subject to the "Water Right Determination and Administration Act of 1969", as amended, article 92 of title 37, C.R.S., and any decree adjudicating the water or water rights.

Source: L. 76: Entire article added, p. 752, § 1, effective July 1. **L. 2003:** Entire section amended, p. 991, § 6, effective August 6.

Editor's note: This section was contained in a 2003 act that was passed without a safety clause. For further explanation concerning the effective date, see page vii of this volume.

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Source:
Colorado Statutes/TITLE 38 PROPERTY - REAL AND PERSONAL/REAL PROPERTY/Interests in Land/ARTICLE 30.5 CONSERVATION EASEMENTS/38-30.5-111. Validation.

38-30.5-111. Validation.

(1) Any conservation easement in gross created on or after July 1, 1976, but before July 1, 1985, that would have been valid under this article except for section 38-30.5-104 (3) is valid and shall be a binding, legal, and enforceable obligation.

(2) Any conservation easement in gross affecting water rights created prior to August 6, 2003, shall be a binding, legal, and enforceable obligation if it complies with the requirements of this article.

Source: L. 85: Entire section added, p. 1203, § 2, effective July 1. **L. 2003:** Entire section amended, p. 992, § 7, effective August 6.

Editor's note: (1) Section 38-30.5-104 (3), which is referenced in this section, was repealed by L. 85, p. 1203, § 3, effective July 1, 1985.

(2) This section was contained in a 2003 act that was passed without a safety clause. For further explanatio concerning the effective date, see page vii of this volume.

Document 1 of 1

Source:
Colorado Statutes/TITLE 39 TAXATION/SPECIFIC TAXES/Income Tax/ARTICLE 22 INCOME TAX/PART 5 SPECIAL RULES/39-22-522. Credit against tax - conservation easements.

39-22-522. Credit against tax - conservation easements.

(1) For purposes of this section, "taxpayer" means a resident individual or a domestic or foreign corporation subject to the provisions of part 3 of this article, a partnership, S corporation, or other similar pass-through entity, estate, or trust that donates a conservation easement as an entity, and a partner, member, and subchapter S shareholder of such pass-through entity.

(2) For income tax years commencing on or after January 1, 2000, and, with regard to any credit over the amount of one hundred thousand dollars, for income tax years commencing on or after January 1, 2003, subject to the provisions of subsections (4) and (6) of this section, there shall be allowed a credit with respect to the income taxes imposed by this article to each taxpayer who donates during the taxable year all or part of the value of a perpetual conservation easement in gross created pursuant to article 30.5 of title 38, C.R.S., upon real property the taxpayer owns to a governmental entity or a charitable organization described in section 38-30.5-104 (2), C.R.S. The credit shall only be allowed for a donation that is eligible to qualify as a qualified conservation contribution pursuant to section 170 (h) of the internal revenue code, as amended, and any federal regulations promulgated in connection with such section. The amount of the credit shall not include the value of any portion of an easement on real property located in another state.

(3) In order for any taxpayer to qualify for the credit provided for in subsection (2) of this section, the taxpayer shall file with the department of revenue at the same time as the taxpayer files a return for the taxable year in which the credit is claimed a summary of a qualified appraisal, as defined in 26 C.F.R. 1.170A-13 (c) (4) (1998); however, if requested by the department, the taxpayer shall submit the appraisal itself.

(4) (a) For a conservation easement in gross created in accordance with article 30.5 of title 38, C.R.S., that is donated to a governmental entity or a charitable organization described in section 38-30.5-104 (2), C.R.S., the credit provided for in subsection (2) of this section shall be an amount equal to one hundred percent of the first one hundred thousand dollars of the fair market value of the donated portion of such conservation easement in gross when created, and forty percent of all amounts of the donation in excess of one hundred thousand dollars; except that, in no case shall the credit exceed two hundred sixty thousand dollars per donation. In no event shall a credit claimed by a taxpayer filing a joint federal return, or the sum of the credits claimed by taxpayers filing married separate federal returns, exceed the dollar limitations of this paragraph (a).

(b) In the case of a partnership, S corporation, or other similar pass-through entity that donates a conservation easement as an entity, the amount of the credit allowed pursuant to subsection (2) of this section shall be allocated to the entity's partners, members, or shareholders in proportion to the partners', members', or shareholders' distributive shares of income from such entity. The total aggregate amount of the credit allocated to such partners, members, and shareholders shall not exceed two hundred sixty thousand dollars, and, if any refund is claimed pursuant to subparagraph (I) of paragraph (b) of subsection (5) of this section, the aggregate amount of the refund and the credit claimed by such partners, members, and shareholders shall not exceed fifty thousand dollars for that income tax year.

(5) (a) If the tax credit provided in this section exceeds the amount of income tax due on the income

of the taxpayer for the taxable year, the amount of the credit not used as an offset against income taxes in said income tax year and not refunded pursuant to paragraph (b) of this subsection (5) may carried forward and applied against the income tax due in each of the twenty succeeding income tax years but shall be first applied against the income tax due for the earliest of the income tax years possible. Any amount of the credit that is not used after said period shall not be refundable.

(b) (I) Subject to the requirements specified in subparagraphs (II) and (III) of this paragraph (b), for income tax years commencing on or after January 1, 2000, if the amount of the tax credit allowed in or carried forward to any tax year pursuant to this section exceeds the amount of income tax due on the income of the taxpayer for the year, the taxpayer may elect to have the amount of the credit not used as an offset against income taxes in said income tax year refunded to the taxpayer.

(II) A taxpayer may elect to claim a refund pursuant to subparagraph (I) of this paragraph (b) only if, based on the financial report prepared by the controller in accordance with section 24-77-106.5, C.R.S., the controller certifies that the amount of state revenues for the state fiscal year ending in the income tax year for which the refund is claimed exceeds the limitation on state fiscal year spending imposed by section 20 (7) (a) of article X of the state constitution and the voters statewide either have not authorized the state to retain and spend all of the excess state revenues or have authorized the state to retain and spend only a portion of the excess state revenues for that fiscal year.

(III) If any refund is claimed pursuant to subparagraph (I) of this paragraph (b), then the aggregate amount of the refund and amount of the credit used as an offset against income taxes for that income tax year shall not exceed fifty thousand dollars for that income tax year. In the case of a partnership, S corporation, or other similar pass-through entity that donates a conservation easement as an entity, if any refund is claimed pursuant to subparagraph (I) of this paragraph (b), the aggregate amount of the refun and the credit claimed by the partners, members, or shareholders of the entity shall not exceed the dollar limitation set forth in this subparagraph (III) for that income tax year. Nothing in this subparagraph (III) shall limit a taxpayer's ability to claim a credit against taxes due in excess of fifty thousand dollars in accordance with subsection (4) of this section.

(6) A taxpayer may claim only one tax credit under this section per income tax year; except that a transferee of a tax credit under subsection (7) of this section may claim an unlimited number of credits. A taxpayer who has carried forward or elected to receive a refund of part of the tax credit in accordance with subsection (5) of this section shall not claim an additional tax credit under this section for any income tax year in which the taxpayer applies the amount carried forward against income tax due or receives a refund. A taxpayer who has transferred a credit to a transferee pursuant to subsection (7) of this section shall not claim an additional tax credit under this section for any income tax year in which the transferee uses such transferred credit.

(7) For income tax years commencing on or after January 1, 2000, a taxpayer may transfer all or a portion of a tax credit granted pursuant to subsection (2) of this section to another taxpayer for such other taxpayer, as transferee, to apply as a credit against the taxes imposed by this article subject to the following limitations:

(a) The taxpayer may only transfer such portion of the tax credit as the taxpayer has neither applied against the income taxes imposed by this article nor used to obtain a refund;

(b) The taxpayer may transfer a pro-rated portion of the tax credit to more than one transferee;

(c) A transferee may not elect to have any transferred credit refunded pursuant to paragraph (b) of subsection (5) of this section;

(d) For any tax year in which a tax credit is transferred pursuant to this subsection (7), both the taxpayer and the transferee shall file written statements with their income tax returns specifying the amount of the tax credit that has been transferred. A transferee may not claim a credit transferred pursuant to this subsection (7) unless the taxpayer's written statement verifies the amount of the tax credit claimed by the transferee.

(e) To the extent that a transferee paid value for the transfer of a conservation easement tax credit to such transferee, the transferee shall be deemed to have used the credit to pay, in whole or in part, the income tax obligation imposed on the transferee under this article, and to such extent the transferee's use of a tax credit from a transferor under this section to pay taxes owed shall not be deemed a reduction in the amount of income taxes imposed by this article on the transferee; and

(f) The transferee shall submit to the department a form approved by the department. The transferee shall also file a copy of the form with the entity to whom the taxpayer donated the conservation easement.

(8) The executive director of the department of revenue may promulgate rules for the implementation of this section. Such rules shall be promulgated in accordance with article 4 of title 24, C.R.S.

(9) Any taxpayer who claims a credit for the donation of a conservation easement contrary to the provisions of this section shall be liable for such deficiencies, interest, and penalties as may be specified in this article or otherwise provided by law.

Source: L. 99: Entire section added, p. 976, § 1, effective August 4. **L. 2000:** (4), (5), and (6) amended and (7) and (8) added, p. 894, § 1, effective August 2. **L. 2001:** (1), (2), (3), (4), and (5)(b)(III) amended, p. 395, § 6, effective August 8; (1), (2), (3), (4), (5)(b)(III), (6), (7)(a), (7)(b) amended and (7)(e) and (7)(f) added, p. 901, § 1, effective January 1, 2003. **L. 2002:** (2) amended and (9) added, p. 510, § 1, effective August 7; (2) amended and (9) added, p. 511, § 2, effective January 1, 2003.

Editor's note: Subsections (2), (4), and (5)(b)(III) were amended in House Bill 01-1364. Those amendments are superseded by the amendments to said subsections in House Bill 01-1090, effective January 1, 2003.

Cross references: For the legislative declaration contained in the 2001 act amending subsections (1), (2), (3), (4), and (5)(b)(III), see section 1 of chapter 133, Session Laws of Colorado 2001.

ANNOTATION

Law reviews. For article, "The Unique Benefits of Conservation Easements in Colorado", see 30 Colo. Law. 49 (December 2001). For article, "Changes to Colorado's Conservation Income Tax Credit Law", see 32 Colo. Law. 65 (February 2003).

THE TRUST *for* PUBLIC LAND

Conserving Land for People

Technical Assistance Services for Conservation Finance Measures

The Trust for Public Land (TPL) has a strong record of successfully designing and passing conservation finance measures for the protection of agricultural lands and open space. During the November 2004 election TPL participated in 38 measures nationwide – 34 of which passed. These 34 measures will generate upwards of $1.9 billion for parks and land preservation over the next 20 years.

The TPL conservation finance team expertise lies in four areas – feasibility research, public opinion survey development, measure design and campaign strategy.

Research – To accurately assess the potential for a successful land conservation/public finance measure, TPL has found that it necessary to conduct background research on a jurisdiction's fiscal capacity and voter and election history. TPL's expert research staff uses the results of this demographic, fiscal, legal and election research to help communities determine the optimal form of the financing mechanism (e.g. sales tax, general obligation bonds, business improvement district), etc.), guide the survey research development process and to assist in making informed decisions about when to place the measure on the ballot.

Public Opinion Survey Development – TPL believes that polling is an essential decision-making tool in every conservation finance measure. A poll can help community leaders evaluate the potential success of a proposed measure; determine voter tolerance for various levels of spending, taxation and indebtedness; and test the effectiveness of themes, messages and arguments (pros and cons) of a proposed measure.

Measure Design – TPL has extensive experience in the drafting of ballot language including legal evaluation and determination of appropriate ballot title, language and arguments. We strongly believe that ballot language is one of the single most important components of a successful measure.

Campaign Strategy – TPL's experts are skilled in campaign message development, targeting, direct mail design, earned media, grassroots organizing, and GOTV efforts. During the 2000 election cycle, TPL and our political affiliate, the Conservation Campaign, designed, produced and mailed 36 different direct mail pieces to over 1.6 million households. In many cases, this direct mail was the only communication with the voters about the measure.

For more information on The Trust for Public Land's services in Colorado please contact Nissa Maddox at 303-837-1414.

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PRIVATE AND PUBLIC GRANT SOURCES AND PUBLIC LAND TRUSTS

Arapahoe County Open Space Program

Great Outdoors Colorado ("GOCO"), (www.goco.org):
- Legacy Initiative projects
- Local government grants
- Open Space grants
- Wildlife grants (including for viewing – Highline Canal-owl stretch)
- Trails grants

Land Trust Alliance (www.lta.org):
Promotes voluntary land conservation measures.

The Trust for Public Land and Conservation Finance Program (www.tpl.org):
Assists communities in creating public funding sources for land conservation.

The Cherry Hills Village Land Preserve, Inc. ("CHV Land Preserve"):

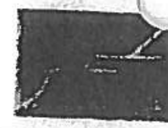
This is our local conservation/preservation organization – a citizen-based, non-governmental organization whose mission is to preserve the rural character of Cherry Hills Village by preserving open lands and natural areas of significant scenic, environmental, historic, and recreational value. The CHVLP realizes this mission by working to:

- Serve as a membership organization for local citizens interested in land preservation.
- Promote efforts to secure conservation easements and other significant open spaces.
- Raise funds and generate other resources to promote the acquisition, maintenance, and enhancement of parks, trails, open space and historic sites.
- Serve to educate the public and to advocate for appropriate development and land protection measures.
- Promote the CHV City Council's development of a vision for land use that focuses on open space of significant scenic, environmental, historic or recreational value.

Colorado Historical Society, State Historical Fund

Colorado Coalition of Land Trusts

Our Mission . . . *The Colorado Coalition of Land Trusts is a not-for-profit organization with a mission to promote and support land conservation excellence in Colorado through leadership, advocacy, education and outreach*



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Other agencies and organizations:

- Colorado General Assembly
- Department of Natural Resources
- Natural Resources Conservation Services (NRCS)
- Division of Wildlife

Land Trust Alliance

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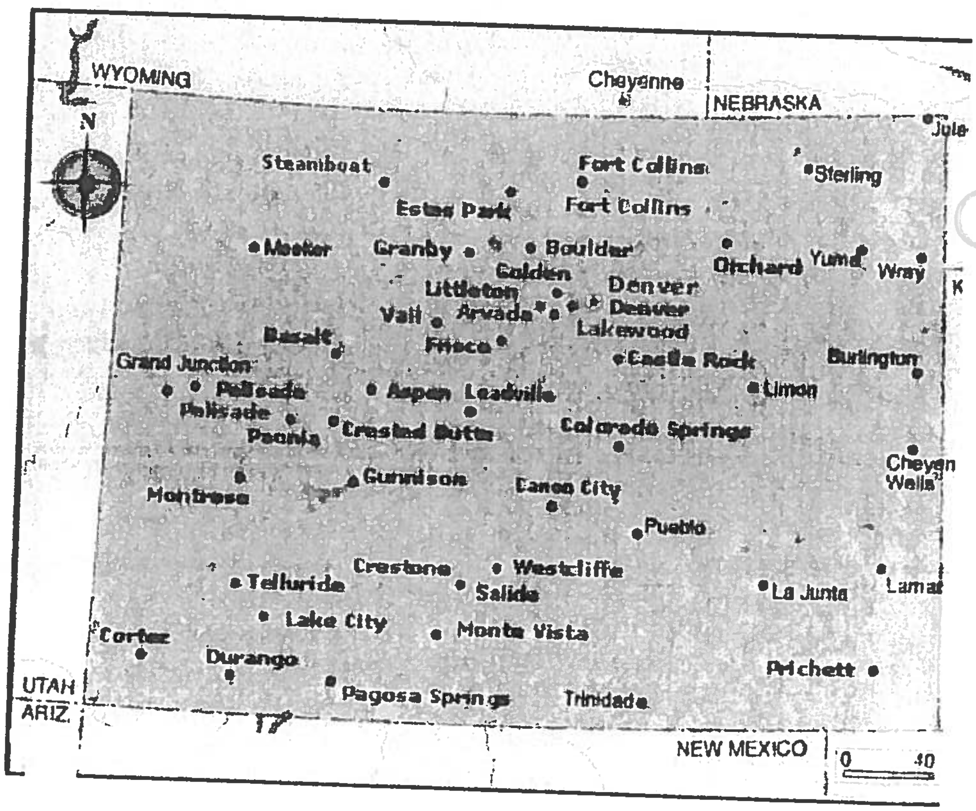
Go To: Local CCLT Land Trusts | National, Regional and Statewide | Municipal

Map of Colorado Conservation Organizations and Municipal Open Programs

Increasing development pressure in recent years has led to the creation of : land trusts in Colorado. Working with municipal open space programs, and and statewide land conservation organizations, these groups are diligently v preserve Colorado's agricultural land, open space, and wildlife habitat. Clicl city for your local land trust.. Red = Local Trusts, Green = National, Regiona Statewide Trusts.



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Colorado Open Lands

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Attorneys

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Appraisers

Consultants

- Baseline Documentation
- Biological
- Conservation Land Planning
- Hazardous Materials
- Land Management
- Mapping & Aerial photography
- Minerals
- Water

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Individuals listed in this directory are included on the basis of their stated a competence and expertise and other information provided by them. Inclusi confirmation of the information nor any endorsement by Colorado Open La

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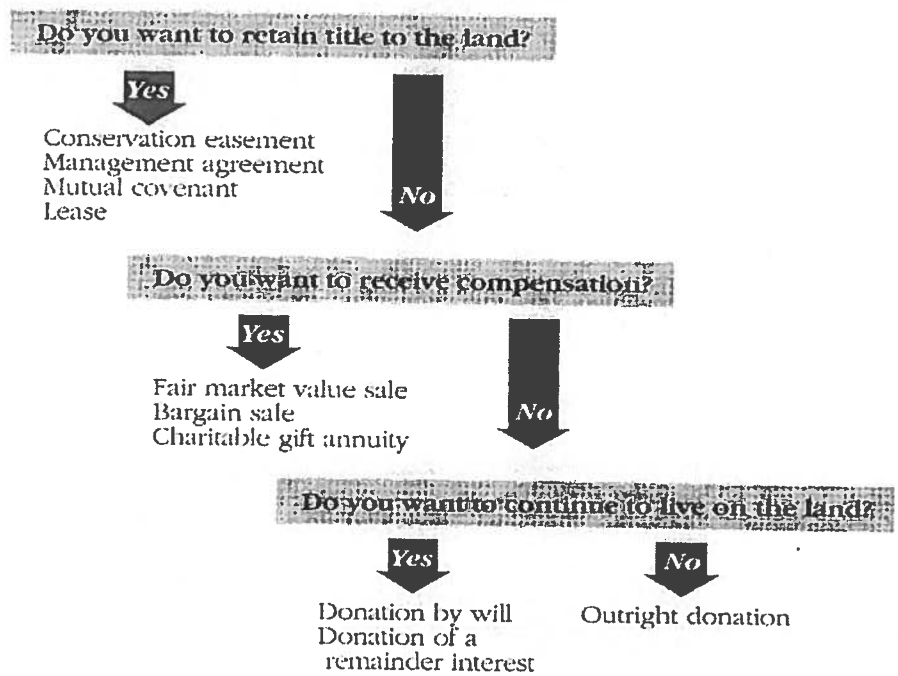
Conservation Options 101
Cherry Hills Village

This chart will serve as a good starting place in your thinking about the many options available for protecting land. But you will want to read further—aspects of your own personal situation or the use of stategies that combine protection techniques can lead to conservation solutions not evident here.



Source: Land Trust Alliance. Conservation Options-A Landowner's Guide. 1999.

Leasing Property

Land can be temporarily protected by leasing it to a qualified organization such as Cherry Hills Village. Allows for lessee to manage the property and ensure protection of conservation values. This is often a good introductory step toward developing a relationship with a property owner and most applicable in the short term.

Protections:

- Limited to duration and enforcement of lease

Management Entity and Long-Term Implications:

- Lessee (potentially Cherry Hills Village)
- Long-term management is directly related to the language and duration of the lease

Preservation Overlay Zoning

Municipality can establish an overlay zone with development restrictions. Creating an overlay zone would require drafting a new ordinance. This ordinance would stipulate what areas could be built on or how limited development could proceed in certain areas. This tool can be controversial from a property-rights perspective but does lend communities flexibility and helps in maintaining a consistent image.

Protections:

- Not permanent
- Protects property and resources from future development

Management Entity and Long-Term Implications:

- Town Planner and City Council would be responsible for implementing this tool
- Long-term management would be up to the landowner and the Village would be responsible for enforcement of the ordinance

Mutual Covenant

Appropriate where the protected conservation values are important to a handful of owners but not of sufficient benefit to the general public to warrant a conservation easement. In this case, there is no tax deduction and no guarantee of enforcement.

Protection:

- Limited protection of conservation values because protection is dependent on the beliefs and efforts of the landowners signing the covenant

Management Entity and Long-Term Implications:

- Property owner

- As landowners change over time, this covenant may lose its power to protect conservation values

Deed Restriction

A deed restriction is a voluntary method used to restrict or define certain uses of a property. Deed restrictions are enforceable by law and are permanent. A conservation easement is one of many types of deed restrictions. Other examples include affordable housing values, size of a lot, distance between the house and the street, etc. If a landowner wishes to conserve open space on his/her property, but does not want a third-party involved, he/she may choose to place a deed restriction on the property. This option does not provide any tax benefits.

Protection:
- Protection levels of conservation values vary in each case
- Flexibility to develop a range of provisions

Management Entity and Long-Term Implications:
- Property owner
- No enforcement from a third-party (e.g., land trust)

Conservation Easement

Voluntary method for landowners to sell or donate their development rights, while retaining ownership of the land. Easements are normally more restrictive and more permanent than relying on regulatory authority for protection. Public access and public influence over resource protection are not guaranteed. If donated, a conservation easement can be treated as a charitable gift and deducted from income tax. It is also valuable in reducing estate taxes when the property passes to potential heirs. A property owner can also receive a tax deduction through a bargain sale of the easement or if the easement is given to a charitable organization in return for a gift annuity.

Protections:
- Permanent
- No development unless specifically stated in the deed of conservation easement (e.g. house envelope)
- Flexible to meet needs of landowner

Management Entity and Long-Term Implications:
- Cherry Hills Village or other governmental entity
- Local land trust such as Colorado Open Lands or South Metro Land Conservancy
- Annual monitoring and enforcement of easement
- Stewardship endowment

Tax Benefits:
- Must be donated in perpetuity to a qualified charitable organization

- Donated exclusively for conservation purposes; must meet ONE of the following:
    - Preservation of land areas for outdoor recreation by, or education of general public
    - Protection of natural habitat for fish, wildlife, or plants
    - Preservation of open space for scenic enjoyment of public or pursuant to a clearly defined federal, state, or local government conservation policy.
    - Preservation of historically important land area or certified historic structure.
- Landowner can qualify for federal and state tax deductions. Colorado has a innovative program that allows for landowners to buy and sell tax credits.