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Easements as Tax Shelters



Hamilton Park is in Hudson County, NJ in view of the Manhattan skyline. Without the cumulative benefit of acquiring many urban tracts of less than the Senate Finance Committee's recommended minimum of ten acres, the park and marina would not have been possible.

In June 2005 the Senate Finance Committee followed up on the notice issued nearly one year ago by the Treasury Department and the Internal Revenue Service in regards to charitable contributions in the form of easements. As design professionals, we generally think of easements in terms of restrictions on, or allowance of, certain activities on another's land. But apparently the government's concern has been that certain grants of easements are more properly categorized as "tax shelters" (a red flag) rather than as protective land use measures. The outcome of the most

recent hearings may instigate a new approach to land use and development as we have been used to seeing it in recent years.

Easements come in two flavors: positive and negative. Positive easements allow the easement holder to do something on someone else's land, and the landowner is still permitted to utilize the land as long as that use does not interfere with the exercise of easement rights. Negative easements prevent a landowner from using his or her land in certain ways. Historic facade easements and conservation easements (both central to the current investigation) fall

into this second category. The purpose of these specific examples is to preserve something that cannot be replaced. In the first instance, the intent is to preserve a structure that has some kind of significance, either architectural or historical, sometimes both. Loss of the structure means that if a change of heart occurred later, replication of the historical physical aspect would be possible only at a very steep price, materials and craftsmanship costing what they do today. Facade easements do not impact the interior of a structure, and the owners can paint the kitchen purple with orange stripes if they want to. Painting the exterior is a different matter, though, and it must be done with approval of the easement holder and/or the local historical commission to assure materials, color, and decoration all fit the era in which the structure's historical importance lies.

Conservation easements also preserve something that cannot be replaced. These are the easements covered by the recent hearings more likely encountered by surveyors and other design professionals. We locate environmentally sensitive areas on sites for protection either by the municipalities or counties regulating subdivisions and land use, and we map and describe areas to be set aside or acquired for open space preservation. The conservation easement protects land from construction or development, thereby restricting the current and future owners' possible income from the land. Thus, there is a monetary value to the easement.

At times the preserved areas are donated not to the municipality, county, or state, but to a private organization that will accept land donations in exchange for a receipt that states a value for the easement rights obtained, in terms of the

development income lost. This can be a motivator for developers who want to maximize the return on an investment. It is increasingly common among “cash poor, land rich” landowners who see the value of preserving land but are not sure they can financially afford to turn down offers to subdivide and develop their land. This method is also used to create green spaces over smaller contiguous, often urban properties.

The derivation of decreased land value (lost development income) as well as the government’s perception of the value of easements over certain properties is the primary focus of the government’s attention. The June 2004 notice (#2004-41) issued by the Treasury Department and the IRS advised taxpayers that the IRS intended to “disallow improper charitable contribution deductions for transfers of easements on real property to charitable organizations and for transfers of easement in connection with purchases of real property from charitable organizations.” Central to much of this concern were two aspects of determination of “qualified conservation contributions,” the first being how the property had been appraised or valued, and the second being whether the federal agencies considered the easement worthy of contribution: would the public benefit be significant? The notice addressed



Courtesy NJ DEP/Green Acres

The Camden City waterfront along the Delaware River allows urban New Jersey residents some of the pleasures their more rural and suburban counterparts take for granted. The greenway along the river, comprising many small tracts, required cooperation between city, county, and state to successfully provide the much needed open spaces usually lacking in cities.

by proposing that no easements should be credited on properties under ten acres and that no easements should be donated by owners still living on the property. The tax deduction for an easement would be reduced from fair

But another component of the current situation is that the conservation easements are not always used for a charitable purpose. One trigger for the investigation involved golf course developments that place a large part of a property in restricted conservation areas in exchange for a significant tax reduction, while creating a private business that generates significant income.

The problems identified by the Committee are real. But perhaps there are reforms that would address the tax issues while not threatening green space initiatives, particularly in urban areas. In cities it is only the cumulative effect of easements over many tracts under ten acres that can provide river walks and similar access to natural resources. Rather than eliminating easements on sites below ten acres, a more stringent appraisal process, with training of certified appraisers, can address one of the government’s concerns. Penalties for misstated values can be increased. Golf course deductions can be prohibited if the commercial operation generates significant income and much of the property is managed contrary to preservation of native habitat. The preservation of open space should remain a goal for the nation, one that is accessible for urban and rural areas alike.

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both historic easements and conservation easements.

In June 2005 the Senate Finance Commission took particular aim at The Nature Conservancy, but also called into question improper donation practices of other groups and laid the groundwork for legislation that could affect many other non-profits. After two years of investigation, the Commission recommended possible reforms to the tax code that alter or remove easements as a possibility for land preservation

market value to 30% of its appraised value, and the deduction for a donation of land would be restricted to no greater than what the owner had paid for the property, or its real estate *basis*.

Apparently part of the difficulty in the “over-valuing” of easements is the fact that few federal regulations govern the way real estate appraisers do their work. Valuation on *basis*, however, will penalize owners of large tracts that have been in the family for generations, bought when land was considerably less pricey.