



## Conservation Partners, LLC

# Quality Standards

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## Introduction

Through the land preservation tax credit program under the Land Conservation Incentives Act of 1999, §58.1-510 *et seq.* of the Code of Virginia (1950), as amended (the “Tax Credit Statute”), the Commonwealth of Virginia offers generous financial incentives to landowners who donate conservation easements (and other interests in land) for conservation purposes in the public interest.\* The Commonwealth is investing in conservation that will preserve and improve the quality of life of Virginians far into the future. However, for the tax credit program to work over the long term, and to ensure that the public receives the greatest conservation benefit possible from the tax revenues expended, there must be some assurance that the following two elements are present:

- (i) Quality Easements. Donated easements must provide significant benefits to the public: the properties encumbered by donated easements must have significant conservation values, the easements must be drafted to adequately protect those values in perpetuity, and the easements must be conveyed to responsible holders who will be willing and able to enforce their terms in perpetuity.
- (ii) Proper Valuation. Easements must not be overvalued by donors. The tax credit program is designed to reward a landowner with a credit equal to 40% of the amount by which the easement reduces the fair market value of the landowner’s land (referred to as the “value” of the easement). However, the credit exceeds that amount—and provides an unwarranted windfall to the landowner at the public’s expense—when an abusive appraisal is used to exaggerate the value of the donated easement.

The Tax Credit Statute expressly incorporates existing law governing the federal income tax deduction for conservation easement donations: to qualify for a state tax credit, an easement must comply with the requirements of §170(h) of the Internal Revenue Code (“§170(h)”), and its value must be substantiated by a “qualified appraisal” prepared by a “qualified appraiser” and conforming to applicable federal requirements.

A credit generated by an easement donation that fails to comply with the requirements of state law (including the requirements of §170(h) incorporated into the Tax Credit Statute) may be disallowed entirely by the Virginia Department of Taxation, and a credit based upon an appraisal that fails to comply with applicable law or overstates the easement’s value may be disallowed in whole or in part.

If the Internal Revenue Service or the Virginia Department of Taxation determined that a donated easement failed to satisfy the necessary requirements or was overvalued, the federal and/or state tax benefits from the donation transaction could be reduced or denied altogether, and buyers of an invalidated credit would likely seek a refund of the purchase price of the credit, along with any interest and penalties imposed on the buyer by tax authorities.

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\* Fee simple and other interests in land qualify under the tax credit program, but most credit claims are made for the donation of conservation and open-space easements, which will be referred to herein as simply “easements.”

In an effort to minimize these risks to credit purchasers and to help protect Virginia's land preservation tax credit program over the long term, Conservation Partners has developed these *Quality Standards* ("Standards"). In keeping with the basic concepts outlined above, these *Standards* have two main components: easement quality and valuation. The easement quality standards are meant to ensure that conservation easement donations provide significant benefits to the public. Valuation standards have to do with easement appraisals, and are meant to ensure that easement donors claim the land preservation tax credits they are entitled to—no more and no less.

Conservation Partners originally developed these *Standards* as a reference and guide for our own internal reviews of easements and appraisals. A few years ago, we decided to share our *Standards* with the public as an informal, introductory resource for landowners, easement holders, and attorneys, appraisers, and tax advisors who work with land conservation transactions. These *Standards* draw upon the cumulative experience of various nationally recognized conservation easement and appraisal experts, and we update these *Standards* periodically in an effort to keep them current with evolving state and national private land conservation practice. However, these *Standards* are not necessarily coextensive with applicable law or professional standards or the requirements of various organizations that accept conservation easement donations, and we can't predict what positions tax authorities may take with respect to easements' or appraisals' compliance with applicable requirements. Thus, Conservation Partners makes no warranty whatsoever regarding these *Standards*, and our acceptance of a land preservation tax credit does not constitute a warranty by Conservation Partners that the easement or appraisal complies with applicable laws or that the credit is valid. Conservation Partners cannot and does not provide legal, tax, or appraisal advice, and it is up to the easement donor's attorney, appraiser, and other professional advisors to ensure compliance with applicable laws and professional standards.

# Conservation Easement Quality Standards

We base our easement quality standards upon the cumulative experience of various nationally recognized conservation easement experts. Fundamentally, our easement quality standards include just two elements:

- First, the land encumbered by an easement must have important conservation value.
- Second, the easement must be drafted to provide an appropriately high level of protection for that conservation value in perpetuity, and must be granted to a holder willing and able to enforce the easement in perpetuity.

Only if those elements are present will an easement provide significant public benefit, which is the whole point of Virginia's land preservation tax credit program.

## Premier Holders

Conservation Partners has worked extensively with several highly professional and expert easement holders who go to great lengths to evaluate and negotiate easements and only accept those that provide significant public benefit. Over time, we have come to generally defer to the judgment of these "premier holders" with respect to easement quality even if the easements they accept do not always conform to the specific recommendations in these *Standards*. Premier holders as of the date of this version of the *Standards* are the Virginia Outdoors Foundation, The Nature Conservancy, the Virginia Board of Historic Resources, the Virginia Department of Forestry, and the Virginia Eastern Shore Land Trust.

## Easement Quality Rules of Thumb

The following Rules of Thumb provide a number of guidelines that help to flesh out the two essential elements above. The Rules of Thumb are intentionally conservative and are meant to encourage easement donations that provide real protection for land with important conservation value.

- I. Characteristics of the Land: A few of the more important factors are listed below, though the list is certainly not exhaustive, and we keep our minds open to new factors indicating important conservation value.
  - A. **Size**: As a general rule, and all else being equal, a larger parcel will have higher conservation value than a smaller one. This is a blunt rule, however, and we have seen many small parcels with exceptional conservation value benefiting the public.
  - B. **Adjacency/Proximity to Other Protected Land**: The protection of a private tract that effectively enlarges or buffers an already protected land area can provide important public benefit. Examples include federal or state-protected conservation areas such as State and National Parks, National Forests, National Wildlife Refuges, Wildlife Management Areas, as well as important private land already protected by a quality

conservation easement. Similarly, the protection of a parcel as part of a government or private “landscape conservation” plan that seeks to secure lasting protection of particular biological, cultural, scenic, or agricultural resources present on a number of adjacent parcels also can provide significant public benefit.

- C. Threatened, Endangered, or Sensitive (TES) Species or Ecosystems: The presence of TES species or rare ecosystem types on a property is a very good indication that the protection of the property will provide significant public benefit. The habitat for such species must be carefully protected by the provisions of the easement.
  - D. Water Resources: Land with significant frontage on perennial creeks, rivers, wetlands, large lakes, bays, etc. can be important to the public because inappropriate use and development of such land could have outside negative impacts on water quality and critical wildlife habitat. Where water resources are an important conservation value of the land, the easement should specifically provide for their protection, for example with adequate “riparian buffers” restricting the use of land along the waterways.
  - E. Scenic Values: Significant public benefit can be created by protecting land that is prominent in the vista viewed by the public from such public vantages as a designated Scenic Byway, national or state park, or designated scenic river or waterway. Like water resources, scenic views should be specifically protected in the deed of easement.
  - F. Historic Values: The protection of land and structures listed on the National Register of Historic Places or located in a designated historic district can provide significant public benefit. The protection of historic resources requires specialized expertise on the part of the easement donee and the donor’s counsel.
  - G. Particular Federal, State, or Local Programs: Public benefit can be provided through the protection of land, such as agricultural or forest land, that has been specifically designated as important by any of a number of governmental conservation programs.
- II. Easement Provisions: The following is a list of the most important factors we look for when evaluating a deed of easement.
- A. Protection in Perpetuity: The easement must effectively protect the conservation values of the property “in perpetuity.”
  - B. Drafting Quality: Perpetual conservation easements are intended to govern the use of the grantor’s property for generations to come, and consequently they should be drafted according to the highest standards of drafting practice. The recitals and provisions should be clear and consistent, and the document should be structured in a logical manner.

- C. **Sufficiency of Recitals:** The recitals at the beginning of the easement should make specific and convincing arguments that the easement complies with all applicable requirements, including those of (i) the relevant state “enabling statute” that allows the creation of such easements in Virginia and (ii) §170(h) of the Internal Revenue Code and the Treasury Regulations promulgated to interpret that statute (the requirements under IRC §170(h) have been incorporated into the state statute setting forth the requirements for land preservation tax credits). In particular, the recitals should describe in detail the specific conservation values of the property and explain how the protection of those values provides significant benefits to the public and qualifies under one or more of the conservation purposes set forth in IRC §170(h) as incorporated into state law (the conservation purposes are meant to ensure that tax incentives are only provided for the protection of land with important conservation value). Generic recitals are probably no longer sufficient in Virginia easements. Given public comments made in the last couple of years by IRS personnel as well as reports that IRS audits of easement donations in Virginia and across the country are emphasizing public benefit, we recommend each easement contain recitals clearly explaining how the protection of the particular property’s specific conservation values provides significant public benefit. Conservation Partners can provide sample recitals to attorneys upon request.
- D. **Retained Rights:** One of the reasons conservation easements are such highly effective tools for private land conservation is they are flexible and customizable, within certain limits. An easement donor typically will retain the right to use the property in a number of ways that are consistent with the protection of its conservation values.

Many easements in Virginia are drafted to permit limited subdivision and new residential construction on the protected land. Some easement donors do need—for economic or family reasons—to reserve a certain level of such “development rights,” and in some situations the land’s conservation values nonetheless can be adequately protected through careful easement planning and drafting. It is important to understand that even though reserving development rights may be permitted or encouraged by the easement grantee, reserving such rights can result in an easement that actually fails to protect the land in the way the donor originally intended.

Instead of simply retaining the maximum rights the easement grantee will allow, the donor and her professional advisors should carefully assess the current and expected uses of the property, and draft the easement to permit only the uses and activities that are essential and appropriate to the donor’s current and expected financial and family circumstances.

The analysis of retained rights is an unavoidably subjective exercise, and the outcome will depend in each case upon the specific rights in question and the nature of the property and its conservation values. The following rules of thumb mostly have to do with residential development, which is the type of retained right that most often presents a problem. Please understand, however, that other types of retained

rights also can impair an easement's ability to provide appropriate protection for the conservation values of land, and retained rights are evaluated on a case-by-case basis.

1. Density limitations:

- a. While "density" limitations are expressed in terms of permitted parcels and residential sites per 100 acres, this is not intended to require scattered, low-density siting of permitted dwellings; to the contrary, often it is advisable to cluster any permitted parcels and dwellings so that the bulk of the protected land remains intact.
- b. A "*residential site*" may include a single-family dwelling (sometimes referred to as a "primary" dwelling), limited ancillary non-residential improvements, and, in some situations, smaller ("secondary") dwellings such as a guest house or garage apartment intended to be subordinate and in close proximity to the primary dwelling. What "close proximity" means will be evaluated on a case-by-case basis, but generally a one to five-acre building envelope (or the functional equivalent) on a parcel of 100 or more acres should sufficiently cluster the permitted dwellings and ancillary improvements so as to constitute a single residential site. In some circumstances, a permitted primitive dwelling such as an appropriately-sited and restricted recreational cabin may not constitute a "residential site" for purposes of these rules of thumb.
- c. If an easement permits one or more "*secondary dwellings*" but does not make it clear that such secondary dwellings must be located in close proximity to a primary dwelling, each permitted secondary dwelling generally will constitute an additional residential site for purposes of these *Standards*. Construction of a dwelling in a new part of a property has an impact whether that dwelling is a 3,500-square-foot "primary" dwelling or a 2,000-square-foot "secondary" dwelling. For example, three dwellings of various sizes widely dispersed on a 150-acre property generally will have a greater negative impact on the property's conservation values than a primary dwelling with two guest houses all clustered together in an appropriate site on that same property.
- d. *Rule of thumb for smaller tracts*: Owners of small to moderate-sized tracts (up to 400 acres) are encouraged to provide that their land remain intact in perpetuity. However, some donors need to retain limited division rights, and these should be limited to a maximum of one parcel and one residential site per 100 acres (for example, a 275-acre tract would be permitted a maximum of two parcels and two residential sites; a 310-acre tract, three parcels and sites). One appropriately-sited and limited residential site often is acceptable on tracts smaller than 100 acres, provided the conservation values are protected.

- e. *Rule of thumb for larger tracts*: Generally speaking, most types of conservation values grow more important as the size of the undeveloped tract increases, and (all else being equal) the protection of larger tracts usually provides more public benefit than the protection of smaller tracts. In order to protect their more important conservation values, fewer proportional parcels and residential sites should be retained on large tracts. On large tracts it can be particularly important to cluster any permitted parcels and residential sites so that the bulk of the protected land remains intact. The following rule-of-thumb guidelines are intended to provide a framework for evaluating retained rights in Virginia easements:
    - (i) 400 – 599 acres: no more than four parcels and residential sites.
    - (ii) 600 – 799 acres: no more than five parcels and residential sites.
    - (iii) 800 – 1,099 acres: no more than six parcels and residential sites.
    - (iv) 1,100 – 1,499 acres: no more than seven parcels and residential sites.
    - (v) 1,500 acres or more: no more than eight parcels and residential sites. On very large tracts, additional parcels and/or residential sites may be acceptable depending upon the specific conservation values and other characteristics of the property.
  - f. “*Gerrymandered easements*” are easements configured in interesting shapes to permit development on unencumbered land next to protected land, usually designed to maximize the profitability of planned residential developments. Conservation Partners generally will not work with tax credits based on gerrymandered easements.
  - g. *Relationship of density to location*: The effect of density on a property’s conservation values depends in part on the *location* of the permitted structures, discussed below.
  - h. *Historic structures*: Properties with multiple existing historic structures obviously would be analyzed with an eye to preserving the historic structures and their setting, and the density limitations above may not apply.
2. *Siting of residences*: At a minimum, most easements should designate “no-build” areas to protect particularly sensitive conservation values. In addition, the siting of residences generally should be more specifically limited through building envelopes designated in the deed of easement and/or a requirement that the easement donee’s written approval of the siting of new, replacement, or relocated dwellings be obtained prior to their construction. Instead of designating envelopes or requiring notice and approval, some premier holders

employ what we call “strong notice” provisions, where the landowner must provide written notice to the holder prior to beginning the construction of permitted residences. The notice must include enough information so that the holder can evaluate the consistency of the proposed construction with the purpose of the easement and object or suggest revisions if necessary, but the landowner need not receive formal approval before proceeding with the project.

3. Siting of agricultural and other non-residential structures: The siting of all new, replacement, or relocated non-residential buildings or other structures should be appropriately limited in the easement, usually through carefully designed “no-build” areas protecting sensitive conservation values, though building envelopes or prior grantee approval may sometimes be required for non-residential structures.
4. Very large non-residential structures: Easements permitting the construction of roofed structures 10,000 square feet in ground area or larger are evaluated on a case-by-case basis, according to the following general principles.
  - a. *Existing structures*: Some existing large structures have little impact on the specific conservation values of the property. Where the impact is significant, sometimes it can be sufficiently mitigated by requiring specific measures in the easement. In other situations, the structure can be removed, or the site of the structure can be excluded from the easement. For example, if the problematic structure is sited in a corner of the property distant from the parts of the property with the most important conservation values, a carve-out may be possible. The parcel excluded from the easement would have to be large enough to encompass the area required for the operation of the structure(s) and any additional area subject to the immediate effects of the operation, such as areas required for waste disposal, areas directly impacted by runoff, etc. This approach is less than ideal because it fails entirely to restrict the area carved out, but it can be useful to salvage an easement protecting important conservation values that otherwise would not be granted.
  - b. *New structures*: The construction of large structures that have minimal, localized impact may be permitted in the conservation easement if they are appropriately sited and subject to mitigating restrictions as necessary. The easement should limit the number and size of the structures, and the easement holder’s written approval of the planned structure should be required prior to commencing construction. Blending architectural forms and materials and/or appropriate screening such as evergreen plantings may be required if the site is not completely hidden from public view by topography. Siting should not impact prime soils, important wildlife habitat, water resources, or other important conservation values.
5. Limits on the size of structures: Easements almost always limit the maximum size of permitted dwellings and non-residential structures, usually according to

square footage of the livable area (for dwellings) or the footprint (for non-residential structures), though height restrictions also are sometimes imposed. Conservation Partners historically has been comfortable with the size restrictions typically imposed by premier holders. Readers should consult the premier holders' websites for detailed guidelines.

6. Cap on total square footage of improvements: In addition to restricting the number of divisions and number and size of residential and other buildings, it is usually appropriate to include in the easement a cap on the total square footage of all buildings and other impermeable improvements. Again, consult the premier holders' websites for detailed guidelines.
  7. Specific non-historic architectural limitations: Under some circumstances—for example when a permitted structure could be sited in an important public viewshed—architectural limitations may be utilized to protect the property's conservation values. Please contact Conservation Partners for more information and sample language. (Architectural limitations also are imposed in many historic preservation easements, and Conservation Partners generally defers to the expertise of the organizations that hold such easements, such as the Virginia Board of Historic Resources, on the specifics of historic restrictions.)
- E. Technical Requirements: The following generally-applicable requirements are based on national easement drafting practice. Once again, other requirements may apply, but the list below includes the requirements that most often present issues for easement donors and their attorneys.
1. Donee. The easement must be donated to a government agency or charitable organization that satisfies all state and federal requirements for a qualified donee, and the donee must be manifestly capable of stewarding and enforcing the easement in perpetuity.
  2. Overarching restriction. Conservation Partners very strongly recommends that the easement deed include an overarching restriction prohibiting activities that are inconsistent with the conservation purposes of the easement.
    - a. *Example*: Various approaches to the overarching restriction will be acceptable to Conservation Partners, but it should be a clear general prohibition rather than a recital that the specific restrictions in the easement suffice to protect the conservation purposes of the donation. The following simple example is taken from the February 4, 2009 Virginia Outdoors Foundation template: “[*Additional optional language. Consult with attorney about whether to include this overarching provision regarding exercise of reserved rights.* Grantor covenants that no acts or uses that are inconsistent with the purpose of this Easement or the conservation values herein protected shall be conducted on the Property.]” Acceptable language also is found in

the current templates used by The Nature Conservancy and the Virginia Eastern Shore Land Trust.

- b. *Rationale:* The overarching restriction protects the conservation values of the property (as well as the easement donee) from future landowners who otherwise inevitably would claim that they have the right to do anything and everything not specifically prohibited in the easement deed. It is impossible to individually name and thereby prohibit all uses of the property that may be inconsistent with the conservation purposes of an easement, because even the most skilled drafter cannot predict the future: the parties cannot possibly at the time the easement is drafted think of all activities and uses that might someday impair the conservation values of the property and specifically prohibit them in the easement. Accordingly, easement drafters across the country often include overarching restrictions in their easements to help ensure the donations are made “exclusively for conservation purposes,” that those purposes are “protected in perpetuity,” and that the easements will “prevent uses of the retained interest inconsistent with the conservation purposes of the donation,” all as required under IRC §170(h).<sup>†</sup>
3. Subordination. Any mortgage or deed of trust encumbering the protected property must be subordinated to the easement or released prior to the donation of the easement.
4. Mining. Surface mining must be prohibited, along with any other type of mining that might be inconsistent with the protection of the conservation values of the property.
5. Baseline documentation. Before the donation is made, documentation must be made available to the donee sufficient to establish the condition of the property at the time of the gift, and the donor and the donee must sign a statement in substance saying “This documentation provides an accurate representation of the protected property at the time of the transfer.”

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<sup>†</sup> All qualifying easement donations must be made “exclusively for conservation purposes,” and those purposes must be “protected in perpetuity” (see IRC §§170(h)(1) and (5)(A)). Those concepts are fleshed out in various provisions in Treas. Reg. §1.170A-14. For example, Treas. Reg. §1.170A-14(e)(2) states that, subject to an exception set forth in Treas. Reg. §1.170A-14(e)(3), “a deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests.” The necessary protection of an easement’s conservation purposes is illustrated in Treas. Reg. §1.170A-14(f), examples (3) and (4). Treas. Reg. §1.170A-14(g)(1) contains the broadest expression of the necessity to protect an easement’s conservation purposes, requiring that “any interest in the property retained by the donor (and the donor’s successors in interest) must be subject to legally enforceable restrictions . . . that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation.” Finally, as part of the open space conservation purposes test, Treas. Reg. §1.170A-14(d)(4)(v) requires that an easement qualifying under that test must not “permit a degree of intrusion or future development that would interfere with the essential scenic quality of the land or with the governmental conservation policy that is being furthered by the donation.”

6. Required notice to donee. The donor must agree in the deed of easement to provide written notice to the donee of the easement before exercising any reserved rights that may, if not exercised in accordance with the terms and restrictions of the easement, impair the conservation values of the property.
7. Donee right of entry. The deed of easement must provide the donee the right to enter the property at reasonable times for the purpose of inspecting the property to determine if there is compliance with the terms of the easement.
8. Donee right to enforce. The deed of easement must provide the donee the right to enforce the conservation restrictions by appropriate legal proceedings, including but not limited to the right to require the restoration of the property to its condition at the time of the donation.
9. Restriction on transfer by donee. The deed of easement must prohibit the donee from transferring the easement unless (i) the transferee is an eligible donee under applicable state and federal law and (ii) the donee requires that the conservation purposes of the easement continue to be carried out.
10. Extinguishment. The deed of easement must contain certain technical “extinguishment” language.

*NOTE: Conservation Partners can provide sample easement provisions to attorneys upon request. In addition, more detailed legal references are included in our template legal opinion, found below.*

## Legal Considerations

### **Section 170(h) of the Internal Revenue Code and Treas. Reg. §1.170A-14**

These *Standards* refer often to §170(h) of the Internal Revenue Code, which has been expressly incorporated into the Virginia Land Conservation Incentives Act of 1999 (§58.1-511, 58.1-512(C)(2)).

It is incumbent upon attorneys and other professionals working with conservation easement donors to familiarize themselves with §170(h) and the Treasury Regulations interpreting that statute. If an attorney representing an easement donor does not have the requisite expertise to reasonably ensure compliance with applicable legal requirements, he or she has an obligation to obtain such expertise before drafting the easement and signing the legal opinion, either through study or by associating with an attorney experienced with the law of conservation easements. As Jonathan Blattmachr of the New York firm Milbank, Tweed stated not long ago in an American Bar Association seminar on conservation easements, “The conservation easement rules contained in section 170(h) of the Internal Revenue Code are among the more complex parts of section 170, which deals with the income tax deduction for donations to charity, which itself may be the most complicated section of the Code.”

Section 170(h) is reproduced below in its entirety (showing revisions included in the Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (2006)), for purposes of reference. Also below is a one-page outline of Treas. Reg. §1.170A-14, which constitutes Treasury’s interpretation of §170(h) and provides additional detail that is crucial to understanding and complying with the statute’s provisions.

#### IRC §170. Charitable, etc., contributions and gifts.

##### (h) Qualified conservation contribution

(1) In general. For purposes of subsection (f)(3)(B)(iii), the term “qualified conservation contribution” means a contribution—

- (A) of a qualified real property interest,
- (B) to a qualified organization,
- (C) exclusively for conservation purposes.

(2) Qualified real property interest. For purposes of this subsection, the term “qualified real property interest” means any of the following interests in real property:

- (A) the entire interest of the donor other than a qualified mineral interest,
- (B) a remainder interest, and

(C) a restriction (granted in perpetuity) on the use which may be made of the real property.

(3) Qualified organization. For purposes of paragraph (1), the term “qualified organization” means an organization which—

(A) is described in clause (v) or (vi) of subsection (b)(1)(A), or

(B) is described in section 501 (c)(3) and—

(i) meets the requirements of section 509 (a)(2), or

(ii) meets the requirements of section 509 (a)(3) and is controlled by an organization described in subparagraph (A) or in clause (i) of this subparagraph.

(4) Conservation purpose defined.

(A) In general. For purposes of this subsection, the term “conservation purpose” means—

(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—

(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 an historically important land area or a certified historic structure.

(B) Special Rules with Respect to Buildings in Registered Historic Districts. In the case of any contribution of a qualified real property interest which is a restriction with respect to the exterior of a building described in subparagraph (C)(ii), such contribution shall not be considered to be exclusively for conservation purposes unless—

(i) such interest—

(I) includes a restriction which preserves the entire exterior of the building (including the front, sides, rear, and height of the building), and

(II) prohibits any change in the exterior of the building which is inconsistent with the historical character of such exterior,

(ii) the donor and donee enter into a written agreement certifying, under penalty of perjury, that the donee—

(I) is a qualified organization (as defined in paragraph (3)) with a purpose of environmental protection, open space preservation, or historic preservation, and

(II) has the resources to manage and enforce the restriction and a commitment to do so, and

(iii) in the case of any contribution made in a taxable year beginning after the date of the enactment of this subparagraph, the taxpayer includes with the taxpayer's return for the taxable year of the contribution—

(I) a qualified appraisal (within the meaning of subsection (f)(11)(E))1 of the qualified property interest,

(II) photographs of all the entire exterior of the building; and

(III) a description of all restrictions on the development of the building.

(C) Certified historic structure. For purposes of subparagraph (A)(iv), the term “certified historic structure” means—

(i) any building, structure, or land area which is listed in the National Register, or

(ii) any building which is located in a registered historic district (as defined in section 47 (c)(3)(B)) and is certified by the Secretary of the Interior to the Secretary as being of historic significance to the district. A building, structure, or land area satisfies the preceding sentence if it satisfies such sentence either at the time of the transfer or on the due date (including extensions) for filing the transferor's return under this chapter for the taxable year in which the transfer is made.

(5) Exclusively for conservation purposes. For purposes of this subsection—

(A) Conservation purpose must be protected. A contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.

(B) No surface mining permitted.

(i) In general. Except as provided in clause (ii), in the case of a contribution of any interest where there is a retention of a qualified mineral interest, subparagraph

(A) shall not be treated as met if at any time there may be extraction or removal of minerals by any surface mining method.

(ii) Special rule. With respect to any contribution of property in which the ownership of the surface estate and mineral interests has been and remains separated, subparagraph (A) shall be treated as met if the probability of surface mining occurring on such property is so remote as to be negligible.

(6) Qualified mineral interest. For purposes of this subsection, the term “qualified mineral interest” means—

(A) subsurface oil, gas, or other minerals, and

(B) the right to access to such minerals.

Treas. Reg. §1.170A-14: Qualified Conservation Contributions

- (a) Qualified Conservation Contributions
- (b) Qualified Real Property Interest
  - (1) Entire interest of donor other than qualified mineral interest
  - (2) Perpetual conservation restriction
- (c) Qualified Organization
  - (1) Eligible donee
  - (2) Transfers by donee
- (d) Conservation Purposes
  - (1) In general
  - (2) Recreation or education
    - (i) In general
    - (ii) Access (public access required)
  - (3) Protection of environmental system
    - (i) In general
    - (ii) Significant habitat or ecosystem
    - (iii) Public access not required
  - (4) Preservation of open space
    - (i) In general
    - (ii) Scenic enjoyment
      - (A) Factors
      - (B) Access
    - (iii) Governmental conservation policy
      - (A) In general
      - (B) Effect of acceptance by government agency
      - (C) Access
    - (iv) Significant public benefit
      - (A) Factors
      - (B) Illustrations
    - (v) Limitation (on permitted development)
    - (vi) Relationship of requirements
      - (A) Clearly delineated governmental policy and significant public benefit
      - (B) Scenic enjoyment and significant public benefit
      - (C) Donations may satisfy more than one test
  - (5) Historic preservation
    - (i) In general
    - (ii) Historically important land area
    - (iii) Certified historic structure
    - (iv) Access
    - (v) Examples
- (e) Exclusively for Conservation Purposes
  - (1) In general
  - (2) Inconsistent use
  - (3) Inconsistent use permitted
- (f) Examples
- (g) Enforceable In Perpetuity
  - (1) In general
  - (2) Mortgage subordination
  - (3) Remote future event
  - (4) Retention of qualified mineral interest
  - (5) Baseline documentation
    - (i) Documentation
    - (ii) Donee's right to inspection and legal remedies
  - (6) Extinguishment
    - (i) In general
    - (ii) Proceeds
- (h) Valuation
  - (1) Entire interest other than qualified mineral interest
  - (2) Remainder interest
  - (3) Perpetual conservation restriction (conservation easement)
    - (i) In general
    - (ii) Fair market value before and after
    - (iii) Allocation of basis
  - (4) Examples
- (i) Substantiation Requirement
- (j) Effective date

## Template Legal Opinion

Conservation Partners recommends but does not require that easement donors obtain a legal opinion regarding their easements' satisfaction of applicable legal requirements. (Note: an easement donor that is a trust or entity will be asked to provide Conservation Partners with a legal opinion substantially in the form of the section of the Template under the heading: "Entity/Trust Easement Grantor and/or Entity/Trust Seller.") This Template Legal Opinion is expressly confined to matters of Virginia state law, but does address certain aspects of federal law that are incorporated into state law. We provide the Template here as a resource for professionals; the Template may be useful to attorneys representing easement donors even if the attorneys do not intend to actually give such an opinion.

The Template is detailed but not onerous. Many of the legal requirements are straightforward and easily satisfied in the deed of easement. Other requirements, which address the conservation values of the land subject to the easement and the extent to which those values are protected by the easement, are more subjective. Very little law exists regarding how to satisfy those subjective requirements, so it would be difficult for even the most expert attorney to guarantee compliance. Consequently, the Template only asks the opining attorney to state that the easement "more likely than not" complies with the subjective requirements (or, with respect to a few of the most subjective requirements, that there is a "reasonable basis" for concluding that the easement so complies), indicating that he or she is aware of such requirements and has made a reasonable effort to ensure that the easement complies.

**VERSION: February 1, 2009. This document is updated from time to time. Please contact Conservation Partners to make sure you have the most current version.** To request an electronic version of this Template Legal Opinion, please send an e-mail to James A. McLaughlin at [jm@conservationpartnersllc.com](mailto:jm@conservationpartnersllc.com).

*NOT LEGAL OR TAX ADVICE: This document is intended for informational purposes only. Conservation Partners does not provide legal or tax advice, and nothing herein is to be considered professional advice of any sort. Nothing contained herein is intended or written to be used (and nothing herein can be used) for the purpose of (i) avoiding penalties under the Internal Revenue Code or (ii) promoting, marketing, or recommending to another party an arrangement relating to any federal tax issue. Readers are responsible for obtaining legal or tax advice based upon their particular circumstances from their own independent professional advisors.*

[Attorney/Firm Letterhead]

[Insert date]

[Insert name and address of credit seller]

[Salutation]:

I represent as counsel [*or* have acted as special counsel to] [insert name of tax credit seller], [insert description of seller; e.g., an individual, husband and wife, a Virginia corporation,

etc.], who is a resident of [state] (“Seller”). Seller [or, if different, name of easement grantor] has donated a/an [open-space/conservation] easement (the “Easement”) to [name of easement holder] (“Grantee”) by [title of deed; e.g., Deed of Gift of Easement] dated [date] (the “Deed of Easement”), which Easement restricts the use and development of certain land comprising approximately \_\_\_\_\_ (\_\_\_\_\_) acres located in \_\_\_\_\_ County, Virginia (the “Property”). The Deed of Easement was recorded in the Clerk’s Office of the Circuit Court of \_\_\_\_\_ County, Virginia on [date] in/as [Deed Book/page or Instrument Number].  
*Optional:* [A copy of the recorded Deed of Easement is attached hereto as Exhibit A.]

You have requested this opinion regarding certain aspects of the validity of the Tax Credit.

### **Applicable Law**

This opinion relates to matters of Virginia law only. Federal law is analyzed herein and opinions are rendered with respect thereto only insofar as the requirements of that federal law have been incorporated into the Land Conservation Incentives Act (as hereinafter defined). Nothing herein is to be considered federal legal or tax advice of any sort, and nothing herein may be relied upon for purposes of penalty protection under federal law.

In rendering this opinion, I have reviewed such law and public records as I have deemed necessary or appropriate in connection with the matters set forth herein, including without limitation the following laws and regulations, which constitute the primary law relevant to my opinion:

- [as applicable] Section 10.1-1009 *et seq.* of the Code of Virginia (1950), as amended (the “Conservation Easement Act”).
- [as applicable] Section 10.1-1700 *et seq.* of the Code of Virginia (1950), as amended (the “Open-Space Land Act”).
- [if easement donated to Virginia Outdoors Foundation] Section 10.1-1800 *et seq.* of the Code of Virginia (1950), as amended.
- [if easement donated to Department of Historic Resources] Section 10.1-2200 *et seq.* of the Code of Virginia (1950), as amended.]
- [if easement donated to Department of Forestry] Section 10.1-1100 *et seq.* of the Code of Virginia (1950), as amended.]
- Section 58.1-510 *et seq.* of the Code of Virginia (1950), as amended (the “Land Conservation Incentives Act”).
- Section 170(h) of the United States Internal Revenue Code of 1986, as amended, and the regulations promulgated thereunder, Treas. Reg. §1.170A-14 (together, “IRC §170(h)”), to the extent the requirements under such federal law have been incorporated into the Land

Conservation Incentives Act.

- Sections 501(c)(3) and 509(a)(2) and (3) of the United States Internal Revenue Code of 1986, as amended, and the regulations pertaining thereto, to the extent the requirements under such federal law have been incorporated into the Land Conservation Incentives Act [*as applicable*] and the Conservation Easement Act.

### **Documents**

With respect to the matters set forth herein, I have examined and am familiar with the following documents:

- The Deed of Easement.
- The “baseline” documentation describing the condition of the Property at the time of the gift of the Easement as required under Treas. Reg. § 1.170A-14(g)(5)(i) (as incorporated into the Land Conservation Incentives Act).
- Such other certificates, documents, records, and materials (including, without limitation, records and/or other materials relating to Seller’s title to the Property), as I have deemed appropriate in connection with this opinion.

### **Assumptions; Reliance; Standard of Opinion**

[*optional*] In rendering this opinion, I have assumed as true the factual matters set forth in Schedule A to this opinion.

[*optional*] I have also relied upon the accuracy and correctness of the factual representations made in the document(s) listed on Schedule B to this opinion, with copies of those documents attached to Schedule B.

[*simple alternative to the two provisions above, relying only on the recitals of fact in the Deed of Easement*] In rendering this opinion, I have relied upon the accuracy and correctness of the descriptions of the conservation values of the Property (but not any legal assertions or conclusions) in the recitals in the Deed of Easement.

Such factual assumptions and/or representations are derived from sources I believe to be reasonably reliable, and no facts have come to my attention that would cause me to question the accuracy and completeness of such information in a material way.

With respect to certain standards under applicable law, many issues requiring interpretation have not been authoritatively addressed. Accordingly, the opinions expressed herein as to the interpretation of the laws and regulations discussed herein are limited to the judicial, administrative, and legislative authorities and policies that are publicly available on the date of this opinion. The laws addressed herein are subject to judicial, administrative, and legislative clarification or change, but I am not aware of material changes that are pending

regarding the laws, policies, and regulations discussed herein that would change the conclusions of the opinions set forth herein.

The opinions set forth herein are sometimes limited to a “more likely than not” or “reasonable basis” standard. When my opinion is limited to a “more likely than not” standard, it is my opinion that the likelihood is greater than fifty percent. When my opinion is limited to a “reasonable basis” standard, for example with respect to compliance with certain highly subjective and difficult-to-quantify elements of IRC §170(h) (as incorporated into the Land Conservation Incentives Act), I cannot state that the likelihood is more than fifty percent, but it is my opinion that there is a reasonable basis for concluding as such.

Based upon and subject to the foregoing, I have reached the following conclusions concerning the Tax Credit:

[as applicable] **Conservation Easement Act**

**Selected Elements of the Conservation Easement Act:**

Selected elements of the Conservation Easement Act are set forth below for informational purposes. The items below are not intended to constitute an exhaustive list of the elements required in order for the Easement to qualify under the Conservation Easement Act.

1. Sections 10.1-1009 and 10.1-1010(C) of the Conservation Easement Act set forth the requirements of a qualified holder of the Easement.
2. Under §10.1-1010(E) of the Conservation Easement Act, the limitations or obligations created by the Easement must “conform in all respects to the comprehensive plan at the time the easement is granted for the area in which the real property is located.”
3. Section 10.1-1012 of the Conservation Easement Act requires that “the party responsible for recording [any instrument conveying a conservation easement] or his agent shall mail certified copies thereof, together with notice as to the date and place of recordation, to the local jurisdiction in which the real property subject thereto is located, the Attorney General of the Commonwealth, the Virginia Outdoors Foundation and to any public body named in such instrument. Certified copies of the instrument creating such easement, together with information specifying the date and place of its recordation, shall be mailed to the local jurisdiction in which the real property subject thereto is located, the Attorney General of the Commonwealth, the Virginia Outdoors Foundation and to any public body named in such instrument. Whenever any conservation easement is on lands that are part of a historic landmark as certified, either by the United States or the Virginia Historic Landmarks Board, any notice required above shall also be given to the Virginia Historic Landmarks Board.”  
Note: the Virginia Historic Landmarks Board is now the Board of Historic Resources.

**Opinion with Respect to the Conservation Easement Act:**

With respect to the requirement under §10.1-1012 above, I have obtained copies of cover

letters by which the required notices were sent [*or* a letter from Grantee stating that copies and notice have been provided to all parties as required under such statute]. Based solely upon such copies of correspondence, the source of which I believe to be reasonably reliable, it is my opinion that the requirements of §10.1-1012 of the Conservation Easement Act have been met.

It is my opinion that the Easement more likely than not is valid and enforceable under the Conservation Easement Act.

*[as applicable]* **Open-Space Land Act**

**Selected Elements of the Open-Space Land Act:**

Selected elements of the Open-Space Land Act are set forth below for informational purposes. The items below are not intended to constitute an exhaustive list of the elements required in order for the Easement to qualify under the Open-Space Land Act.

1. Section 10.1-1700 of the Open-Space Land Act sets forth the requirements of a qualified holder of the Easement.
2. Under §10.1-1701 of the Open-Space Land Act, if a public body acquires land or interests in land for open space use, “[t]he use of the real property for open-space land shall conform to the official comprehensive plan for the area in which the property is located.”

**Opinion with Respect to the Open-Space Land Act:**

It is my opinion that the Easement more likely than not is valid and enforceable under the Open-Space Land Act.

**Land Conservation Incentives Act (excluding §IRC 170(h))**

**Selected Elements of the Land Conservation Incentives Act (excluding §IRC 170(h)):**

Selected elements of the Land Conservation Incentives Act are set forth below for informational purposes. The items below are not intended to constitute an exhaustive list of the elements required in order for the Easement to qualify under the Land Conservation Incentives Act.

1. Sections 58.1-511 and 512(C)(4) of the Land Conservation Incentives Act set forth the requirements of a qualified holder of the Easement.
2. Section 58.1-512(C)(3) of the Land Conservation Incentives Act provides that “[a]ny fee interest, or a less-than-fee interest, in real property that has been dedicated as open space within, or as part of, a residential subdivision or any other type of residential or commercial development; dedicated as open space in, or as part of, any real estate development plan; or dedicated for the purpose of fulfilling density requirements to obtain approvals for zoning, subdivision, site plan, or building permits shall not be a qualified donation under this

article.”

3. Under §58.1-512(C)(5) of the Land Conservation Incentives Act, the preservation, agricultural preservation, historic preservation or similar use and purpose of the Property must be “assured in perpetuity” under the Easement.

Opinion with Respect to the Land Conservation Incentives Act (excluding §IRC 170(h)):

Seller has represented to me that neither Seller nor any person or entity affiliated with Seller nor an immediate family member of Seller has claimed any land preservation tax credit with respect to a donation of a fee or less-than-fee interest in any other portion of a recorded parcel of land that is included in the Property within the preceding 11 years and, based solely upon such representation, it is my opinion that no credits are required to be aggregated with the Tax Credit under §58.1-512(D)(3)(b) of the Land Conservation Incentives Act.

It is my opinion that the Tax Credit more likely than not is valid and transferable under all provisions of the Land Conservation Incentives Act except the requirements of §IRC 170(h) incorporated under §58.1-511 and §58.1-512(C)(2) of the Land Conservation Incentives Act as described below.

**IRC §170(h) Incorporated into the Land Conservation Incentives Act**

Selected Elements of IRC §170(h) Incorporated into the Land Conservation Incentives Act:

Under §58.1-511 of the Land Conservation Incentives Act, the Easement must “compl[y] with the requirements of” IRC §170(h) and under §58.1-512(C)(2) of the Land Conservation Incentives Act, the donation of the Easement must “qualif[y] as a charitable deduction under” IRC §170(h). Selected elements of IRC §170(h) and the Treasury Regulation promulgated thereunder, Treas. Reg. §1.170A-14, are set forth below for informational purposes. The items below are not intended to constitute an exhaustive list of the elements of IRC §170(h) as incorporated into the Land Conservation Incentives Act.

1. IRC §170(h)(3) and Treas. Reg. §1.170A-14(c) set forth the requirements of a “qualified organization.”
2. Treas. Reg. §1.170A-14(c)(2) provides that a deduction will be allowed “only if in the instrument of conveyance the donor prohibits the donee from subsequently transferring the easement..., whether or not for consideration, unless the donee organization, as a condition of the subsequent transfer, requires that the conservation purposes which the contribution was originally intended to advance continue to be carried out. Moreover, subsequent transfers must be restricted to organizations qualifying, at the time of the subsequent transfer, as an eligible donee” under Treas. Reg. §1.170A-14(c)(1).
3. Under IRC §170(h)(1), the Easement must be granted “exclusively for conservation purposes.” IRC §170(h)(4) defines “conservation purpose,” and such definition is elaborated in Treas. Reg. §1.170A-14(d) (the four conservation purposes described in IRC §170(h)(4)

and Treas. Reg. §1.170A-14(d) are referred to as the “Conservation Purposes”). As part of the “open space” Conservation Purpose, Treas. Reg. §1.170A-14(d)(4)(v) requires that an easement must not “permit a degree of intrusion or future development that would interfere with the essential scenic quality of the land or with the governmental conservation policy that is being furthered by the donation.”

4. Treas. Reg. §1.170A-14(e)(2) provides that, subject to an exception set forth in Treas. Reg. §1.170A-14(e)(3), “a deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests” (the “Inconsistent Use Rule”).
5. Treas. Reg. §1.170A-14(g)(1) requires that “any interest in the property retained by the donor (and the donor’s successors in interest) must be subject to legally enforceable restrictions (for example, by recordation in the land records of the jurisdiction in which the property is located) that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation.”
6. Treas. Reg. §1.170A-14(g)(2) provides that “no deduction will be permitted under this section for an interest in property which is subject to a mortgage unless the mortgagee subordinates its rights in the property to the right of the qualified organization to enforce the conservation purposes of the gift in perpetuity.”
7. IRC §170(h)(5)(B) provides that, subject to a “so remote as to be negligible” exception, “in the case of a contribution of any interest where there is a retention of a qualified mineral interest,” the requirement that the conservation purpose of the contribution be protected in perpetuity “shall not be treated as met if at any time there may be extraction or removal of minerals by any surface mining method.” In addition, under Treas. Reg. §1.170A-14(g)(4)(i), no deduction will be allowed if (i) “at any time there may be extractions or removal of minerals by any surface mining method” or (ii) “any method of mining that is inconsistent with the particular conservation purposes of a contribution is permitted at any time.” See also the Inconsistent Use Rule under Treas. Reg. §1.170A-14(e)(2).
8. Treas. Reg. §1.170A-14(g)(5) imposes certain requirements if the donor of a qualified real property interest “reserves rights the exercise of which may impair the conservation interests associated with the property” as set forth below:
  - a) Treas. Reg. §1.170A-14(g)(5)(i): Before the donation is made, documentation must be made available to the donee that is “sufficient to establish the condition of the property at the time of the gift.” Furthermore, “[i]f the terms of the donation contain restrictions with regard to a particular natural resource to be protected, such as water quality or air quality, the condition of the resource at or near the time of the gift must be established.” Such documentation must be accompanied by a statement signed by the donor and a representative of the donee clearly referencing the documentation and in substance saying “This natural resources inventory is an accurate representation of [the protected property] at the time of the transfer.”

- b) Treas. Reg. §1.170A-14(g)(5)(ii): “[T]he donor must agree to notify the donee, in writing, before exercising any reserved right, e.g. the right to extract certain minerals which may have an adverse impact on the conservation interests associated with the qualified real property interest. The terms of the donation must provide a right of the donee to enter the property at reasonable times for the purpose of inspecting the property to determine if there is compliance with the terms of the donation. Additionally, the terms of the donation must provide a right of the donee to enforce the conservation restrictions by appropriate legal proceedings, including but not limited to, the right to require the restoration of the property to its condition at the time of the donation.”
9. Under Treas. Reg. §1.170A-14(g)(6)(i), “If a subsequent unexpected change in the conditions surrounding the property that is the subject of a donation . . . can make impossible or impractical the continued use of the property for conservation purposes, the conservation purpose can nonetheless be treated as protected in perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee’s proceeds . . . from a subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original contribution.” Under Treas. Reg. §1.170A-14(g)(6)(ii), “at the time of the gift the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right, immediately vested in the donee organization, with a fair market value that is at least equal to the proportionate value that the perpetual conservation restriction at the time of the gift, bears to the value of the property as a whole at that time,” and when a change in conditions gives rise to the extinguishment of a perpetual conservation restriction, “the donee organization, on a subsequent sale, exchange, or involuntary conversion of the subject property, must be entitled to a portion of the proceeds at least equal to that proportionate value of the perpetual conservation restriction.”

Opinion with Respect to IRC §170(h) Incorporated into the Land Conservation Incentives Act:

For purposes of qualification under the Land Conservation Incentives Act only, it is my opinion that any rights retained by the grantor of the Easement to divide, construct dwellings or other improvements upon, and otherwise use the Property are sufficiently limited in the Easement so that there is a reasonable basis for concluding that (i) the Easement will prevent uses of the Property inconsistent with the conservation purposes of the donation as required under Treas. Reg. §1.170A-14(g)(1), (ii) the Easement complies with the Inconsistent Use Rule under Treas. Reg. §1.170A-14(e)(2), and (iii) [*applicable if the Easement purports to qualify under the open space Conservation Purpose*] the Easement complies with Treas. Reg. §1.170A-14(d)(4)(v).

For purposes of qualification under the Land Conservation Incentives Act only, it is my opinion that there is a reasonable basis for concluding that the Easement complies with the requirements of and qualifies as a charitable deduction under IRC §170(h).

**Appraisal Not Covered by Opinion**

Sections 58.1-512(B) and 58.1-512.1 of the Land Conservation Incentives Act set forth

certain requirements with respect to substantiating the fair market value of qualified donations, and Treas. Reg. §1.170A-14(h) addresses the valuation of contributions under IRC §170(h). I am not an appraiser, and I express no opinion as to the accuracy of any appraisal substantiating the fair market value of the Easement or whether the fair market value of the Easement is substantiated in compliance with §58.1-512(B) and §58.1-512.1 of the Land Conservation Incentives Act, Treas. Reg. §1.170A-14(h), or any other applicable state or federal requirements.

### **Title Matters**

It is my opinion that, except for certain restrictions on transfer contained in the Deed of Easement as required under IRC §170(h) and designed to ensure that the conservation restriction will be dedicated to conservation purposes, marketable title to the Easement has been conveyed to Grantee, and no defects in or liens or encumbrances on such title limit the enforceability of the Easement or impair the validity or transferability of the Tax Credit.

[*optional*] In rendering this section of this opinion, I have relied upon the title opinion of \_\_\_\_\_ [or] the [commitment for an] owner's title policy with respect to the Property listed on Schedule C to this opinion, with a copy of such document attached to Schedule C. Such title [opinion/policy] has been updated to the date and time of the recordation of the Deed of Easement.

*[In making the opinion required in this paragraph, the opining attorney may do any of the following: (i) attach no other title documentation because the opining attorney prepared the title work associated with the donation of the Easement, (ii) expressly rely upon another attorney's legal opinion of title, or (iii) expressly rely upon a title insurance policy (or commitment) issued by a title insurance company. Any such separate opinion or policy/commitment must be listed in Schedule C and attached thereto. At least a 60-year title search is recommended, and in any event the title work must be updated to the recordation of the Deed of Easement.]*

#### [*as applicable*] **Entity/Trust Easement Grantor and/or Entity/Trust Seller:**

1. One or more grantor of the Easement is not an individual person (whether Seller and/or any other entity, and whether one or more, the "Entity/Trust Grantor"), and it is my opinion that:
  - a) The Entity/Trust Grantor took all action necessary to authorize its execution, delivery, and performance of the Deed of Easement and all other contracts, tax forms and filings, and other documents to which such Entity/Trust Grantor is a party and that are necessary or proper to effect the donation of the Easement and registration of the Tax Credit (such other documents are referred to herein collectively as the "Additional Documents").
  - b) The Entity/Trust Grantor had at the time of the grant of the Easement the power, right, and authority to grant and convey the Easement and undertake and assume its obligations under the Deed of Easement and the Additional Documents, and the person(s) who executed and delivered the Deed of Easement and the Additional Documents on behalf of the Entity/Trust Grantor was/were authorized to do so and to bind the Entity/Trust

Grantor.

- c) The Easement and the Additional Documents (as applicable) constitute binding obligations of the Entity/Trust Grantor, enforceable against the Entity/Trust Grantor in accordance with their respective terms.
2. With regard to Seller, which is not an individual person, it is my opinion that:
    - a) Seller has taken all action necessary to authorize its execution, delivery, and performance of all contracts, tax forms and filings, and other documents necessary or proper to Seller's marketing and sale of the Tax Credit (such documents are referred to herein collectively as the "Credit Sale Documents").
    - b) [Name(s) and/or title(s) of person(s) authorized] (the "Authorized Person[s]") is/are authorized to execute and deliver the Credit Sale Documents on behalf of Seller.
    - c) If Seller is a "pass-through" entity, the Authorized Person has the discretion to hold and/or distribute Seller funds.

#### **Conclusion; Limitations**

The opinions set forth herein are rendered solely for the use of the addressees of this letter and may not be relied upon, in whole or in part, by any other person, firm, corporation, or entity for any purpose without my prior written consent. I have not undertaken to advise you of matters of fact or changes of law that come to my attention after the date hereof that would require an amendment to this opinion. I do not believe that any opinion contained herein is based on any unreasonable legal assumptions, representations, or conclusions.

*[attorney's valediction and signature]*

*[optional]*

#### **Schedule A to Opinion Letter: Factual Assumptions**

In connection with the opinion set forth in the letter above, I have assumed as true the factual matters set forth below:

1. The genuineness of all signatures and the conformity to original documents of all documents submitted to me as certified copies.
2. I have confirmed the following facts based on sources I believe to be reasonably reliable, and I know of no facts to the contrary, but I make no other representation or warranty regarding the following facts, which are material to my conclusions in this opinion in that the substantial correctness of the following facts, considered together, is essential to the argument that the Easement satisfies one or more of the Conservation Purposes under IRC §170(h):

*[List specific recitals of fact from the Easement as necessary, such as the type and quality of conservation values present on the encumbered land, the extent of development pressure on the encumbered land, etc. Do **not** list conclusions of logic or law listed in the recitals to the Easement (e.g., do not list “this Easement is granted exclusively for conservation purposes under IRC §170(h)(1)(C) because it qualifies under the open space conservation purpose of IRC §170(h)(4)(A)(iii)”].*

3. *[If applicable:]* The due adoption and validity of the laws and regulations recited in the Deed of Easement as “clearly delineated governmental conservation policy.”
4. Seller has not used or previously transferred the Tax Credit.
5. Seller will not claim a credit under any other Virginia law for costs related to the Property.
6. *[Any other assumptions of fact reasonably necessary to the opinion.]*

*[optional]*

Schedule B to Opinion Letter: Factual Representations

In connection with the opinion set forth in the letter above, I have also relied upon the correctness of the factual representations made in the following document(s), copies of which are attached to this Schedule B:

- 1) *[Any factual representations the opining attorney relies upon in the foregoing opinion should be listed on this Schedule B and attached hereto.]*

*[optional]*

Schedule C to Opinion Letter: Third Party Title Investigation

In connection with the opinion set forth in the letter above, I have relied upon the *[describe attorney’s legal opinion of title or title insurance policy issued by a title insurance company]*, a copy of which is attached to this Schedule C.

## Conservation Easement Appraisal Standards

Conservation Partners will not market credits that are based on appraisals we feel are abusive or not appropriately supported by market evidence. The following appraisal standards represent our attempt to address several problem areas in easement appraising based upon the cumulative experience of various nationally recognized conservation easement appraisal experts, but these standards are not intended as a step-by-step guide to appraising easements and we make no representation that these standards are coextensive with applicable legal or regulatory requirements.<sup>‡</sup>

The donor of a conservation easement will be eligible for a Virginia land preservation tax credit only if the value of the easement is substantiated by an appraisal that meets certain applicable legal and regulatory requirements (*see* §58.1-510 *et seq.* of the Code of Virginia (1950), as amended, and the Guidelines for Qualified Appraisals adopted by the Virginia Department of Taxation on January 9, 2007). An appraisal that fails to meet those requirements, or that overstates the value of the easement, may cause the tax credit to be disallowed in whole or in part if it is successfully challenged by the IRS or the Virginia Department of Taxation.

No one can reliably predict what positions tax authorities may take with respect to appraisals' valuation assertions or compliance with applicable requirements, and our acceptance of an appraisal and the credit based upon that appraisal does not constitute a warranty by Conservation Partners to the credit seller that the appraisal complies with applicable legal and regulatory requirements or that the credit is valid. It is up to the seller's appraiser and other professional advisors to ensure such compliance.

*The standards outlined below are intended for internal screening purposes only. Nothing herein is to be considered legal or tax advice.*

**VERSION: February 1, 2009. This document is updated from time to time. Please contact Conservation Partners, LLC to make sure you have the most current version.**

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<sup>‡</sup>For a more in-depth treatment of techniques for appraising easements, see James H. Boykin, *Transfer Methods and Valuation Procedures For Conservation Easements* (Right of Way International Education Foundation, 1998) (hereinafter, "Boykin"), *Appraising Easements, Guidelines for Valuation of Land Conservation and Historic Preservation Easements* (Land Trust Alliance, 3<sup>rd</sup> ed., 1999) (hereinafter, "Appraising Easements"), and *A Conservation Easement Appraisal Guide: A Brief Overview of Easement Valuation in Colorado* (available from the Colorado Coalition of Land Trusts at [www.cclt.org](http://www.cclt.org)). For examples of comprehensive general appraisal standards, see *The Uniform Standards of Professional Appraisal Practice* (The Appraisal Foundation) ("USPAP"), *U.S. Dept. of Justice, Uniform Appraisal Standards For Federal Land Acquisitions* (Appraisal Institute, 2000) (the "Yellow Book"), and appraisal standards published by federal agencies such as the U.S. Fish and Wildlife Service (342 FW 1, *Appraisal Handbook*).

## **Selected Technical Requirements**

- I. **Qualified Appraisal/Appraiser.** Federal legislation passed in 2006 substantially modified the “qualified appraisal” and “qualified appraiser” requirements by expanding §170(f)(11)(E) of the Internal Revenue Code. The IRS issued transitional guidance regarding the new law in Notice 2006-96 (see below re: proposed new regulations interpreting the expanded statute). In response to those changes as well as existing requirements, Conservation Partners requires both of the following:
- A. The appraiser must sign the current (December 2006 or later) version of the donor’s Form 8283, which includes certain important required declarations. See Appraisal Summary section below.
  - B. The appraiser must make the following express declarations in the appraisal report:
    - 1. This appraisal report has been prepared for income tax purposes and in a manner consistent with the substance and principles of *The Uniform Standards of Professional Appraisal Practice* (The Appraisal Foundation).
    - 2. I am licensed in the Commonwealth of Virginia to appraise the type of property appraised in this report, and I regularly perform appraisals of the type of property appraised in this report.
    - 3. I have not been prohibited from practicing before the Internal Revenue Service by the Secretary of the Treasury under §330(c) of Title 31 of the United States Code at any time during the three-year period ending on the date of this appraisal.
    - 4. I certify I am a qualified appraiser under §170(f)(11) of the Internal Revenue Code and I declare that, because of my background, experience, education, and membership in professional associations, I am qualified to make appraisals of real estate and, in particular, conservation easements.
    - 5. I understand that this appraisal will be used in connection with a tax return or claim for refund, and a substantial or gross valuation misstatement resulting from this appraisal may subject me to a civil penalty under §6695A of the Internal Revenue Code.
- NOTE:** The IRS has issued proposed new “Substantiation and Reporting Requirements for Cash and Noncash Charitable Contribution Deductions.” The comment period runs until November 5, 2008. Please see the Resources page at [www.conservationpartnersllc.com](http://www.conservationpartnersllc.com) for a PDF of the proposed new regulations, with information on submitting comments.
- II. **Affidavit:** Under the amended Land Conservation Incentives Act of 1999, the appraisal report must include an affidavit by the appraiser stating, among other things, that to the best of his or her knowledge and belief the valuation complies with §58.1-512.1 of the Code of Virginia (1950), as amended, See *Guidelines for Qualified Appraisals* adopted by the

Virginia Department of Taxation on January 9, 2007.

*Format:* The Tax Department has suggested a sample format for the required affidavit, adapted below. Please include the following affidavit in the “Certification” section of your appraisal reports submitted to Conservation Partners for review. The affidavit does not need to be sworn before a notary public.

The following is intended to constitute the affidavit required under §58.1-512.1 of the Virginia Land Conservation Incentives Act of 1999 and *Guidelines for Qualified Appraisals* adopted by the Virginia Department of Taxation on January 9, 2007:

I declare under penalty of perjury to the best of my knowledge and belief:

(i) that the valuation made in the foregoing appraisal report complies with §58.1-512.1 of the Code of Virginia (1950), as amended;

(ii) that all of the relevant facts and assumptions that form the basis for the valuation and compliance with §58.1-512.1 are set forth in section(s) \_\_\_\_\_ of the appraisal report [*list the section titles for (i) discussion and analysis of the subject property’s market, neighborhood, road access, etc., (ii) description of the property, (iii) discussion of zoning applicable to the property, and (iv) (most importantly) the before-easement highest and best use analysis*]; and

(iii) that such facts are true and correct to the best of my knowledge and belief except as qualified in the referenced sections of the appraisal report, and if qualified, that the stated reservations concerning the facts were taken into account in the valuation.

III. Timing: The appraisal: (i) must be made not earlier than 60 days prior to the date of contribution of the appraised property (the date the easement is recorded), and (ii) must be made and received by the donor before the due date (including extensions) of the tax return on which the donor first claims a deduction for the easement donation. Treas. Reg. §1.170A-13(c)(3)(i)(A) and (3)(iv)(B).

IV. History of the Subject Property: We generally recommend using a 5-year look-back period because that’s what the IRS requires of its own appraisers. Section 4.48.6.2.3 (1) of the Internal Revenue Manual states that IRS appraisers should obtain “The history of the property, including any sales within the five (5) years preceding the valuation date or any sales since the valuation date to the present. Both periods of sales should include the sales dates, prices, mortgage amounts, and the names of the sellers, buyers and mortgage lenders.” Note: Conservation Partners does not specifically require mortgage history in appraisal reports.

V. Required Information: Treas. Reg. §1.170A-13(c)(3)(ii) requires that the following information be included in a qualified appraisal (the italicized language below corresponds with subparagraphs (A) through (K) of that Regulation):

- A. *“A description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property that was (or will be) contributed.”* Both the easement and the property encumbered by the easement should be described.
- B. *“In the case of tangible property, the physical condition of the property.”* The physical condition of the subject property at the time of the easement donation should be described.
- C. *“The date (or expected date) of contribution to the donee.”* If the appraisal is retrospective, the date of contribution generally should be the date the easement was recorded.
- D. *“The terms of any agreement or understanding entered into (or expected to be entered into) by or on behalf of the donor or donee that relates to the use, sale, or other disposition of the property contributed.”* Language similar to the following sample language may be included in an easement appraisal report to comply with this requirement:

Treas. Reg. §1.170A-13(c)(3)(ii)(D) requires that a qualified appraisal include the terms of any agreement relating to the donee’s use or disposition of the property contributed. The deed conveying the subject conservation easement (a copy of which is included in this report) does contain certain restrictions on transfer as required under §170(h) of the Internal Revenue Code. However, Treas. Reg. §1.170A-14(h)(3)(ii) provides that “the value of a perpetual conservation restriction shall not be reduced by reason of the existence of restrictions on transfer designed solely to ensure that the conservation restriction will be dedicated to conservation purposes.” Accordingly, I have not reduced the fair market value of the subject easement to account for such restrictions on transfer. I am not aware of any agreements relating to the donee’s use or disposition of the property contributed as described in Treas. Reg. §1.170A-13(c)(3)(ii)(D) other than those contained in the deed of easement and designed solely to ensure that the conservation restriction will be dedicated to conservation purposes.

- E. *“The name, address, and (if a taxpayer identification number is otherwise required by section 6109 and the regulations thereunder) the identifying number”* of the appraiser and, if applicable, the name, address, and taxpayer identification number of the appraiser’s partnership or employer. See IRS publication 561, page 10, item 5 in the list of information included in a qualified appraisal: “5. The name, address, and taxpayer identification number of the qualified appraiser and, if the appraiser is a partner, an employee, or an independent contractor engaged by a person other than the donor, the name, address, and taxpayer identification number of the partnership or the person who employs or engages the appraiser.” In addition, proposed regulations governing the substantiation of charitable contributions were issued by the Treasury Department in August of 2008, and these regulations, if adopted, would unequivocally require the taxpayer identification number of the qualified appraiser be included in the appraisal

report. NOTE: there are serious privacy issues associated with placing an individual's social security number on a document that is reviewed by numerous parties. Conservation Partners does not recommend placing tax identification numbers of any kind on *draft* appraisal reports. The numbers should only be filled in on the printed *final* report at the last minute. Reports with individual social security numbers should not be sent electronically over the Internet by email or otherwise. Finally, the following excerpt from the "Explanation of Provisions" section of the proposed substantiation Regulations (Federal Register August 7, 2008 (Vol. 73, No. 153, p. 45912)) may provide some guidance to concerned appraisers:

Expressing concerns about identity theft, some commenters requested elimination of the requirements of supplying the appraiser's taxpayer identification number on Form 8283 and in the appraisal, as currently required under Sec. 1.170A-13(c)(3)(ii)(E) and 1.170A-13(c)(4)(ii)(I). The concern arises from appraisers who do not have a taxpayer identification number other than a social security number. The proposed regulations continue to require this information because, pursuant to Sec. 301.6109-1(a)(1)(ii)(D) of the Procedure and Administration Regulations, an appraiser may obtain an employer identification number even if the appraiser does not have employees. This number may be obtained by completing Form SS-4, "Application for Employer Identification Number." See Pub. 1635, "Understanding Your Employer Identification Number." If an appraiser is employed by a firm, the firm's employer identification number should be used.

- F. *"The qualifications of the qualified appraiser who signs the appraisal, including the appraiser's background, experience, education, and membership, if any, in professional appraisal associations."*
- G. *"A statement that the appraisal was prepared for income tax purposes."*
- H. *"The date (or dates) on which the property was appraised."*
- I. *"The appraised fair market value (within the meaning of [Treas. Reg.] §1.170A-1(c)(2)) of the property [i.e., the easement] on the date (or expected date) of contribution."* If the appraisal is retrospective, the date of contribution should be the date the easement was recorded. The appraisal report should recite the referenced Regulation's definition of fair market value: "The fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts."
- J. *"The method of valuation used to determine the fair market value."* As discussed below, the appraiser should describe the "before and after" method used to "determine" (i.e., estimate) the value of the easement, along with the approach(es) used to value the property in each of the before-easement and after-easement components of the appraisal.
- K. *"The specific basis for the valuation, such as specific comparable sales transactions...."* The appraiser should give detailed, specific descriptions of the data used in the appraisal,

for example, the comparable sales used in each of the before-easement and after-easement components of a before and after easement appraisal.

VI. Appraisal Summary: The appraisal summary requirement is fulfilled by IRS Form 8283.

- A. Form 8283. Section B (page 2) of the Form 8283 must be filled out and signed and dated by the appraiser and the donee, and a copy of the Form 8283 must be furnished to the donee. Be sure the most recent revision of the Form is used, currently the December 2006 version.
- B. Supplemental Statement. A statement must be attached to the donor's Form 8283 "showing the [fair market value] of the underlying property before and after the gift and the conservation purpose furthered by the gift." Treas. Reg. §1.170A-14(i). The most recent Instructions for Form 8283 (Rev. December 2006) require the donor to attach a statement that:
1. "Identifies the conservation purposes furthered by your donation,"
  2. "Shows, if before and after valuation is used, the FMV of the underlying property before and after the gift,"
  3. "States whether you made the donation in order to get a permit or other approval from a local or other governing authority and whether the donation was required by a contract, and"
  4. "If you or a related person has any interest in other property nearby, describes that interest."

**Appraisal Methodology**

- I. "Fair Market Value" of a Conservation Easement: the "Substantial Record of Sales of Easements" Rule and the Before and After Method.
- A. The Treasury's preference: sales of easements. Treas. Reg. §1.170A-14(h)(3)(i) provides that if "a substantial record of market-place sales of easements comparable to the subject easement (such as sales pursuant to a governmental program)," is "available to use as a meaningful or valid comparison," "the fair market value of the donated easement [must be] based on the sales prices of such comparable easements." *See also* the Instructions for Form 8283 (Rev. December 2005), page 2, "Qualified conservation contribution" section: "The best evidence of the FMV of an easement is the sales price of a comparable easement. If there are no comparable sales, the before and after method may be used." Note that contrary to popular misunderstanding, this rule addresses *sales of easements*, not *sales of properties encumbered by easements*.
- B. Second choice: the before and after method. Treas. Reg. §1.170A-14(h)(3)(i) also provides that if no such "substantial record" is "available to use as a meaningful or valid

comparison,” the value of an easement for purposes of §170(h) of the Internal Revenue Code “as a general rule (but not necessarily in all cases)” is “equal to the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property after the granting of the restriction.” Thus, in the absence of a substantial record of marketplace sales of easements, the appraiser generally should use the traditional “before and after” method to value the easement.

- C. Practical application of the rule. The Treasury Regulations are quite clear in their preference for the direct valuation of easements based on marketplace sales of easements. However, for several practical and theoretical reasons it would be remarkable for a government (or private) easement purchase program to generate data that a careful appraiser would consider to be “available to use as a meaningful or valid comparison,” and, thus, fully sufficient as the basis of an appraisal valuing the easement directly. For example, in *Browning v. Commissioner*, 109 T.C. 303, 319 (1997), the Tax Court held that the record of sales from a Maryland county’s easement purchase program was not “available to use as a meaningful or valid comparison” as required in the Regulations because the county and the easement sellers intended to engage in “bargain” transactions and, thus, the sales were not produced in an “uninhibited market.” See also Boykin, at 34; *Appraising Easements*, at 24. While data from easement purchase programs almost always will be insufficient on its own to support the direct valuation of an easement, appraisers sometimes may find such data useful within the context of a before and after easement appraisal.
- D. Sample language. Because it is a threshold rule, the appraiser should address the “substantial record of sales of easements” rule early in the appraisal report, before beginning the before and after analysis, preferably in the section of the report in which “market value” is explained and defined. The following is an example of language that has been used in Virginia appraisals to address this requirement:

The Substantial Record of Sales of Easements Rule: Treas. Reg. §1.170A-14(h)(3)(i) provides that if “a substantial record of market-place sales of easements comparable to the subject easement (such as sales pursuant to a governmental program),” is “available to use as a meaningful or valid comparison,” “the fair market value of the donated easement [must be] based on the sales prices of such comparable easements,” but if no such “substantial record” is “available to use as a meaningful or valid comparison,” the value of an easement for purposes of §170(h) of the Internal Revenue Code “as a general rule (but not necessarily in all cases)” is “equal to the difference between the fair market value of the property it encumbers before the granting of the restriction and the fair market value of the encumbered property after the granting of the restriction.”

Analysis of Marketplace Sales: The purchase programs operating in the Commonwealth of Virginia have not purchased, for fair market value, a sufficient number of easements that are sufficiently comparable to the subject easement to

generate a “substantial record” sufficient to support the valuation of the subject easement by direct comparison with such easement purchases. However, the appraiser will consider any relevant data from easement purchase programs in the course of appraising the subject easement using the before and after method as described below.

Use of the Before and After Method: Because no substantial record of marketplace sales of easements comparable to the subject easement is available to use as a meaningful or valid comparison, in accordance with Treas. Reg. §1.170A-14(h)(3)(i), this appraisal will use the commonly accepted “before and after” methodology for estimating the fair market value of the subject easement; that is, the fair market value of the easement is equal to the difference between the fair market value of the property it encumbers immediately before the granting of the easement and the fair market value of the encumbered property immediately after the granting of the easement. For purposes of the appraisal of the subject property before and after the grant of the conservation easement, “fair market value” is defined as required under Treas. Reg. §1.170A-1(c)(2) as “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.”

II. Enhancement and Incidental Benefit Rules. The appraisal report must address the rules under Treas. Reg. §1.170A-14(h)(3)(i) regarding “enhancement” and incidental “financial or economic benefit” to the donor. The Treasury Regulations provide three rules requiring that benefits inuring directly or indirectly to the easement donor because of the donation be taken into account when the donor’s charitable deduction is calculated. For a much more in-depth discussion of the enhancement rules, see James H. Boykin, PhD and James A. McLaughlin, “Addressing Enhancement in Conservation Easement Appraisals,” in *The Appraisal Journal*, Volume LXXIV, Number 3: Summer 2006.

A. Enhancement Rule #1: The grantor/family contiguous parcel rule. The fourth sentence of Treas. Reg. §1.170A-14(h)(3)(i) states: “The amount of the deduction in the case of a charitable contribution of a perpetual conservation restriction covering a portion of the contiguous property owned by a donor and the donor’s family (as defined in section 267(c)(4)) is the difference between the fair market value of the entire contiguous parcel of property before and after the granting of the restriction.”

1. The regulatory language is a bit confusing, but Example 10 of Treas. Reg. §1.170A-14(h)(4) implies that the grantor/family contiguous parcel rule is intended to include in the before and after appraisal all parcels of property that are contiguous to the encumbered property and owned by the donor and/or the donor’s family. Thus, if land contiguous to the land encumbered by the subject easement is owned by the donor or a member of the donor’s family as defined in §267(c)(4) of the Internal Revenue Code (i.e., brothers and sisters by whole or half blood, spouse, ancestors, and lineal descendants), such contiguous land must be valued together with the encumbered land in the before and after easement appraisal.

2. In Example 10 of Treas. Reg. §1.170A-14(h)(4), the fair market values of ten contiguous but separately-platted one-acre lots are simply added together, without any discounting, in both the before and after-easement components of the hypothetical appraisal (eight of the lots are encumbered by the hypothetical easement). Some experts have commented that Example 10 necessarily assumes market conditions were such that all ten lots would have sold separately in a very short period of time, and appraisers should be aware that separate, undiscounted valuation of numerous individual parcels will not often be appropriate. For an in-depth discussion of this issue in the context of determining the “larger parcel” for purposes of eminent domain appraisals, see J.D. Eaton, *Real Estate Valuation in Litigation* (Chicago: Appraisal Institute, 1995), 92-101.

B. Enhancement Rule #2: The other property/related person rule. The fifth sentence of Treas. Reg. §1.170A-14(h)(3)(i) states: “If the granting of a perpetual conservation restriction ... has the effect of increasing the value of any other property owned by the donor or a related person, the amount of the deduction for the conservation contribution shall be reduced by the amount of the increase in the value of the other property, whether or not such property is contiguous.” Under the other property/related person rule, if the subject easement enhances the value of (i) non-contiguous land that is owned by the donor or a member of the donor’s family and/or (ii) contiguous or non-contiguous land that is owned by a “related person” as defined in §267(b) or §707(b) of the Internal Revenue Code (those sections of the Code refer to various familial, entity, and trust relationships), the value of the donor’s contribution must be reduced by an amount equal to the value of any such enhancement.

Note that the two enhancement rules are different from each other, and should be addressed separately in the appraisal report. The first rule tells the appraiser that some properties contiguous to the subject property encumbered by the easement must be appraised with the subject property in the before and after appraisal, while the second asks the appraiser to separately consider the easement’s effect upon a potentially large class of other properties. The proper method of estimating enhancement is a before and after appraisal of the property in question. All Rule #1 property (grantor/family contiguous property) will be appraised before and after the easement along with the subject property. To estimate the enhancement of Rule #2 property (other property/related person), the appraiser must conduct a separate before and after appraisal of each property in question. Often it will be quite obvious to the appraiser that a particular property is not enhanced by the easement, but the appraiser nonetheless must fully explain his or her reasoning for that conclusion in the appraisal report. Please contact Conservation Partners if you have any questions about the enhancement rules and how to address them under these *Standards*.

C. Incidental benefit rule. The donor’s charitable income tax deduction must be reduced by an amount equal to the value of any “financial or economic benefit” that “the donor or a related person receives, or can reasonably expect to receive.” Treas. Reg. §1.170A-14(h)(3)(i) (sixth, seventh, and eighth sentences). This rule sometimes applies to

incidental benefits accruing to the easement “donor” such as “quid pro quo” entitlements provided by local government in exchange for the easement conveyance. Appraisers only rarely need to spend much time on this rule in easement appraisals.

- D. Addressing the rules even when inapplicable. Even if the enhancement rules are not applicable (i.e., no relevant parcels exist) and there is no incidental benefit to the donor from the donation, the enhancement and incidental benefit rules should be addressed in the appraisal report. The following is a sample of the type of language that should be included in appraisal reports under such circumstances:

“Under Treas. Reg. §1.170A-14(h)(3)(i), the amount of the deduction for a conservation contribution must be reduced in the event certain benefits accrue to the donor as a result of the donation. The donor of the subject easement has represented the following to me (see attached letter from donor): (i) that neither the donor nor any family member (as defined in §267(c)(4) of the Internal Revenue Code; i.e., brothers and sisters by whole or half blood, spouse, ancestors, and lineal descendants) or related person (as defined in §267(b) or §707(b) of the Internal Revenue Code, referring to various familial, entity, and trust relationships) owns any other property in the vicinity of the subject property, and (ii) that other than potential federal, state, and local tax benefits, neither the donor nor any family member or related person has received or reasonably expects to receive any financial or economic benefit as a result of the donation of the subject easement.” [*The appraiser also may want to attach to the appraisal a copy of the acknowledgement letter from the easement donee, required to be kept in the donor’s records under Treas. Reg. §1.170A-13(f), containing a statement of whether not the donee provided any goods or services in consideration for the easement donation. If the appraiser is aware that the transaction is a bargain sale, that fact should be noted here and perhaps elsewhere in the report, depending upon the nature of the assignment.*]

- III. The Before and After Method. In an easement appraisal employing the “before and after” method, the appraiser essentially must prepare two appraisals: the first estimating the fair market value of the land immediately before the donation of the easement (the “before-easement value”) and the second estimating the fair market value of the land immediately after the donation (the “after-easement value”). The value of the easement is equal to the difference between the before-easement value and the after-easement value. Treas. Reg. §1.170A-14(h)(3)(i). The following is a discussion of the before-easement and after-easement components of an appraisal employing the before and after method.

- A. Before-easement value. Estimating the fair market value of land immediately before the donation of an easement should be no different from any run-of-the-mill appraisal of land. The Treasury Regulations define “fair market value” as “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.” Treas. Reg. §1.170A-1(c)(2). Thus, while the appraisal of the land’s before-easement value should take into account the unencumbered land’s highest and best use (“HBU”) which, in many cases, will be residential subdivision (rather than, for example, agricultural use), the appraiser nevertheless should be estimating the price at which the land would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of relevant facts. **In other words, the appraiser should be estimating the price at which the donor realistically could sell the land in its current state in the open market.**

1. Highest and best use. The appraisal must include a thorough, well-reasoned, and convincing discussion of the subject property's before-easement HBU. The HBU analysis is crucial to the appraisal and should not be given short shrift in the appraisal report. With respect to before-easement valuation in an easement appraisal, Treas. Reg. §1.170A-14(h)(3)(ii) essentially incorporates the generally-accepted understanding of HBU, stating that "the fair market value of the property before contribution of the conservation restriction must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent the restriction, would in fact be developed, as well as any effect from zoning, conservation, or historic preservation laws that already restrict the property's potential highest and best use." That rule is articulated more extensively in two important valuation cases.
  - a. Olson v. U.S., 292 U.S. 246 (1934): When determining whether a certain use should be considered in an appraisal, the appraiser must follow the rule articulated by the United States Supreme Court in *Olson*: "The highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future is to be considered, not necessarily as the measure of value, but to the full extent that the prospect of demand for such use affects the market value [of the property]" (at 255). The Court went on to state that "Elements affecting value that depend upon events or combinations of occurrences which, while within the realm of possibility, are not fairly shown to be reasonably probable should be excluded from consideration" (at 257).
  - b. Stanley Works v. Commissioner, 87 T.C. 389 (1986): In a case addressing the valuation of a conservation easement for purposes of the federal charitable income tax deduction, the Tax Court held that "the focus of the [*Olson* rule], as applied to this case, is whether it is reasonable to conclude that a hypothetical willing buyer in [the year the conservation easement was donated] would have considered the Stanley Works property as the site for [the particular HBU of a hydroelectric pumped storage facility]. If a hypothetical buyer would not reasonably have taken into account that potential use in agreeing to purchase the property, such potential use should not be considered in valuing the property" (at 401-402).
2. Subdivision development analysis. Appraisers sometimes use the "subdivision development analysis" (the "SDA") to obtain grossly exaggerated before-easement values that bear no rational relation to the price at which easement donors could actually expect to sell their land in the open market.
  - a. Description of the SDA. The SDA is a type of discounted cash flow appraisal analysis incorporating aspects of appraisers' three traditional approaches to value (sales comparison, cost, and income), and it is intended to mimic the valuation process that would be employed by a prospective purchaser interested in acquiring the subject property for development. The appraiser first estimates the total gross proceeds that would be realizable from lot sales if the property were

developed to its fullest extent. The gross proceeds figure then is discounted for the various factors that a prospective developer would consider, such as the risk and delay associated with obtaining any necessary approvals or zoning changes, the time it would take to sell all of the lots, the various costs associated with developing the property such as marketing, engineering, and infrastructure costs, and the profit a developer would demand given the overall risk and difficulty of pursuing the development project. That discounted figure then is presented as the fair market value of the property.

- b. A complex, speculative method. The SDA is a useful land valuation tool under some circumstances, but it also is well-suited to the task of exaggerating the value of land because it is complex, often highly speculative, and subject to manipulation. An appraiser using the SDA can produce unrealistically high values by subtly manipulating one or more of the several variables employed in the analysis, and refuting the appraiser's conclusions can be costly and time-consuming. In addition, no matter how much care and skill is employed in preparing a SDA, its prediction of fair market value will almost always be highly speculative in comparison to the value obtained using a more traditional appraisal method, such as the sales comparison approach. Accordingly, use of the SDA to value land is limited under established appraisal standards:
- (i) *The Appraisal of Real Estate (Appraisal Institute, 12th ed., 2001), p. 346.* "When used on its own without an abundance of reliable market data, [the SDA] can be the least accurate raw land valuation technique"... "The technique... is most persuasive when the sales comparison method provides additional support."
  - (ii) *The Uniform Standards of Prof. Appraisal Practice (The Appraisal Foundation ed., 2006), SMT-2.* "Because of the compounding effects in the projection of income and expenses, even slight input errors can be magnified and can produce unreasonable results"... "[The SDA] is best applied in developing value opinions in the context of one or more other approaches."
  - (iii) *U.S. Dept. of Justice, Uniform Appraisal Standards (Appraisal Institute, 2000), p. 45.* "When comparable sales are available with which to accurately estimate the property's market value, the [SDA] should not be relied upon as the primary indicator of value, as it is considerably more prone to error."
- c. The SDA in court. Federal and state courts have been inconsistent in their attitude toward the SDA in valuation cases involving charitable donations of land and conservation easements, eminent domain, and *ad valorem* real property tax assessment.
- (i) Charitable donations. In the context of valuing charitable donations of land and conservation easements, the Tax Court has accepted the SDA without question where both the IRS and the taxpayer asserted valuations based on

the SDA (*Symington v. Commissioner*, 87 T.C. 892 (1986); *Clemens v. Commissioner*, 64 T.C.M. (CCH) 351 (1992); *Branch v. Commissioner*, T.C. Memo 1987-321; *Glick v. Commissioner*, T.C. Memo 1997-65 (in *Glick*, the court also based its preference for the SDA on the lack of comparable sales)). On the other hand, the Tax Court also has rejected primary reliance on the SDA (or some version thereof purporting to derive the value of the subject property from the value of subdivided lots or other prospective development) when appropriate comparable sales were available to use in a sales comparison approach (*Akers v. Commissioner*, T.C. Memo 1984-490, aff'd 799 F.2d 243 (6<sup>th</sup> Cir. 1986); *D. L. Fannon v. Commissioner*, T.C. Memo 1989-136 (in rejecting the taxpayer's by-lot valuation, the court noted that the values of the large parcels analyzed in an alternate sales comparison approach "reflected the possibility that [the parcels] would be subdivided in the future, and, thus, their values were appropriately used to determine the pre-easement value"); *Imbesi v. Commissioner*, T.C. Memo 1981-484; *Van Zelst v. Commissioner*, T.C. Memo 1995-396, aff'd 100 F.3d 1259 (7th Cir. 1996)). See also *Whitehouse Hotel Limited Partnership et al. v. Commissioner*, 131 T.C. No. 10 (U.S.T.C. Oct. 30, 2008).

- (ii) The Schapiro case. Some appraisers cite *Schapiro v. Commissioner*, T.C. Memo 1991-128, as support for their improper use of the SDA. In *Schapiro*, the court adopted the taxpayer's appraisals of the before-easement value of two parcels of land using what essentially was a subdivision development analysis that did not discount the gross proceeds to account for the costs and risks associated with development under the rationale that the taxpayers could perform the subdivision development themselves "with a minimum of expense." However, the decision in *Schapiro* prompted the IRS to issue an Action on Decision recommending nonacquiescence and stating that "the court erred on a legal matter when it adopted the petitioners' expert's version of the development analysis because his method did not take into account all of the development costs and, therefore, overstated the value of each parcel of land before the granting of the easement." Action on Decision Re: *John and Eleanor Schapiro v. Commissioner*, AOD 1991-023, 1991 WL 772481 (1991). Moreover, *Schapiro*: (i) does not change established appraisal standards limiting the use of the SDA (the Action on Decision pointedly refers to those standards, which the Tax Court apparently ignored, by noting: "If the market data approach is rejected because there are no sufficiently comparable properties, then it *may* be appropriate to use a development analysis to value vacant land." (*emphasis added*)), and (ii) does not change the fundamental rule that, for purposes of the federal charitable income tax deduction, the before-easement value of the land is defined as the *fair market value* of that land, or the price at which the land would change hands between a willing buyer and a willing seller (i.e., *price at which the donor could realistically sell his land in its current state in the open market*).
- (iii) Eminent domain. In the context of eminent domain proceedings, a minority

of jurisdictions allow the SDA as evidence of market value (*see, e.g., Dash v. State*, 491 P. 2d 1069 (1971)), while the majority adopt a more restrictive rule, either prohibiting the SDA outright, or allowing it only as evidence of HBU and not to show the value of the property (*see, e.g., Harlingen v. Charboneau*, 48 S.W. 3d 177 (2001)). *See generally*, J.D. Eaton, *Real Estate Valuation in Litigation* 254-257 (1995) (hereinafter, “Eaton”); *Nichols on Eminent Domain*, vol. 4, §12B.14 (2004).

- (iv) Virginia law regarding the SDA. The Supreme Court of Virginia has consistently exhibited skepticism toward the SDA in eminent domain and tax assessment cases. *See Fruit Growers Express Company v. City of Alexandria*, 216 Va. 602 (1976), where the Court considered and rejected the minority rule allowing valuation evidence based upon SDA because “to permit such evidence would open a flood-gate of speculation and conjecture that would convert an eminent domain [or tax assessment] proceeding into a guessing contest” (at 609, quoting *Yoder v. Sarasota County*, 81 So. 2d 219, 221 (Fla. 1955)). *See also Appalachian Power Co. v. Anderson*, 212 Va. 705 (1972); *Commonwealth Transportation Commissioner v. Pruitt Properties, Inc.*, 62 Va. Cir. 95 (2003); *Stafford Regional Airport Commission v. Beulah Lawrence*, 39 Va. Cir. 179 (1996).
- d. The SDA and fair market value. As mentioned above, the SDA is complex and manipulable. In addition, the SDA generally cannot, on its own, indicate the fair market value of land. *See Fruit Growers Express Company v. City of Alexandria*, 216 Va. 602, 608 (the SDA only indicates that “a particular purchaser might be willing to pay a price equal to the [valuation obtained using the SDA] if he relied upon a particular interfusion of assumptions and future projections”); *Harlingen v. Charboneau*, 48 S.W. 3d 177 (the SDA “assumes that a willing buyer will value the land at the highest price that still allows a reasonable return on the investment. But a competitive market does not ordinarily guarantee that willing buyers will pay the highest price they can afford, for they will often have the option of purchasing comparable property for less money elsewhere.”).
- e. Conservation Partners’ standards for use of the SDA. Given the Supreme Court of Virginia’s skeptical view of the SDA in eminent domain and tax assessment proceedings, and given that valuation for purposes of land preservation tax credits occurs in the context of a low-oversight tax incentive program where the Department of Taxation must rely on a one-sided assertion of value by the easement donor who has a financial incentive to assert aggressive values, Conservation Partners finds persuasive the arguments for a restrictive rule allowing heavy reliance upon the SDA only under rare circumstances. Conservation Partners applies the following standards with respect to the SDA in our review of easement appraisals:
  - (i) Establishing that the HBU of the subject property before the easement is residential subdivision *does not* automatically permit the appraiser to rely on

the SDA to establish the before-easement value of the property. Most often, the less speculative sales comparison approach is more appropriate, and the determination that the subject property's HBU is residential subdivision merely guides the appraiser's choice of comparable sales—that is, the appraiser must find sales of similar properties with a similar HBU and compare those properties with the subject.

- (ii) Where sufficient data for the various components of the SDA is available, the SDA may (and sometimes should) be used to support an assertion that the HBU of the subject property is for subdivision and sale as a certain number of residential, recreational, or other types of lots.
- (iii) Where sufficient data for the various components of the SDA is available *and* the appraiser has convincingly established that the HBU of the subject property is for subdivision purposes, the SDA may (and sometimes should) be used as a *secondary* analysis to support the appraiser's value conclusion derived through the use of a less speculative appraisal method such as the sales comparison approach.
- (iv) In rare situations where (i) sufficient data for the various components of the SDA is available, (ii) the appraiser has convincingly established that the HBU of the subject property is for subdivision purposes, *and* (iii) less speculative appraisal methods cannot be implemented effectively, heavier reliance upon the SDA may be justified. For example, when the very best comparable sales available are so few and dissimilar to the subject property that a sales comparison approach would involve highly speculative adjustments and assumptions, a careful, realistic, fully supported SDA based upon extensive relevant data may well improve the accuracy of the appraisal. In addition, as-yet undeveloped land in an active, ongoing subdivision development project may best be valued using the SDA. Generally, as more *meaningful* legal and physical steps have been taken to bring the subject property closer to a completed subdivision with lots being sold, the SDA becomes more persuasive as evidence of the property's value. *See* Eaton, at 254; *U.S. v. 147.47 Acres of Land*, 352 F. Supp. 1055, 1060. However, circumstances indicating heavy reliance on the SDA are *rare*, and the appraiser must overcome a strong presumption against allowing heavy reliance on the SDA.
- (v) The SDA may not be used as the *sole* appraisal method. **Claims that the sales comparison approach is unavailable are often made without justification, and as a rule such claims will be viewed with extreme skepticism.** To present proof that the sales comparison approach is unavailable, in most cases the appraiser essentially must conduct a sales comparison approach valuation of the subject property and demonstrate how and why it has no merit. This is a restrictive rule expressly intended to discourage frivolous over-reliance on the SDA. The appraiser who justifies

his or her reliance on the SDA by claiming that there are no comparable sales to developers is caught in a Catch-22: as Dr. Jack Boykin points out in his presentations on easement appraising, if there truly are no such sales, the highest and best use of the subject property is probably not for residential subdivision.

(vi) Clearly the SDA can be an important and, in some situations, indispensable tool in the valuation of real estate. But it must be used correctly. If the SDA is used in an appraisal report, Conservation Partners insists that the following requirements be met in the report:

- (1) The appraiser must state a persuasive rationale, in compliance with the standards above, for including the SDA in the report at all.
- (2) Each aspect of the analysis—from projected engineering costs, to sellout and discount rates, to the profit a developer is likely to expect—must be fully explained and supported in the appraisal report. This can be a difficult and time-consuming analysis requiring extraordinary expertise on the appraiser’s part (*see* Boykin, at 39-43).
- (3) The SDA may not be used in a speculative manner, and—this is *extremely* important—all variables and uncertainties must be resolved conservatively to mimic the choices of a prudent investor. *See, e.g., Glick v. Commissioner*, T.C. Memo 1997-65 (the court, in its reconciliation of the parties’ SDAs, allocated \$820,000 to sewer system costs even though there was some question as to whether such costs would have to be incurred, because “a prudent investor would consider the uncertainty of this expense and include the potential cost. . .into any valuation of the Property”).

B. After-easement value.

1. Highest and best use. Careful determination of the HBU of the subject property after the donation of the easement is crucial to the after-easement component of an easement appraisal. The appraiser should conduct a separate HBU analysis in the after-easement component of the easement appraisal, and that analysis should include a discussion of the specific restrictions the subject easement places on use and development of the subject property and their effect on the property’s HBU. *See* Treas. Reg. §1.170A-14(h)(3)(ii). Note that in some markets, easements permitting large-lot or “farmette” residential subdivision and development may not significantly change the highest and best use of the encumbered land, and therefore the diminution in value caused by such easements likely will be modest.
2. Subdivision development analysis. The SDA sometimes is used in the after-easement component of a before and after appraisal. Because the SDA is so complex and easily manipulated, its use to estimate after-easement values should be viewed with the

same skepticism expressed above with respect to its use to estimate before-easement values. The SDA may, in some situations, be useful to support an after-easement analysis where important development rights have been reserved under the terms of the easement.

3. Sales comparison approach. In most cases, the appraiser should use the sales comparison approach to value the subject property after the donation of the easement. Two types of property—easement-encumbered land and land burdened by analogous restrictions—are likely to have a HBU similar to the HBU of easement-encumbered property, and appraisers should use sales of such property in the sales comparison approach. Such sales, however, can be hard for appraisers to find, and generally only easement appraisal specialists have invested the significant time and effort necessary to build useful databases of appropriate after-easement comparables.
  - a. Easement-encumbered land. The best comparable sales are sales of other properties encumbered by easements, where both the encumbered properties and the easements are comparable to the subject property and easement. We acknowledge that few real estate markets in Virginia will provide an appraiser with many comparable sales of easement-encumbered land. If the appraiser can find no or only a few such sales in the relevant market, the appraiser should search in other, similar markets, even if such markets are relatively distant from the subject market. The IRS reportedly prefers even distant easement-encumbered comparable sales data to no easement-encumbered comparable sales data at all. In addition, recent reports have surfaced that in some areas the IRS has been collecting after-easement data purporting to show little or no diminution in properties encumbered by conservation easements. The appraiser must carefully scrutinize all of the available after-easement data to ensure its correct use and interpretation (see below).
  - b. Land limited by analogous restrictions. To supplement scarce, dissimilar, or distant easement-encumbered comparable sales, the appraiser should cite sales of other land in the subject property's market with a HBU that is reasonably comparable to the HBU of the subject property as restricted by the easement. Examples include land burdened by such analogous restrictions as restrictive zoning, physical limitations that prevent or limit development (e.g., unsuitable soils, steep slopes, floodplain), restricted access, etc. *See Boykin*, at 34.
  - c. Evaluation and adjustment. When evaluating and making adjustments to both types of after-easement comparable sales, the following three elements must be fully discussed in the report:
    - (i) The characteristics of the *property* that was sold must be analyzed, and the property's comparability with the subject property must be established.
    - (ii) The *market* in which the comparable sale occurred must be analyzed and shown to be reasonably similar to the subject's market.

- (iii) The *terms* of the easement or the *specific nature* of the analogous restrictions encumbering the property sold must be analyzed so that their comparability with the terms of the subject easement can be determined.
4. Percentage diminution method. In some situations, the “percentage diminution” method can be used to supplement the direct sales comparison approach in the after-easement component of the appraisal. Under this method, the appraiser carefully analyzes market data specifically relevant to show the likely effect of the subject easement on the value of the property, and derives a percentage to apply to the before-easement value, calculating the after-easement value and the easement value simultaneously. *See, e.g., Johnston v. Commissioner*, T.C. Memo 1997-475; *Strasburg v. Commissioner*, T.C. Memo 2000-94). NOTE: the appraiser may not estimate the value of the easement using a *standard* percentage diminution derived from a generalized study of market data, case law, the appraiser’s experience or imagination, or other sources. *See* Instructions for Form 8283 (Rev. December 2006), page 3, “Qualified conservation contribution” section: “The FMV of a conservation easement cannot be determined by applying a standard percentage to the FMV of the underlying property.”

### **Addenda**

- I. Competence. Evidence of the appraiser’s competence to appraise easements must be attached to the appraisal report. Conservation Partners looks for extensive easement-specific experience.
- II. Copy of Easement. A copy of the final easement with recording stamps should be attached to the appraisal report.
- III. Supporting Documentation. If the truth of a fact or legal analysis is crucial to the appraisal, for example the number of parcels permitted under current zoning/subdivision laws, the appraiser should obtain third-party documentation supporting that fact or analysis. Copies of letters from county officials and attorneys’ opinion letters can be very useful in this regard.

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