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THE USES AND ABUSES OF CONSERVATION EASEMENTS

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Over the last 20 years, conservation easements have exploded as the preferred mechanism to preserve land in its natural state. Conservation easements are voluntarily donated and are designed to ensure that land uses will be restricted in perpetuity to preserve open space, wildlife habitat, scenic, and other uses for the benefit of the public at large. All 50 states and the District of Columbia have now enacted conservation easement-enabling legislation. In California, for example, Civil Code section 815 provides that “[t]he Legislature finds and declares that the preservation of land in its natural, scenic, agricultural, historical, forested, or open-space condition is among the most important environmental assets of California” and that it is in the “public interest” to encourage the voluntary conveyance of conservation easements to qualified nonprofit organizations. These organizations have fiduciary duties to the donor of the easement and to the public to ensure that the conservation values of the environment are upheld.

To put this explosive growth in perspective, 20 years ago approximately 300,000 acres of land in the United States were subject to conservation easements donated to private, tax-exempt charitable trusts. Today, over 7,000,000 acres are so held, an almost 25-fold increase. This

amount of acreage is in addition to the millions of acres held in trust by federal, state, and local governmental entities. However, nothing in life is free, and that adage rings true with conservation easements. Donors of conservation easements to private charitable trusts are often for-profit commercial corporations. By conveying a conservation easement, the corporation can reap federal, state, and local tax benefits. A deduction of the fair market value of the easement from income is common.

The value of the easement to the donor is typically the difference between the market value of the donor’s property before and after conveyance of the easement. For example, an easement will be valued at \$200,000 if the property is worth \$500,000 before the donation, and is worth \$300,000 after the donation. Tax benefits are often used by donors to secure increased cash flow for the development of other land holdings which are not subject to the conservation easement.

With over 7,000,000 acres now subject to conservation easements, tax abuse is inevitable. The estimate of possible tax abuses by the Internal Revenue Service is alarming. Earlier this year the Land Trust Alliance (a land trust umbrella organization) noted that the Internal Revenue Service had

reviewed 250 conservation easement donations in the State of Colorado alone and found only three that should not be challenged, largely because they may have failed to meet the “conservation purposes” test of the tax code or because the valuation of the easement is suspect. In 2005 the Congressional Joint Committee on Taxation recommended eliminating and modifying several key tax benefits of conservation easements, citing serious policy and compliance issues. Although the recommendation was not adopted, the issue will likely surface again.

Although the majority of tax abuses relate to inflated easement valuations, the Internal Revenue Service has begun paying close attention to the requirement that the conservation values of the easement be maintained in perpetuity.

Indeed, a growing body of tax court precedent is being established which will define the rules of the game for years to come. Several key precedents are worth noting. In *Turner v. Commissioner of Internal Revenue*, the United States Tax Court ruled last year that an Alexandria, Virginia real estate company could not claim \$342,000 in tax deductions in connection with the grant of a conservation easement which on paper precluded development of scenic land once owned by George Washington. The company claimed that it was entitled to develop up to 62 residences on smaller lots, yet voluntarily limited development to 30 residences pursuant to the grant of a conservation easement. However, the tax court concluded that the company could not have developed 62 lots under existing zoning, and further held that even limited development precluded the intended preservation of a historically important land area.

In *Glass v. Commissioner of Internal Revenue*, the United States Court of Appeals for the Sixth Circuit upheld a ruling by the Tax Court which permitted a conservation

easement deduction. The conservation easement restricted development other than for a personal residence on approximately 10 acres of land in Emmet County, Michigan. The easement served to protect bald eagles, Lake Huron Tansy, and Pitcher’s Thistle, all of which were threatened species. Even though certain rights were retained by the donor, such as the ability to construct footpaths, construct a day shelter and boathouse, and cut vegetation, the Court of Appeals concluded that retained rights were consistent with the conservation goal. The Court of Appeals was also persuaded that the charitable land trust was able and willing to enforce the easement in perpetuity due to staff expertise and significant financial resources.

The paucity of precedent regarding the tax aspects of conservation easements leaves questions unanswered. In many instances, the donor and the land trust will be eager to sign and record a deed of conservation easement without complete assurance that the land will remain in a conserved state in perpetuity. One example is a deed of conservation easement between a mining company and the charitable Napa County Land Trust, encompassing approximately 6,000 acres in Napa, Yolo, and Lake Counties, California. The intent of the conservation easement is to prohibit commercial land use in the 6,000 acres in perpetuity, including the extraction of minerals and hydrocarbons. However, the deed of conservation easement contains a cryptic reference to “title risks” identified in several preliminary title reports which were issued prior to execution of the deed of conservation easement. What were the title risks? The deed of conservation easement does not say, leaving the reader to conclude that there is nothing that can compromise the conservation objectives.

It so happens that the mining company did not own the subsurface oil and gas rights to a significant portion of the 6,000 acres, a

fact which was not referenced in the deed of conservation easement, yet which was known to the Napa County Land Trust. At the time the deed of conservation easement was executed in 2002, the subsurface oil and gas rights were in fact owned by Texaco Exploration and Production, Inc., which was not a signatory.

Use of the surface estate is a legally protected property right of owners of subsurface minerals, including oil and gas. Potential uses of the surface estate include the construction of tanks, sumps, pipes, pipelines, roads, fences, dikes, rigs, shafts, etc. All of these potential uses are actually set forth verbatim in the original 1927 grant deed of the oil and gas rights. All of these potential uses are also inconsistent with the conservation values of the easement. Undoubtedly, the Napa County Land Trust is assuming that the current owner will never obtain the entitlements needed to extract oil and gas; therefore, risk of use of the surface estate is low. Only time will tell if this proves to be the case.

However, in the rush to record such a sizeable easement, neither the members of the public nor the contributors to the Napa County Land Trust were fully informed of

the title risks. Extraction of oil and gas will entail uses of the surface estate which are not consistent with the purposes of a conservation easement. Yet, the oil and gas rights were severed and recorded first and are superior to the conservation easement. This could jeopardize the viability of the conservation easement. Civil Code section 815.2 (b) requires that conservation easements be perpetual in duration. Indeed, the Land Trust Alliance currently has a standard of practice in place on this very issue, requiring negotiation with the legal owner of the mineral estate to ensure that conservation values are not undermined.

At a minimum, full disclosure, acknowledgment, and assessment of the title risks in the recorded conservation easement would have been the most prudent course of action for the Napa County Land Trust.

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