How the US Tax Code Can Save Our Most Endangered Species Part I: A Survey of Conservation Easement Law and How the Tax Code Helps Private Landowners Make the Most Beneficial Impact to Our Most Threatened Species

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Ecologists around the world acknowledge that a single organism's extinction affects other organisms in the ecosystem and that the loss of even one species can start a harmful chain reaction affecting the environment as a whole. To address environmental and conservation goals in the United States, Congress passed the Endangered Species Act (ESA) in 1973, which was designed to promote the recovery of threatened and endangered species and to prevent extinction. *See Benefits of Conserving Endangered Species*, FEMA (Apr. 1, 2022), https://bit.ly/3jlNzRA. Over 2,300 species of wildlife and plants that Congress has determined to be "of aesthetic, ecological, educational, historical, recreational, and scientific value to the Nation and its people" are listed on the ESA. *Id.* The ESA has recognized that one of the most effective ways to protect the threatened and endangered species in the United States is to protect and conserve the "critical habitat" on which these species depend. *Id.*

Conserving critical habitats is a primary way humans can help protect threatened species, in combination with implementing specialized wildlife management and protection programs. *See* ESA, Pub. L. No. 93-205, 87 Stat. 884; *see also Benefits of Conserving Endangered Species*, *supra*. A geographical area that contains certain physical and biological features essential to conservation of an endangered or threatened species is considered a "critical habitat." For example, floodplains are critical habitat for the survival of several endangered species like sturgeon. *See Benefits of Conserving Endangered Species*, *supra*. For the Atlantic Salmon, which was originally listed as an endangered species in 2000, it is critical to protect the oxygenated pools in which they live. *Id.* The US Federal Emergency Management Agency (FEMA), one of the leading federal agencies implementing the ESA, recognizes that the preservation and protection of these natural habitats is critical for the survival of the many species. FEMA specifically proposes that to recover the most threatened species, government action should include the acquisition of conservation easements and conservation management agreements, making the US government a key player in undertaking conservation efforts through the use of conservation easements. *Id.*

Of the more than 40,000 animals on the International Union for Conservation of Nature's (IUCN) Red List of endangered species, over 16,000 of them are facing extinction primarily due to habitat loss. *See*

Background & History, IUCN Red List, https://bit.ly/2TRpCkn. Some notable North American species threatened predominantly by territory destruction include the Gulf sturgeon, Hine's emerald dragonfly, bog turtles, Columbia Basin pygmy rabbit, the lesser prairie-chicken, Mississippi sandhill cranes, the Florida panther, and the monarch butterfly. For instance, the lesser prairie-chicken's population has declined by as much as 97 percent and the species is currently endangered because of habitat fragmentation resulting from industrial development and farming. Similarly, the pygmy rabbit, one of the smallest rabbit species, is endangered due to large-scale destruction of sagebrush plains. The need for preservation extends to aquatic habitats as well. Water habitats are being destroyed, threatening precious species such as the Devil's Hole pupfish, which is facing a high risk of extinction due to habitat loss. These are just a few examples of the harmful effects to wildlife from habitat destruction caused by human development.

When discussing and recommending actions that have the greatest affect on the recovery of a species, ecologists often propose an *ecosystem approach*, an approach that includes identifying, protecting, and acquiring appropriate habitats to support that particular species. Take, for example, the Gulf sturgeon. Gulf sturgeon are profoundly affected by development and other land-use decisions that affect the water quantity and quality within the floodplain areas where they live. To protect Gulf sturgeon, we need to protect the habitats that affect their life cycle, including floodplains adjacent to the streams and rivers where they spawn. *See Top 10 U.S. Endangered Species Threatened by Human Population*, Ctr. for Biological Diversity, https://www.biologicaldiversity.org/programs/population_and_sustainability/species.html ("Gulf sturgeon lay eggs on the waterlines along the banks of rivers, and maintaining the right level of water is critical to their breeding success…"). But how can the US tax code help restoration, protection, and acquisition of these critical habitats for these most threatened species?

Surprisingly, the US tax code provides for an excellent remedy to ease habitat loss for vital animals and protect the lands they need to survive through the creation of conservation easements. The United States' foresight in establishing preferred tax treatment of conservation easements to encourage landowners to actively participate in undertaking conservation efforts on private property has already proven to be one of the most significant conservation tools available for combating habitat loss.

This article will be presented in two parts, discussing how conservation easements are a necessary part of conservation advancement in the United States. Part I will review the legislative intent behind conservation easement law and address the tax and legal benefits of successful easement establishment. Part II, in a later issue of this magazine, will delve into the current legal landscape surrounding conservation easements and pitfalls to avoid when practicing in this area of the law. Part II will also highlight the successes of certain conservation areas and present proposals for legislative reforms for the improvement of conservation easement law in order to curtail litigation of certain aspects.

Public Policy and Legislative Intent Behind Conservation Easement Law

Journalist William Whyte is credited with coining the term "conservation easement" in the 1950s when he advocated for using private land-use controls to accomplish landscape preservation goals. *See* Carol Necole Brown, *A Time to Preserve: A Call for Formal Private-Party Rights in Perpetual Conservation Easements*, 40 Ga. L. Rev. 85 (2005) (U. of Ala. Pub. L. Rsch. Paper No. 08-07), https://bit.ly/3PRUEWg; *see also* William H. Whyte, *The Last Landscape* 2–14 (1968). Generally speaking, conservation easements are designed to preserve the servient land in an undeveloped or natural state. *See* 4 *Powell on Real Property* § 34.11[3] (Michael Allan Wolf ed., 2022); *Protecting the Land—Conservation Easements Past, Present, and Future* (Julie Ann Gustanski & Roderick Squires eds. 2000); *see also* Cohen, *Progress and Problems in Preserving Ohio's Natural Heritage Through the Use of Conservation Easements*, 10 Cap. U. L. Rev. 731, 731 n.2 (1981). The "core purpose of conservation easements, however, is to protect

from the inexorable march of development." Nicholas Carson, Note, *Easier Easements: A New Path for Conservation Easement Deduction Valuation*, 109 Nw. U. L. Rev. 739 (2015). In practice, easements typically protect wildlife habitats, open space, outdoor recreation areas, and scenic views but also are regularly used for establishing public parks and historic sites and buildings. Farmland and working forests can also be protected with the use of conservation easements. *See* Melissa Waller Baldwin, *Conservation Easements: A Viable Tool for Land Preservation*, 32 Land & Water L. Rev. 89, 103 (1997); Jess R. Phelps, *Defining the Role of Agriculture in Agricultural Conservation Easements*, 45 Ecology L. Rev. 647, 677–701 (2018).

Currently, almost all state legislatures and Congress have passed laws establishing conservation easements to support and encourage nationwide conservation goals. State laws and the Internal Revenue Code provide for useful tax incentives to encourage landowners to consider setting up conservation easements. *See* IRC § 170(h) (2012) (allowing a conservation contribution for "a restriction (granted in perpetuity) on the use which may be made of the real property"). *See also* C. Timothy Lindstrom, *Recent Developments in the Law Affecting Conservation Easements: Renewed Tax Benefits, Substantiation, Valuation, "Stewardship Gifts," Subordination, Trusts, and Sham Transactions*, 11 Wyo. L. Rev. 433, 435–443 (2011); Itzchak E. Kornfeld, *Conserving Natural Resources and Open Spaces: A Primer on Individual Giving Options*, 23 Env't L. 185, 197 (1993).

Select Federal Conservation Easement Law Provisions

The language of the Internal Revenue Code sheds light on the legislative intent behind implementation of conservation easement laws. For instance, a qualified conservation contribution under §170(h)(1) of the IRC means a contribution of a "qualified real property interest," to a "qualified organization" that is made "exclusively for conservation purposes." *See generally* 26 C.F.R. § 1.170A-14(b)(2) (qualified conservation contributions). In the context of conservation contributions, "conservation purpose" is defined to mean (i) the preservation of land areas for outdoor recreation by, or the education of, the general public; (ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (iii) the preservation of open space (including farmland and forest land) where such preservation is effected (I) for the scenic enjoyment of the general public; or (II) pursuant to a clearly delineated federal, state, or local governmental conservation policy, and will yield a significant public benefit; or (iv) the preservation of a historically important land area or a certified historic structure. 26 U.S.C.A. § 170.

The donation of a "qualified real property" interest to protect a significant relatively natural habitat in which fish, wildlife, or plant communities normally live will typically meet the conservation purpose standard. Significant habitats include, and are not limited to, (1) habitats for rare, endangered, or threatened species of animal, fish, or plants; (2) natural areas that represent quality examples of a terrestrial community or aquatic community; and (3) natural areas that are included in, or that contribute to, the ecological viability of a local, state, or national park, nature preserve, wildlife refuge, wilderness area, or other similar conservation area. *See generally* IRS, *Conservation Easement Audit Technique Guide* (rev. 2021); *see also Champion Retreat Golf Founders, LLC v. Comm'r*, T.C. Memo 2022-106 (Oct. 17, 2022); *Champions Retreat Golf Founders, LLC v. Comm'r*, 959 F.3d 1033, 1036–37 (11th Cir. 2020).

A charitable deduction is also allowed for preserving open space (including farmland and forest land) if the preservation will yield a significant public benefit and is undertaken either (1) under a clearly delineated federal, state, or local government policy or (2) for the scenic enjoyment of the general public. 26 U.S.C.A. § 170. Public benefit will be evaluated by considering all pertinent facts and circumstances. Among the factors considered are (1) uniqueness of the property to the area, (2) intensity of land development, (3) opportunity for the general public to use the property or appreciate its scenic values, (4) importance of the property in preserving a local or regional landscape or resource that attracts tourism or

commerce, (5) likelihood that the charity will acquire equally desirable and valuable substitute property, and (6) consistency of the open space use with a legislatively mandated program identifying particular parcels of land for future protection. *Id*. The ecological importance and clear intent of protecting natural land and wildlife habitat are evident from the direct language of the IRC relating to the provisions for conservation easements.

Legislative Background

The concept of conservation easements was born out of necessity as Congress "recognized the need for preservation of open land and historic buildings, [but also acknowledged that] owning the land outright, or 'in fee' would be expensive and inefficient." Carson, *Easier Easements*, *supra*. The conservation easement tax deduction would "encourage private landowners to voluntarily restrict the use of their land in exchange for a decrease in taxes owed to the federal government." *Id*. And this incentive has worked. Studies show a steady increase in land protected by conservation easements since the laws were enacted. *See* Jess R. Phelps, *Moving Beyond Preservation Paralysis?: Preservation Easements in an Uncertain Regulatory Future*, 91 Neb. L. Rev. 121 (2012).

The legislative history underlying section 170(h) is further illuminating. A 1980 Senate Report addressing conservation easement law states:

> The committee believes that the preservation of our country's natural resources and cultural heritage is important, and the committee recognizes that conservation easements now play an important role in preservation efforts. The committee also recognizes that it is not in the country's best interest to restrict or prohibit the development of all land areas and existing structures. Therefore, the committee believes that provisions allowing deductions for conservation easements should be directed at the preservation of unique or otherwise significant land areas or structures.

S. Rep. No. 96-1007, at 9 (1980), 1980-2 C.B. 599, 603.

The 1980 Senate Report lends additional insight to the legislative intent behind conservation easements and explains:

> For the contribution to be protected in perpetuity, [t]he contribution must involve legally enforceable restrictions on the interest in the property retained by the donor that would prevent uses of the retained interest inconsistent with the conservation purposes. . . . By requiring that the conservation purpose be protected in perpetuity, the committee intends that the perpetual restrictions must be enforceable by the donee organization (and successors in interest) against all other parties in interest (including successors in interest).

Id. at 13–14, 1980-2 C.B. at 605–06.

The case of *Glass v. Commissioner* is an example of the court considering the legislative intent and conservation goals of easement law in the context of applying section 170(h). 124 T.C. 258 (2005); *see* Nicholas M. Agopian, *Conservation Easements—Preserving Privately Owned Natural Habitats: Guidance for Interpreting 26 U.S.C. § 170(h)(4)(a)(II)*, 6 Wyo. L. Rev. 447, 476–77 (2006). The *Glass* court interpreted section 170(h)(4)(A)(ii) to provide that a qualified real property interest will meet the conservation purposes test if that interest is contributed "to protect a significant relatively natural habitat in which a fish, wildlife, or plant community, or similar ecosystem, normally lives." In this case, the taxpayer's expert testified that the contributed land was a known roosting spot for bald eagles. The taxpayers were able to prove that the shoreline they were conserving met the conservation purpose of protecting a natural habitat or ecosystem and, accordingly, qualified under section 170(h)(4)(A). The *Glass* court noted that Congress, through the enactment of section 170(h), intended to support

preservation of our country's natural resources through the contribution of easements and, in this case, though contributions of the conservation easements, which serve to preserve this nation's natural resources of bald eagles, Lake Huron tansy, and an area bluff, which were consistent with the statute's objective. *Glass v. Comm'r*, 124 T.C. 258, 283–84 (2005), *aff'd*, 471 F.3d 698 (6th Cir. 2006) (citing S. Rep. No. 96-1007, at 9, 1980–2 C.B. at 603).

Tax Benefits of Establishing a Conservation Easement and Nuances of Implementation

What are the benefits to a private landowner? A charitable contribution of a qualified conservation easement can result in several tax benefits, such as allowing for income, gift, and estate tax deductions. The tax benefits derived from easement contributions are some of the primary considerations for individuals when contemplating these contributions. 5.10 Charitable Conservation Easements, 2012 WL 2515347; Howard Zaritzky, *Tax Planning for Family Wealth Transfers: Analysis with Forms*, ¶ 5.10 (Oct. 2022) (Charitable Conservation Easements). Taxpayers may also appreciate that they can continue to use the property even after the establishment of an easement, although changes in the use of the land may be prohibited or restricted in certain aspects. *Id*.

An individual can maximize the benefits of the charitable contribution by imposing an easement on land and then transferring the property, subject to the easement, to a noncharitable donee, such as the person's heirs. *Id*. Implementing this plan of devising property with a conservation easement in place serves dual purposes: It prohibits the donee's development of the land, but it also functions as a reduction in the value of the property for tax purposes. *See id*.; *see also* C. Timothy Lindstrom, *A Guide to the Tax Aspects of Conservation Easement Contributions* (Mar. 2007), https://bit.ly/3FH1Tve. To properly implement this plan, the contributed real property interest must be the decedent's entire interest in the property (other than a qualified mineral interest, which the decedent's estate may retain), a remainder interest, or a perpetual conservation easement. The benefits may be significant, and the conservation contribution can result in an income tax deduction for the donor while alive, can reduce the gift tax on the interest given to the family member, and can lessen the overall value of the estate for estate tax purposes. *See* IRC § 170(h)(2).

Deduction Valuations

Qualified conservation contributions are allowed up to the excess of 50 percent of the taxpayer's adjusted gross income (AGI) over the amount of all other allowable charitable contributions—and the carryover can be extended for 15 years. 26 U.S.C. § 170(b)(1)(A)–(C). (Qualifying farmers and ranchers can deduct up to 100 percent rather than 50 percent of AGI.)

Generally, the deductible amount of a conservation easement is the difference between the values of the burdened property before and after the donation. Zaritzky, *supra*, ¶ 5.10. It is rare but possible that the value of the taxpayer's retained property may increase because of the easement. In these instances, the contribution is deductible only to the extent that its value exceeds the value of the benefits received. *See* LTR 200208019; Shannon R. Jemiolo & Ian Redpath, *The Benefits and Pitfalls of Qualified Conservation Contributions*, 102 Tax Notes State 625 (Nov. 8, 2021).

The amount of the tax deduction will depend on the form of the interest given. In the case of perpetual restrictions (including easements), the deduction is equal to the fair market value of the easement, based on the sale of comparable easements at the date of the contribution. In a scenario where there are no adequate easement comparables (which arise often) then the general rule is that the value equals the difference between the fair market value of the property before granting the easement and the fair market value of the property after granting the easement. *See* Treas. Reg. § 1.170A-14(h)(3)(ii). *See also, e.g.*, *Dunlap v. Comm'r*, TC Memo. 2012-126 (May 1, 2012). This is referred to as "before-and-after"

valuation.

If the "before-and-after" valuation method is used, then the fair market value of the property before granting the easement must be measured based on the property's highest and best use. *See, e.g.*, *Esgar Corp. v. Comm'r*, TC Memo. 2012-35 (Feb. 6, 2012), *aff'd*, 744 F.3d 648 (10th Cir. 2014) (holding that agriculture was the highest and best use of the property where taxpayers were not able to show that there was demand for use as a more profitable gravel pit); *see, e.g.*, *Mountanos v. Comm'r*, TC Memo. 2013-138 (June 3, 2013), *aff'd*, 651 F. App'x 592 (9th Cir. 2016) (taxpayer presented expert testimony that the highest and best use of his recreational ranch was for a vineyard and residential development, but taxpayer could not show that this use was legally permissible; charitable contribution deduction was denied because taxpayer failed to demonstrate that the easement impeded the highest and best use of the property).

The grant of a conservation easement may also reduce the property's value for ad valorem taxes under respective state law for property tax purposes. For instance, Florida Statute § 193.501 provides, in pertinent part, that land subject to a conservation easement for at least 10 years will be valued by the property appraiser for tax purposes based only on its "value for the present use, as restricted by" the conservation easement.

Use of Appraisals

It is important to provide a qualified appraisal in support of the charitable deduction with claimed values over certain amounts. IRC § 170(f)(11)(c). See Costello v. Comm'r, TC Memo. 2015-87 (May 6, 2015) (denying charitable deduction of more than $5.5 million where appraisal was not a qualified appraisal because it did not provide an accurate description of the property contributed and did not inform the IRS of the key terms of the agreements among the taxpayers). Problems with appraisals can arise when the appraisal reports fail to apply sanctioned methods of valuation, apply unreasonable valuation methods, or make use of comparable property sales that are too distant in time or location to be truly comparable to the transaction at hand. See, e.g., Butler v. Comm'r, TC Memo. 2012-72 (Mar. 19, 2012).

Conclusion

When properly implemented, conservation easements can be an enormous benefit to the environment and contribute significantly to the overall success of U.S. conservation efforts. Many landowners have viewed the tax deductibility of unrealized value impairment from conservation easements as a worthwhile incentive for undertaking conservation efforts on their private property, but this legal landscape is not without its perils, of which practitioners should be aware.

Part II will delve further into the current legal landscape surrounding conservation easements and pitfalls to avoid when practicing in this area of the law and will discuss proposed legislative changes for the productive advancement of federal conservation easement law.