MEMORANDUM

DATE: October 31, 2008

TO: Everglades Restoration Conference


RE: Conservation Easement - The Basics

I. What is a Conservation Easement?

A. Conservation easements are defined in Section 704.06 of the Florida Statutes

1. “a right or interest in real property which is appropriate to retaining land or water areas predominantly in their natural, scenic, open, agricultural, or wooded condition; retaining such areas as suitable habitat for fish, plants, or wildlife; retaining the structural integrity or physical appearance of sites or properties of historical, architectural, archaeological, or cultural significance; or maintaining existing land uses and which prohibits or limits any or all of the following:

(a) Construction or placing of buildings, roads, signs, billboards or other advertising, utilities, or other structures on or above the ground.

(b) Dumping or placing of soil or other substances or material as land fill or dumping or placing of trash, waste, unsightly or offensive materials.

(c) Removal or destruction of trees, shrubs, or other vegetation.

(d) Excavation, dredging, or removal of loam, peat, gravel, soil, rock, or other natural substances in such manner as to affect the surface.

(e) Surface use except for purposes of permitting the land or water area to remain predominantly in its natural condition.

(f) Activities detrimental to drainage, flood control, water conservation, erosion control, soil conservation, or fish and wildlife habitat preservation.
(g) Acts or uses detrimental to such retention of land or water areas.

(h) Acts or uses detrimental to the preservation of the structural integrity or physical appearance of sites or properties of historical, architectural, archaeological, or of cultural significance.”

2. Conservation easements are perpetual, undivided interests in property and may be created in the form of a restriction, easement, covenant, or condition in any deed, will, or other appropriate document.

3. Conservation easements may be acquired by any governmental body or agency or by a charitable corporation or trust.

4. Conservation easements run with the land and are binding to all subsequent owners of the property.

B. Creation of an Easement by Sale.

1. An easement can be created by the sale of the easement to another party.

   (a) A landowner sells certain rights over its property to another, in return, the landowner receives a benefit in the form of cash or other assets.

   (b) Typically, this is done with a governmental agency who needs the land for various preservation purposes.

2. Example - The South Florida Water Management District’s purchase of flowage easements for the restoration of the Kissimmee River project.

C. Charitable Creation of an Easement.

1. This is the granting of an easement for no consideration in return.

2. A landowner permits another to enforce restrictions on the landowner’s property.

3. If properly structured, a charitable easement can provide income and estate tax benefits.

II. Tax Consequences of the Sale of an Easement.

A. Income Tax

1. The sale of an easement is a “realization event” that may result in the recognition of gain or loss.

   (a) If the landowner’s use of the property is substantially reduced by the easement, then the transaction is treated as a sale of the property.
(i) Sale of a perpetual easement and retention of bare legal title is treated as a sale.

(ii) Examples

(A) Sale of a perpetual easement to a portion of the land to the State for the purpose of a highway, and the landowner retained no beneficial interest in the sold portion.

(B) Sale of an easement that permits and in fact causes constant flooding of the property.

(C) Sale of a perpetual conservation easement by a landowner to obtain mitigation credits.

(b) If the landowner’s use of the property is not substantially reduced by the easement, then the transaction is not treated as a sale of the property.

(i) Landowner sells a ‘flowage deed’ to the State providing a perpetual easement to flood designated properties at such infrequent intervals as not to deprive the landowner of any substantial beneficial use of the properties.

(ii) Easement does not stop the landowner’s use for cattle grazing.

2. If the landowner’s use is substantially reduced, then the sale of the easement is treated as a sale of the property.

(a) Gain or loss is recognized.

(b) The character of the recognized gain or loss, capital v. ordinary, is subject to the nature of the property.

3. If the landowner’s use is not substantially reduced, then the sale of the easement is considered a recovery of basis.

(a) Loss is not recognized.

(b) Gain is recognized to the extent the proceeds received exceed the basis in the property.

(c) The character of the recognized gain is subject to the nature of the property.

4. Even if gain is realized, tax deferral opportunities exists to avoid gain recognition.

(a) Like-kind exchanges pursuant to I.R.C. Section 1031 can be used to roll-over the proceeds received from the sale of an easement into new property.
(i) The replacement property takes a “carried over” basis

(A) The adjusted basis of the sold property, plus

(B) Any additional money used to acquire the replacement property.

(C) No gain will be recognized if all of the proceeds received are used to acquire the replacement property.

(ii) **Very strict timing rules to qualify.**

(iii) The sale of an easement constitutes the sale of real property. Rev. Rul. 59-121

(iv) The proceeds from the sale of credits under a rural land stewardship program constitute the sale of real property. PLR 200649028

(b) If the easement is sold under “threat of condemnation” or actually taken under an eminent domain action, I.R.C. Section 1033 can be used to roll-over the proceeds received into new property. I.R.C. Section 1033 has much more lenient timing rules.

5. **Comprehensive Example**

(a) SFWMD purchases the perpetual right to store water on 50 acre section of a 1,000 acre ranch abutting the Kissimmee River for $400,000. In addition, the SFWMD obtains a flowage deed for $500,000 to flood 950 acres at such infrequent intervals as not to deprive the rancher of the ability to graze cattle.

(b) The taxpayer’s basis in all 1,000 acres is $1 million or $1,000/acre.

(c) The easement over the 50 acres is considered a sale. The landowner will recognize a gain of $350,000 ($400,000 - $50,000) for this sale.

(d) The easement over the 950 acres is not considered a sale. The landowner does not recognize gain, but the basis of its property is reduced by $500,000 to $450,000 ($1,000,000 - $50,000 [for the prior sale] - $500,000).

(e) If the SFWMD purchased the easement over the 50 acres under threat of condemnation, then I.R.C. Section 1033 can be used to defer the recognized gain.

B. **Estate and Gift Tax**

1. Estate and gift taxes are based upon the fair market value of the property.
2. If an interest in the property, or an entity owning the property, is transferred during life, the fair market value for gift tax purposes will be discounted as a result of the restrictions resulting from the easement.

3. If the landowner dies owning an interest in the property, or an entity owning the property, the fair market value of the property will be discounted for estate tax purposes as a result of the restrictions resulting from the easement.

(a) To the extent the proceeds from the easement sale have not been used or gifted, such proceeds will be included in the landowner’s taxable estate.

(b) The special use valuation discount of I.R.C. Section 2032A is still available.

C. Property Tax

1. Annual taxes may be reduced, depending on current exemptions or classifications applied to the property - e.g. agriculture classification.

2. Restrictions will result in limiting the “highest and best use” of the property, thereby reducing its taxable value.

III. Tax Consequences of a Charitable Easement.

A. Income Tax

1. I.R.C. Section 170(f)(3) provides generally that no charitable contribution deduction is allowed for a transfer to a charitable organization of less than the taxpayer's entire interest in property unless the transfer is of a “Qualified Conservation Contribution.”

2. Charitable deductions are allowed for a “Qualified Conservation Contribution” which can include certain easements.

(a) Qualified conservation contributions are defined as:

(i) The entire interest in the property other than certain mineral interests;

(ii) A remainder interest in the property; or

(iii) A perpetual restriction on the use of the property.

(b) The contribution must be for a conservation purpose.

(i) The preservation of land 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 farm land and forest land, where such preservation is for the scenic enjoyment of the general public or pursuant to a federal, state or local governmental conservation policy; or

(iv) The preservation of historically important land area or a certified historic structure.

(c) The donation of a qualified conservation contribution is considered a contribution of a capital asset.

(d) The amount of the deduction is equal to the fair market value of the contribution, not it’s adjusted basis. The valuation and documentation of the deduction are crucial. Deductions for contributions of capital assets are limited to:

(i) 30% of an individual taxpayer’s income.

(ii) 10% of a corporation’s income.

(e) Important Caveat. The fair market value of a contribution will be reduced by the amount of the ordinary income or short term capital gain that would have resulted had the contributed property been sold at its fair market value as determined at the time of contribution. Therefore, to take advantage of the deduction, the taxpayer must have held the property for the requisite time period (greater than one year) and purpose (investment) such that any gain would have qualified for long term capital gain.

(f) Any unused deduction may be carried forward to the next five (5) years.

(g) A donor’s adjusted basis in the retained property is reduced by the donated portion’s share of the adjusted basis. This reduction is determined by reference to the ratio of the fair market value of the contribution to the fair market value of all of the property before the contribution.


(a) Does not apply to contributions made in tax years beginning after December 31, 2009, which is the extended benefit from the Food, Conservation, and Energy Act of 2008.

(b) Increases the charitable deduction amount to 50% of the income of an individual and the carry forward period to fifteen (15) years.
(c) Special rules for individuals and corporations who are a “qualified farmer or rancher”.

(i) A “qualified farmer or rancher” is defined as a taxpayer whose gross income from the trade or business of farming (as defined in I.R.C. Section 2032A(e)(5)) is more than 50% of the taxpayer’s gross income for the tax year.

(ii) Deduction increased to 100% of the taxpayer’s income for all pre-August 18, 2006 contributions.

(iii) Post-August 17, 2006 contributions are also increased to 100%, but if the property contributed was used in agriculture or livestock production (or was available for such use), then the property owner must retain the right to use the property for agriculture or livestock production after the contribution.

B. Estate and Gift Tax

1. As in sale transactions, the fair market value of the property will be discounted due to the restrictions resulting from the easement.

2. If the easement is a “qualified conservation easement” which essentially is a qualified conservation contribution (with some exceptions), then an additional exclusion of up to $500,000 is available.

(a) The exclusion is a reduction in a decedent’s taxable estate.

(b) The exclusion is equal to 40% of the fair market value of the property on the date of the decedent’s death (considering the reduction in value due to the easement) but is capped at $500,000 for decedents dying after 2001.

(c) An election must be made to obtain this exclusion.

(d) The special use valuation discount of I.R.C. Section 2032A is still available.

C. Property Tax - same benefits as in sale transactions.

About the Authors
Michael Minton, Brad Gould and Richard Withers are tax attorneys with Dean, Mead, Minton & Zwemer. They are members of the firm's Agribusiness Industry Team, which has a long history of representing agribusiness throughout the State of Florida. The Team represents clients in all aspects of their operations, including formation and administration of business entities, tax planning, real estate transactions, environmental issues, eminent domain and property rights, pesticide litigation, worker protection and safety, insurance coverage analysis and litigation, estate planning and business succession planning.
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