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## Charitable Gifts of Conservation Easements: Lessons from the US Experience in Enhancing the Tax Incentive

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### PRÉCIS

Au Canada, la Loi de l'impôt sur le revenu accorde un traitement avantageux au titre des gains en capital pour le don intégral d'une terre écosensible ou le don d'un intérêt foncier partiel dans une terre écosensible en faveur d'une municipalité, du gouvernement fédéral ou provincial ou d'un organisme de bienfaisance admissible voué à la conservation au moyen du programme des dons écologiques (PDE). Ces dons prennent de plus en plus la forme d'une servitude de conservation (conventions obligatoires entre le propriétaire et l'organisme de conservation qui a pour but d'empêcher de façon permanente toute forme d'aménagement ou de créer des obligations expresses dans l'atteinte de certains objectifs de conservation). Le présent article compare les principales caractéristiques des incitatifs fiscaux actuellement offerts au Canada et aux États-Unis accordés aux dons de servitudes de conservation et s'interroge sur la nécessité pour le PDE du Canada de bonifier ses dispositions actuelles pour qu'elles comprennent certaines des caractéristiques américaines visant à accroître les dons auprès des contribuables ayant beaucoup de terres et qui souhaitent accroître leurs liquidités. Ces caractéristiques comprennent des crédits d'impôt transférables, de plus longues périodes de report sur des années ultérieures, la possibilité de report sur des années antérieures, des crédits d'impôt remboursables limités, ainsi que les transferts intergénérationnels des crédits pour organismes de bienfaisance inutilisés.

### ABSTRACT

In Canada, the Income Tax Act provides favourable capital gains treatment for gifts of full and partial interests in ecologically sensitive land made to eligible conservation charities, municipalities, and federal and provincial governments through the ecological gifts program (EGP). Such donations increasingly take the form of conservation easements — binding agreements between landowners and conservation organizations that permanently restrict land development or create affirmative obligations in favour of specific conservation objectives. This article compares key features of the current

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Canadian and US tax incentives for donations of conservation easements with a view to considering whether Canada's EGP should expand its current provisions to include some US features aimed at increasing donations from "land-rich and cash-poor" taxpayers. These features include transferable tax credits, longer carryforward periods, the possibility of carrybacks, limited refundable tax credits, and intergenerational transfers of unused charitable credits.

**KEYWORDS:** CHARITIES ■ LAND ■ GIFTS ■ TAX INCENTIVES ■ CANADA ■ UNITED STATES

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## INTRODUCTION

Private land conservation is vital to protect North America's environmental heritage and to prevent the potentially irreversible destruction of natural land features required to support biodiversity, water quality, runoff prevention, carbon sequestration, climate change mitigation measures, and many other ecological services.<sup>1</sup> Ecologically important land is often owned by farmers, ranchers, or cottagers who are not prepared to give up the land's productive or personal use. A conservation easement, instead of an outright transfer, becomes the only viable option to secure voluntary conservation of the property's ecological features. Also known as conservation covenants, conservation easements are binding agreements between landowners

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1 Ecological services such as wetland water filtration, native vegetation soil retention, flood control, and insect pollination are classic examples of positive externalities—"direct, unintentional and uncompensated" actions that benefit the well-being of others. These positive externalities provide public goods that are not generally taken into account in a landowner's private decisions on the development, use, or sale of property. These public goods may therefore be undersupplied and represent a potential market failure. Sheila M. Olmstead and Nathaniel O. Keohane, *Markets and the Environment* (Washington, DC: Island Press, 2007), 66-67. See also J.B. Ruhl, Steven E. Kraft, and Christopher L. Lant, *The Law and Policy of Ecosystem Services* (Washington, DC: Island Press, 2007), 63-67.

and a charity or government entity that permanently restrict land development or create affirmative obligations in favour of specific conservation objectives. For example, a conservation easement can be used to prohibit residential subdivision on large tracts of environmentally sensitive land, preserve native grasslands that serve as containment filters along a shoreline, or restrict the use of pesticides in a sensitive watershed area.

Income tax incentives, delivered via statutory charitable donation provisions, are used in Canada and the United States to encourage the creation of conservation easements that preserve ecological services and their related economic and social benefits. In Canada, the Income Tax Act<sup>2</sup> provides enhanced tax incentives,<sup>3</sup> beyond those available in respect of ordinary charitable gifts, for gifts of full and partial interests in ecologically sensitive land made to eligible conservation charities, municipalities, and federal and provincial Crown agencies through the ecological gifts program (EGP). The EGP was introduced in 1995 as a tool for encouraging the conservation of habitat and biodiversity across Canada; it is administered by Environment Canada in cooperation with federal, provincial, and municipal governments.<sup>4</sup> Since the program's inception, the most important change has been the gradual and, ultimately, the complete exemption of qualifying ecological gifts from capital gains taxation.<sup>5</sup> In the United States, enhanced tax incentives are currently provided at the federal and state levels for qualified conservation contributions to federal, state, or local government units or agencies, or charitable organizations committed to conservation purposes.<sup>6</sup> Conservation charities in Canada and the United States are often referred to as "land trusts," and for ease of reference, that term will be used in this article to refer to all types of eligible recipients of qualifying conservation gifts.

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2 RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the ITA").

3 Individual donors can claim a tax credit for ecological gifts pursuant to ITA subsection 118.1(3); corporate donors can deduct the value of an ecological gift from their income pursuant to ITA subsection 110.1(1). The definition of "total ecological gifts" in ITA subsection 118.1(1) (and paragraph 110.1(1)(d) for corporate donations) limits the eligible recipients of ecological gifts (see the discussion below under the heading "Qualified Recipients: The Donee's Stewardship Capacity"). The enhanced tax benefits available to corporations that make ecological gifts are largely the same as those available to individuals and are not discussed in this article.

4 Information about the program is available on the Web site of the Canadian Wildlife Service, Environment Canada, at <http://www.cws-scf.ec.gc.ca/egg-pde>. For an overview of the tax consequences of gifts through the EGP, see Ann Hillyer and Judy Atkins, *Giving It Away: Tax Implications of Gifts To Protect Private Land* (Vancouver: West Coast Environmental Law Research Foundation, 2004).

5 ITA paragraph 38(a.2). Gifts of ecologically sensitive land and conservation easements made outside the EGP qualify for the charitable tax credit but not the elimination of taxable capital gains.

6 US federal tax law on charitable contributions of conservation easements is found in section 170(h) of the Internal Revenue Code of 1986, as amended (hereinafter referred to as "the IRC") and section 1.170A-14 of the US Code of Federal Regulations (hereinafter referred to as "Treasury

This article focuses on gifts of conservation easements, as distinct from gifts of full fee-simple interests. Conservation easements have unique characteristics, and the number of such donations is beginning to outstrip fee-simple charitable gifts. The purpose of the article is to consider how the EGP might be enhanced to encourage the donation of easements on ecologically sensitive land, consistent with the government's policy goals.<sup>7</sup> Possible tax incentives include transferable credits, longer carryforward periods, carryback periods, limited refundable tax credits, and intergenerational transfers of unused charitable credits. The discussion draws on a comparison of Canadian and US incentive provisions, and specifically considers US initiatives at both the federal and state levels aimed at increased land conservation through private donations.<sup>8</sup> In some respects, these programs have been successful, but they have not been entirely free from criticism or abuse.

In Canada, the EGP is part of the federal government's broader commitment to ensure the protection of species at risk and biodiversity by, among other things,<sup>9</sup> supporting the protection of ecologically sensitive land, which is often the habitat for rare and threatened species. More recently, the government has expressed a commitment to reduce greenhouse gas emissions and address climate change. Land protection and land-use management through ecological gifts can be part of an effective greenhouse gas emissions and climate change strategy. Forests, grasslands, and wetlands function as carbon sinks by removing carbon dioxide from the

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regs.”). Contributions to government units must be made exclusively for public purposes. Charitable organizations must be tax-exempt under IRC section 501(c)(3), meet the public support test in section 509(a)(2), and include conservation as one of the organization's purposes.

This article does not discuss in detail the US federal estate and gift tax benefits for easement donations, although it is noted that landowners are often partially motivated to donate easements because of concerns that their heirs will have to sell the property to pay estate taxes. Conservation easements reduce US federal estate tax by lowering the property's fair market value and making the property potentially eligible for an additional 40 percent exclusion from the estate value (IRC section 2031(c)(8)(C)). For a discussion of both the estate and gift tax benefits from conservation easement donations, see C. Timothy Lindstrom, *A Tax Guide to Conservation Easements* (Washington, DC: Island Press, 2008), 191-218.

- 7 Environment Canada has expressed interest in further enhancements to the EGP. In this regard, author Karen Cooper along with Ann Hillyer and Judy Atkins prepared an unpublished Environment Canada internal discussion paper, “Tax Incentives for Charitable Gifts of Conservation Easements,” (May 2008) on transferable tax credits.
- 8 Several key aspects of the US federal tax incentives discussed in this article were introduced in 2006 as temporary provisions and were due to expire at the end of December 2009. However, there is significant lobbying to reinstate these provisions and make them permanent. For further discussion, see *infra* notes 60 to 63 and the related text. State initiatives include transferable income tax credits and extended carryforward periods. Transferable income tax credit programs allow donors to sell all or a portion of their unused state conservation income tax credit value to other taxpayers in the same state, who can then use the purchased income tax credit value against their own tax payable.
- 9 Notably, the enactment of the Species at Risk Act, SC 2002, c. 29.

atmosphere. As well, the degree of natural vegetative cover in and around agricultural land can have an impact on natural carbon storage and release.<sup>10</sup>

In both Canada and the United States, the tax incentives for land conservation complement other tools such as regulation, zoning, and direct spending measures. Tax incentives can sometimes be more efficient than direct regulation, for several reasons: the large number of private landowners; the difficulty of detecting and tracking activities that may have a negative impact on land features and habitats; the need for active, adaptive, and individualized plans; and the high political costs of imposing conservation requirements on unwilling landowners.<sup>11</sup> Tax incentives partially compensate landowners for positive externalities that benefit the broader public, and for which there is no commercial market making direct spending measures less feasible. Income-tax-based charitable donation credits and deductions create a market environment by defining a group of potential beneficiaries (charities and governmental entities) with which landowners can negotiate, and by establishing an economic value for the ecological services provided by the land.<sup>12</sup> Direct spending measures and tax incentives can be combined for an overall approach that is less expensive and avoids costly and protracted expropriation proceedings.

Enhanced tax benefits for land protection have significantly spurred the growth of land trusts and increased the quantity and quality of land holdings of all conservation organizations. In Canada, since the introduction of the EGP in 1995, 692 ecological gifts valued at over \$427 million have been donated, protecting 117,454 hectares of land of national, provincial, and regional importance.<sup>13</sup> The most recent US Land Trust Alliance five-year census estimates that, together, the alliance's 1,660 member organizations have acquired conservation easements totalling 6,245,969 acres

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10 Sara J. Wilson and Richard J. Hebda, *Mitigating and Adapting to Climate Change Through the Conservation of Nature* (Salt Spring Island, BC: The Land Trust Alliance of British Columbia, 2008); and Steven A. Kennett, Arlene J. Kwasniak, and Alastair R. Lucas, "Property Rights and the Legal Framework for Carbon Sequestration on Agricultural Land" (2005-2006) vol. 37, no. 2 *Ottawa Law Review* 171-214, at 173-74, noting that carbon sequestration achieved through land management is a recognized climate change strategy. However, Kennett et al. conclude that the current statutory regime for conservation easements is not an adequate basis for carbon sequestration transactions necessary for implementing a climate change strategy: *ibid.*, at 198-205.

11 See James Boyd, Kathryn Caballero, and R. David Simpson, "The Law and Economics of Habitat Conservation: Lessons from an Analysis of Easement Acquisitions" (2000) vol. 19, no. 1 *Stanford Environmental Law Journal* 209-55, at 210-20; Stephanie Stern, "Encouraging Conservation on Private Lands: A Behavioral Analysis of Financial Incentives" (2006) vol. 48, no. 3 *Arizona Law Review* 541-84, at 547-50; and Kennett et al., *supra* note 10, at 175-76.

12 James Salzman, "Creating Markets for Ecosystem Services: Notes from the Field" (2005) vol. 80, no. 3 *New York University Law Review* 870-961, at 883-84.

13 Data reported to the end of December 2008, as confirmed to the authors by the national coordinator of the EGP in an e-mail dated May 19, 2009. For more recent figures, see "Ecological Gifts Program: History" at the Canadian Wildlife Service Web site, *supra* note 4.

(2,527,654 hectares).<sup>14</sup> The Land Trust Alliance more recently conducted a tax incentive impact survey, which estimates a 36 percent increase in acres protected through conservation easements in the two years following the introduction of the enhanced federal tax incentives in 2006.<sup>15</sup>

In considering improvements to the existing regime, it is worth noting certain characteristics of conservation easements that should be taken into consideration in the design of anything new. Conservation easements can often have a high appraisal value, which can generate significant tax benefits.<sup>16</sup> However, land trusts seeking

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14 Rob Aldrich and James Wyerman, *2005 National Land Trust Census Report* (Washington, DC: Land Trust Alliance, 2006) (<http://www.landtrustalliance.org/about-us/land-trust-census/2005-report.pdf>). The Land Trust Alliance survey does not include easements held by national-level trusts or by federal, state, or local government entities. For example, in the survey time period, the Nature Conservancy, a land trust operating on the national level, reported that it held easements encumbering an additional 2.7 million acres in 2005. Commentators consider the Land Trust Alliance survey data to be incomplete and note that accurate data are hard to come by. The vast majority of states do not require a special index or set of recording books for conservation easements, and other surveys indicate that land trusts themselves are sometimes unclear as to the easements that they own. See Gerald Korngold, "Solving the Contentious Issues of Private Conservation Easements: Promoting Flexibility for the Future and Engaging the Public Land Use Process" (2007) no. 4 *Utah Law Review* 1039-84, at 1046; Bay Area Open Space Council, *Ensuring the Promise of Conservation Easements* (San Francisco: Bay Area Open Space Council, 1999), cited in Jeff Pidot, *Reinventing Conservation Easements: A Critical Examination and Ideas for Reform*, Policy Focus Report (Cambridge, MA: Lincoln Institute of Land Policy, 2005); and Elizabeth Byers and Karin Marchetti Ponte, *The Conservation Easement Handbook*, 2d ed. (Washington, DC: Land Trust Alliance, 2005), 8-9, noting that hundreds of public agencies across the United States hold conservation easements.

15 Land Trust Alliance, "Tax Incentive Survey Results" (<http://www.landtrustalliance.org/policy/taxincentives/federal/survey>). The Land Trust Alliance surveyed 480 land trusts that together represented over 90 percent of the easement acreage reported in the 2005 land trust census. The easements held at the end of 2007 were compared with data that these land trusts had given the Land Trust Alliance in 2003 and 2005. The survey indicates that 2,027,553 acres (820,525 hectares) were protected with conservation easements in the first two years following the introduction of the enhanced federal tax incentive in 2006. This represents an additional 535,000 acres (216,507 hectares) over the protected acreage reported as of 2005, or an increase of 36 percent. It is notable that to minimize data distortion, the survey excluded easements in excess of 100,000 acres. The survey also reports an increase of almost 50 percent in the number of easements added in the two post-incentive years over those reported in the two years before.

16 Nancy A. McLaughlin, "Increasing the Tax Incentives for Conservation Easement Donations—A Responsible Approach" (2004) vol. 31, no. 1 *Ecology Law Quarterly* 1-115, at 26, noting that rising land values, development pressures, and the type of permanent restrictions that qualify for the federal tax incentive typically result in high valuations of donated easements. McLaughlin cites anecdotal evidence from 17 reported Internal Revenue Service (IRS) cases challenging easement valuations where the courts ultimately approved easement values ranging from \$20,800 to \$4,970,000. Also, the Land Trust Alliance reports that the average conservation easement donation in the United States is valued at \$400,000. See Land Trust Alliance, "IRS Audits of Conservation Easements" (<http://www.landtrustalliance.org/policy/taxincentives/ce-audits/irs-audits>).

conservation easement donations argue that “land-rich and cash-poor” taxpayers<sup>17</sup> are unable to take full advantage of the tax benefits generated by a gift of a conservation easement. Conservation easements also present unique long-term enforcement problems. Unlike a gift of land in fee simple, where the donor has no further responsibilities or rights vis-à-vis the gifted property, conservation easements create an active, ongoing, and permanent relationship between the donor-landowner and the charitable or government easement holder. Subsequent landowners, often beneficiaries of a deceased donor, have the burden of the conservation encumbrance without the tax incentive and without necessarily sharing the ecological vision that motivated the initial gift. This ongoing relationship can create pressure points over time to resist, modify, or terminate the easement.<sup>18</sup> Land trusts have ongoing stewardship rights and concomitant costly responsibilities, including maintenance, monitoring, and enforcement, which can become more difficult to meet with the passage of time or if subsequent landowners are non-supportive.

Ideally, enhancements to the conservation easement income tax incentives should strive to maximize conservation goals; increase economic efficiency by recognizing the ongoing and future public benefit of the ecological services provided;<sup>19</sup> address distributional inequities for moderate- and low-income donors and subsequent landowners; and strengthen the bond between landowners and charitable organizations to ensure lower compliance costs for easement holders.

In the United States, critics point to a proliferation of conservation easement transactions with questionable environmental value and involving aggressive tax planning. The criticism is particularly intense in some states where transferable credits are available.<sup>20</sup> However, these criticisms have not dampened interest in the

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17 The land-rich and cash-poor taxpayer is often referred to in support of lobbying efforts by land trusts to increase tax incentives: McLaughlin, *supra* note 16, at 47-48 (see especially footnotes 173 and 174).

18 For example, Susan F. French, “Perpetual Trusts, Conservation Servitudes, and the Problem of the Future” (2006) vol. 27, no. 6 *Cardozo Law Review* 2523-36, at 2529, cites the case of a family seeking a release from an agricultural-use restriction for a portion of a 68-acre farm, only 11 years after granting a perpetual servitude to the city of Encinitas, California (reported by Joel Millman, “Flower Power Struggle,” *Wall Street Journal*, November 2, 2005, B1). French remarks that “[s]kyrocketing land values and changing ownership of restricted lands will lead to escalating challenges to development restrictions.” See also Boyd et al., *supra* note 11, at 228.

19 The fair market value of the conservation easement donation is measured by the diminished value of the land using a “before and after” fair market value comparison. The ongoing public good achieved by the easement and the high social and environmental costs that would be incurred if the property were developed are not part of the valuation process. It is argued by some that the donation subsidy is not likely to adequately compensate for the actual market failure: see Boyd et al., *supra* note 11, at 244-45. Future landowners, particularly those who inherit the property, continue to contribute to the public good without compensation, although in some jurisdictions the local property tax may be reduced because of the easement.

20 Media reports question the appropriateness of easement donations for land between homes in an expensive subdivision (\$800,000-\$2,000,000 homes); for land along the fairway of a golf

United States in using transferable income tax credits. Encouraged by evidence that transferable credits with certain features significantly stimulate the pace of conservation easement donations, other states are considering adopting similar measures. Despite a targeted audit blitz by the Internal Revenue Service (IRS), resulting in challenges to an estimated \$15 million of federal tax benefits received for donations of easements in Colorado,<sup>21</sup> in 2008 Colorado expanded its conservation easement tax credit transfer program, albeit with specific reform measures aimed at curbing abuse.<sup>22</sup> As discussed below, the Canadian EGP addresses such forms of abuse through its pre-certification of both environmental qualifications and valuation.

This article compares the Canadian and US income tax incentives for conservation easements and considers possible design modifications for Canada's EGP incorporating elements of the US approach. We begin with a brief description of conservation easements and their attractions and drawbacks. We then outline key features of the Canadian income tax provisions and US incentives adopted at both the federal and state levels. This overview is followed by a comparison of the tax costs and benefits of Canada's incentives and the approach adopted in Colorado—a state that provides transferable and refundable credits and a 20-year carryforward period. For this purpose, we use the example of a moderate-income Canadian farmer motivated to donate a conservation easement. Finally, we consider whether incentives modelled on the US provisions would be appropriate in Canada from both a practical and a policy perspective. We conclude that an approach that combined a longer carryforward period with an intergenerational transfer of unused credits on death and a limited carryback period would have many advantages. On the other hand, a transferable tax credit would involve a larger fiscal expenditure and higher transaction costs, as well as more complex anti-abuse provisions; moreover, such a provision

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course that hosts professional (PGA) tournaments; for parcels that allow oil and gas wells and wind farms; for very small (one-third of an acre) parcels; and for ranchettes where the owner can still build multiple homes. The reports also chronicle ongoing audits of inflated appraisal values. See Jerd Smith and Burt Hubbard, "Abuses Taint Land Deals: Conservation Easements Approved for Pricey Subdivisions, Fairways, Small Parcels," *Rocky Mountain News*, February 9, 2008 (<http://www.rockymountainnews.com/news/2008/feb/09/abuses-taint-land-deals/>); and David Migoya, "IRS Finds a Third of Easements in Probe Are Faulty," *Denver Post*, November 29, 2007 ([http://www.denverpost.com/colleges/ci\\_7584710](http://www.denverpost.com/colleges/ci_7584710)).

- 21 The nationwide IRS investigation covered more than 400 conservation easement donations, of which 290 were in Colorado. See Margaret Jackson, "IRS Latest To Scrutinize Conservation Easements," *Denver Post*, June 29, 2008 ([http://www.denverpost.com/ci\\_9725601](http://www.denverpost.com/ci_9725601)); and Migoya, *supra* note 22.
- 22 Colorado increased the maximum credit amount from \$260,000 to \$375,000. In addition, House Bill 08-1353, passed in June 2008, included provision for the review of easement appraisals by the Colorado Division of Real Estate, with the power to suspend or impose penalties on appraisers; the creation of a conservation easement oversight commission, with a mandate to administer a certification program for conservation easement holders and to advise the Division of Real Estate and the state Department of Revenue; and the introduction of a minimum pre-donation land holding period requirement.

would be a significant departure from the general Canadian income tax prohibition against transferring tax attributes between unrelated entities. Therefore, in our view, a transferable tax credit is not a feasible design option for the EGP.

## **CONSERVATION EASEMENTS: ATTRactions AND DRAWBACKS**

“Conservation easement” is the popular name for a binding agreement between a landowner and a charity or government entity that places restrictions on the future use of the land or creates obligations to achieve specific conservation goals. For example, the easement grantor may agree to forgo the use of the land for certain economic activities, such as commercial development, residential subdivision, grazing livestock within a set distance from a watershed, or harvesting trees that provide the habitat for a particular species. The easement may be granted in order to preserve natural and physical features, such as wetlands, freshwater ponds, or large tracts of native grasslands. To fulfill this objective, the agreement may set out specific affirmative obligations, such as developing and implementing an approved sustainable forest management plan, or imposing prohibitions on the use of chemical herbicides and pesticides or the discharge of septic or waste water in sensitive watershed areas.<sup>23</sup> Special provincial and state statutes are required to create enforceable rights in the hands of easement holders, since the common law does not generally recognize this form of encumbrance.<sup>24</sup>

By definition, conservation easements eligible for tax incentives are within the private-public realm of charitable activity.<sup>25</sup> Public support of a private charity’s

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23 Byers and Ponte, supra note 14, at chapters 19 and 20.

24 Conservation easements are non-possessory interests in land recorded on the title, and include easements, servitudes, or covenants. Common-law constraints necessitating specific conservation easement enabling statutes include non-recognition or limited recognition of easements “in gross,” which benefit the public at large or an entity rather than a neighbouring parcel of land (dominant tenement) appurtenant to the encumbered land (servient tenement); and non-enforcement of “negative easements,” which impose restraints on the servient tenement’s future economic use and alienability. For an extensive discussion of the common-law doctrines relating to conservation easement, see Jeffrey A. Blackie, “Conservation Easements and the Doctrine of Changed Conditions” (1989) vol. 40, no. 6 *Hastings Law Journal* 1187-1222. For a discussion of the common law relating to easements in Canada and the civil law relating to servitudes in Quebec, see Judy Atkins, Ann Hillyer, and Arlene Kwasniak, *Conservation Easements, Covenants and Servitudes in Canada: A Legal Review*, North American Wetlands Conservation Council (Canada) Report no. 04-01 (Ottawa: NAWCC, 2004).

25 The drafters of the United States Uniform Conservation Easement Act (1981) (UCEA), 12 ULA 55 (Supp. 1985), wanted to situate conservation easements within the realm of private decision making. In this regard, charitable activity and charitable entities represent private, non-governmental actions. See Mary Ann King and Sally K. Fairfax, “Public Accountability and Conservation Easements: Learning from the Uniform Conservation Easement Act Debates” (2006) vol. 46, no. 1 *Natural Resources Journal* 65-129, at 82-89. However, the public-private line is actually blurred. Charitable entities and charitable activities are subject to public scrutiny and

conservation program is achieved via tax-subsidized charitable donations. The United States Uniform Conservation Easement Act (1981) (UCEA),<sup>26</sup> and most provincial and state legislation, restricts conservation easement holders to charitable organizations, generally land trusts, and government entities. By adopting this restriction, the UCEA drafters sought to avoid overly prescriptive statutory provisions. They believed that charities

were trustworthy enough to exercise discretion in the absence of public oversight and would not take on obligations and responsibilities that they could not uphold. The commissioners were confident that the law concerning charitable organizations and levels of federal and state tax law would prevent abuse.<sup>27</sup>

Commentators describe a recent virtual explosion of conservation easement activity in the United States. The 2005 census of the Land Trust Alliance reports that between 2000 and 2005 the number of acres held under conservation easements by land trusts increased by 148 percent (from 2.5 million to 6.2 million acres).<sup>28</sup> In the same period, land trusts increased their fee-simple holdings by a more modest 40 percent.<sup>29</sup> In Canada, approximately 42 percent of all ecological gifts to date have been partial interests in land (that is, easements, servitudes, or covenants).<sup>30</sup>

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accountability through a variety of judicial and statutory mechanisms, including the potential loss of charitable registration. See Nancy A. McLaughlin and Mark Benjamin Machlis, "Protecting the Public Interest and Investment in Conservation: A Response to Professor Korngold's Critique of Conservation Easements" (2008) no. 4 *Utah Law Review* 1561-94, at 1565, where the authors observe that "neither conservation easements nor land trusts can be accurately described as 'private,' and to refer to them as such obscures the essential public nature of both."

- 26 *Supra* note 25. Forty-nine states have conservation easement statutes, of which about half are based on the UCEA. See Nancy A. McLaughlin, "Rethinking the Perpetual Nature of Conservation Easements" (2005) vol. 29, no. 2 *Harvard Environmental Law Review* 421-522, at 426, especially footnotes 13 and 15; see also Atkins et al., *supra* note 24, at 81-83.
- 27 King and Fairfax, *supra* note 25, at 86. In the United States, burgeoning easement activity, uneven stewardship capacity among land trusts, and reported instances of abusive or questionable tax-driven conservation transactions suggest that the UCEA drafters were overly confident in the ability of the charitable sector to provide restraint and oversight. See generally McLaughlin, *supra* note 16.
- 28 Aldrich and Wyerman, *supra* note 14.
- 29 The trend toward easement acquisition has been consistent since 1988. See McLaughlin, *supra* note 16, at 4-5; and Korngold, *supra* note 14, at 1047-48.
- 30 *Supra* note 13. See also Environment Canada, Canadian Wildlife Service, *The Canadian Ecological Gifts Program Handbook 2005* (Gatineau, QC: Environment Canada, 2005) (herein referred to as "the EGP handbook"), "The Ecological Gifts Program: Ecosensitivity Criteria," and "The Ecological Gifts Program: Retaining the Right To Use Land Donated as an Ecological Gift" (all available at <http://www.cws-scf.ec.gc.ca>).

Conservation easements offer significant advantages, as compared with fee-simple ownership, for both the donor and the recipient land trust:

- Easements are cheaper to purchase—an important consideration in circumstances where the landowner needs partial compensation such that the transfer is part gift and part sale.<sup>31</sup>
- Where the landowner prefers to retain personal use of the donated property (as is often the case), a conservation easement is the only way to curtail future development.<sup>32</sup>
- An easement can result in a more efficient allocation of resources: ownership responsibility costs, such as maintenance and insurance, often remain with the landowner, while the monitoring and maintenance of the conservation attributes are undertaken through the land trust's expertise, effort, and expense.<sup>33</sup> Donating through a conservation easement also keeps productive property in the local property tax base. Conservation goals can be achieved at a lower economic efficiency cost than that of some regulatory approaches.<sup>34</sup>
- Each conservation easement is an individually negotiated, and thus unique, arrangement drafted to maximize the achievement of particular conservation goals and to minimize the restrictions on the landowner's personal or productive use. Working conservation easements are tailored to preserve the landowner's livelihood by allowing compatible productive economic activities, such as farming, ranching, and small-scale woodlot production, while at the same time preserving the land's significant ecological values.<sup>35</sup> Balancing targeted

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31 In the United States, this kind of transaction is referred to as a “bargain sale.” See Jeffrey O. Sundberg and Richard F. Dye, *Tax and Property Value Effects of Conservation Easements*, Lincoln Institute of Land Policy Working Paper (Cambridge, MA: Lincoln Institute of Land Policy, 2006). In Canada, proposed amendments to section 248 of the ITA related to split receipting would permit similar transactions: Canada, Department of Finance, Bill C-10, *Income Tax Amendments Act, 2006*, October 29, 2007, proposed subsections 248(30), (31), and (32). This bill ceased to exist when Parliament was dissolved on September 7, 2008 and has not yet been reintroduced.

32 Boyd et al., *supra* note 11.

33 However, there can be significant transaction costs in establishing an easement, as well as management and enforcement costs. See Boyd et al., *supra* note 11, at 219-20; for descriptions of easement holder's responsibilities, see Byers and Ponte, *supra* note 14, at 22, and chapter 9. For an economic analysis of easement holders' and landowners' rights and a comparison of the transaction costs of easements and full ownership, see Dominic P. Parker, “Land Trusts and the Choice To Conserve Land with Full Ownership or Conservation Easements” (2004) vol. 44, no. 2 *Natural Resources Journal* 483-518, at 501-8.

34 Boyd et al., *supra* note 11, at 218; and Stern, *supra* note 11, at 546-49.

35 For a description of agricultural and working forest easements, see Byers and Ponte, *supra* note 14, at chapter 13.

conservation goals with compatible private economic rights creates economic efficiency comparable to that which is often accomplished through full fee ownership.<sup>36</sup> Of course, the allowable productive uses must be well defined in order to ensure compatibility with the easement's conservation purposes.<sup>37</sup>

On the other hand, there is now an extensive body of reform-oriented criticism of conservation easements, mostly by US authors. US commentators question whether conservation easements provide a public benefit commensurate with their public subsidy. Concerns most often noted include poor integration into established forms of public review, resulting in overall poor land-use planning, lack of transparency, and oversight of what is essentially private land-use control;<sup>38</sup> and underresourced easement holders with insufficient capacity to evaluate, monitor, and enforce easements.<sup>39</sup> There is also a lively debate on the perpetuity requirement for conservation easements, citing the costs to future generations who do not receive the benefits, restrictions that have outgrown their environmental relevance, and other unanticipated burdens.<sup>40</sup>

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36 See Parker, *supra* note 33, at 498-501, 511-13, and 516-17, describing transaction costs and specialization gains. Parker concludes that dividing ownership between environmental amenities and non-conservation outputs can be cost-effective, subject to the caveat that imperfectly specified rights and some costly monitoring and enforcement activities can reduce the cost savings generated by specialization.

37 Retained rights to engage in commercial activities must be carefully defined so as not to harm the conservation purposes specified in the easement.

38 Pidot, *supra* note 14, at 7, 13-15, and 31, describing uncertain cost-benefit calculus, ad hoc decision making, and "backyard" easements with questionable conservation values; Joan Youngman, "Taxing and Untaxing Land: Open Space and Conservation Easements" (2006) vol. 41, no. 11 *State Tax Notes* 747-62, at 759 and 761, describing "leapfrog" sprawl and blocked construction of affordable housing; Korngold, *supra* note 14, 1059-60; and Leigh Raymond and Sally K. Fairfax, "The 'Shift to Privatization' in Land Conservation: A Cautionary Essay" (2002) vol. 42, no. 3 *Natural Resources Journal* 599-639, at 636-37.

39 Pidot, *supra* note 14, at 18-21; and Korngold, *supra* note 14, at 1062. See also Sally K. Fairfax, Lauren Gwin, Mary Ann King, Leigh Raymond, and Laura A. Watt, *Buying Nature: The Limits of Land Acquisition as a Conservation Strategy, 1780-2004* (Cambridge, MA: MIT Press, 2005), 268-69, where the authors note that a large number of land trusts were formed in the past 20 years and that these organizations have no track record and limited resources for stewardship and enforcement. Canadian land trusts also face difficulties with effective monitoring: see L. Campbell and C.D.A. Rubec, *Land Trusts in Canada: Building Momentum for the Future*, Wildlife Habitat Canada and Environment Canada Report (Ottawa: Wildlife Habitat Canada, 2006), 16, citing a British Columbia study surveying 100 non-government organizations.

40 Although most enabling statutes do not have a perpetuity requirement, in both the United States and Canada, easements are usually granted in perpetuity, in order to qualify for income tax benefits. For a summary of the criticism, see Julia D. Mahoney, "The Illusion of Perpetuity and the Preservation of Privately Owned Lands" (2004) vol. 44, no. 2 *Natural Resources Journal* 573-600; Julia D. Mahoney, "Perpetual Restrictions on Land and the Problem of the Future" (2002) vol. 88, no. 4 *Virginia Law Review* 739-87, at 756; and John D. Echeverria, "Regulating

Another persistent criticism is that easement acquisition is often opportunistic:

[A]lmost uniformly, easement deals are constructed to meet the specific financial and real estate needs of the donor or seller. Conserved land thus comes under protection because it is available . . . not necessarily because it is an appropriate parcel to conserve. The landowner, rather than the trust, drives the process.<sup>41</sup>

One author warns that the conservation agenda can become hijacked by other political interests, resulting in conservation easement programs that “in fact are simply methods of subsidizing existing farmers or landowners . . . but [do] not always achieve conservation objectives.”<sup>42</sup>

Critical commentary directed at the US federal tax incentives also underscores the problems relating to easement fair market value determinations. In addition, efficiency and equity concerns are often noted. For example, one author points out that in the absence of information about the percentage of landowners who require the financial inducement of the tax incentive to make the gift, the value of those easements, or the aggregate cost of the incentives, it is impossible to assess the efficiency of the US federal incentive program.<sup>43</sup> The same author questions whether the US federal tax deduction structure could ever provide appropriate incentives for land-rich and cash-poor landowners; she also suggests that further increases under the charitable deduction provisions might only provide a windfall to affluent landowners.<sup>44</sup>

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Versus Paying Land Owners To Protect the Environment” (2005) vol. 26, no. 1 *Journal of Land, Resources, and Environmental Law* 1-46, at 25. But see McLaughlin, supra note 26, at 430, arguing that cy pres can be used to strike a balance “between the landowner’s desire to exercise dead hand control and society’s interest in ensuring that assets perpetually devoted to charitable purposes continue to provide benefits to the public.” For a discussion of issues relating to the modification and termination of tax-deductible perpetual conservation easements in the United States, see, for example, Nancy A. McLaughlin and W. William Weeks, “In Defense of Conservation Easements: A Response to ‘The End of Perpetuity’” (2009) vol. 9, no. 1 *Wyoming Law Review* 1-96; and Nancy A. McLaughlin and Mark Benjamin Machlis, “Amending and Terminating Perpetual Conservation Easements” (2009) vol. 23, no. 4 *Probate and Property* 52-56.

41 Raymond and Fairfax, supra note 38, at 627. See also Parker, supra note 33, at 516-17.

42 Gwenann Seznec, “Effective Policies for Land Preservation: Zoning and Conservation Easements in Anne Arundel County, Maryland” (2005) vol. 23, no. 3 *Virginia Environmental Law Journal* 479-525, at 487.

43 McLaughlin, supra note 16, at 92.

44 Ibid., at 99-105. McLaughlin notes that there is little hard evidence supporting the existence of a target group of land-rich, cash-poor landowners, and explains that “the fundamental mathematics of the charitable income tax deduction work against efforts to use that mechanism to provide a meaningful incentive” to such taxpayers: *ibid.*, at 100. As we will discuss in the next section of the article, the Canadian EGP delivers the tax benefit through a credit, which in theory is less susceptible to criticism on the ground of equity than is the case for a deduction structure.

Three types of reform are generally suggested in the US literature:

1. tightening appraisal rules and standards;
2. correcting deficiencies in the selection of easement property and the drafting of easement terms; and
3. instituting higher standards through accreditation mechanisms to ensure the stewardship capacity of easement holders.

As we will discuss in the next section, to a great extent Canada's EGP already deals with valuation appraisal problems and environmental integrity in easement selection as part of the initial eligibility process, making the program less susceptible to the criticisms raised in the United States.

The critical commentary in the United States has thus far paid little attention to the intergenerational equity or the behavioural effectiveness of the income tax benefit's design. For example, both the charitable deduction and the charitable credit provide a one-time, upfront subsidy to the initial easement donor. This design does not consider the value of the ongoing ecological services provided by the land and the need to reinforce the ongoing relationship between the landowner and the land trust. As a result, the incentive provisions may be inequitable for subsequent owners of property that is subject to maintenance obligations and restrictions on the use of the land in perpetuity. The design of the tax benefit also fails to take advantage of lessons to be learned from the behavioural literature, which suggests that ongoing financial incentives provide better support for the desired behaviour—in this case, compliance and a strong working relationship between the donor, the donor's heirs, and the recipient land trust.<sup>45</sup> In a later section of the article, we will consider approaches that increase and stagger benefits across a longer time span, as well as intergenerational credit transfers.

## **KEY FEATURES OF THE TAX TREATMENT OF CONSERVATION EASEMENT DONATIONS IN CANADA AND THE UNITED STATES**

In both Canada and the United States, private voluntary conservation measures are supported through federal and provincial/state income tax incentives delivered via charitable gift provisions. While the structure and details are different, both countries single out conservation gifts for extra incentives beyond what is available for most other charitable donations of capital property. To provide the background for the hypothetical example and the policy discussion that follows, this section presents a comparison of the key features of the Canadian and US incentive programs.

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<sup>45</sup> See the discussion in Stern, *supra* note 11.

### Tax Incentive Structure: Credit or Deduction, Overall Limit, Carryforward, and Transferability

A brief overview of the basic rules for charitable donations is the starting point for comparing each country's enhanced income tax incentives for creating conservation easements. In Canada, individual taxpayers who make gifts to qualified donees receive a non-refundable tax credit.<sup>46</sup> Each year's credit is calculated by applying the lowest federal marginal tax rate (15 percent in 2009) to the first \$200 of the donor's total eligible donations for the year and the highest rate (29 percent in 2009) to the balance.<sup>47</sup> For most charitable donations, the total amount qualifying for the credit in a year may not exceed a specified annual limit, currently 75 percent of the donor's net income.<sup>48</sup> Any unused portion of qualifying charitable donations for the year can be carried forward for five years, at which point the availability of the credit for the unused amount expires. Donations of capital property, including land, trigger a deemed disposition, which can result in taxable capital gains.<sup>49</sup> Provincial income tax provisions mirror the federal treatment, albeit at the much lower provincial tax rates.<sup>50</sup>

In the United States, charitable donations qualify as itemized deductions for those who choose itemization over a standard deduction.<sup>51</sup> The itemized deduction

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46 ITA subsection 118.1(3).

47 ITA subsection 117(2).

48 As discussed below, the limit does not apply to Crown gifts and ecological gifts. See ITA subsection 118.1(1), the definition of "total gifts."

49 Generally, a taxpayer who disposes of property by way of gift is deemed to have received proceeds of disposition equal to the fair market value of the property at that time under ITA paragraph 69(1)(b). If the fair market value of the property exceeds its adjusted cost base, the taxpayer will realize a capital gain as a result of the disposition. For most gifts of property, 50 percent of the capital gain is included in income for the year and is subject to tax. Income recapture of excess capital cost allowance can also occur for depreciable property. However, ITA subsection 118.1(6) will allow the donor to elect an amount between the adjusted cost base and the fair market value of the gifted property to be the donor's proceeds of disposition, thus allowing a reduction in the amount of capital gains triggered and the eligible amount of the gift. See *Interpretation Bulletin* IT-288R2, "Gifts of Capital Properties to a Charity and Others," January 16, 1995, paragraph 1, for a detailed discussion of these rules. Again, an exception is provided for certain ecological gifts: see *infra* note 55 and the accompanying text.

50 There is a lively debate in Canada on whether charitable gifts should get special tax recognition. See generally David Duff, "Charitable Contributions and the Personal Income Tax: Evaluating the Canadian Credit," in Jim Phillips, Bruce Chapman, and David Stevens, eds., *Between State and Market: Essays on Charities Law and Policy in Canada* (Montreal: McGill-Queen's University Press, 2001), 407-56; and Neil Brooks, "The Tax Credit for Charitable Contributions: Giving Credit Where None Is Due," in the same volume at 457-84.

51 The standard deduction varies according to the taxpayer's filing status. In 2009, the deductions were \$5,700 for a single filer, \$11,400 for joint filers, and \$8,350 for a single head of household (all amounts in US dollars). Along with charitable contributions, itemized deductions include medical and dental expenses, interest on a home mortgage, union dues, employee travel expenses, and other specified items. There is an additional overall limit on certain itemized deductions, including charitable deductions under IRC section 68; however, the overall limit is expected to be phased out after 2009.

structure ties the amount of the tax subsidy to the individual donor's federal marginal tax rate, which ranged from 10 percent to 35 percent in 2009. Charitable contributions are also subject to an annual contribution limit calculated as a percentage of the taxpayer's "adjusted gross income" (AGI). There is an overall annual limit of 50 percent of AGI for cash and non-capital property.<sup>52</sup> Capital properties are subject to a lower 30 percent limit (2009).<sup>53</sup> Conservation easements would ordinarily be considered capital property, absent the special incentives discussed below. Unused portions of deductible donations can be carried forward for five years. In contrast to the Canadian provisions, donations of capital property are not treated as taxable dispositions. Most states also provide a deduction based on the federal deduction.<sup>54</sup> As will be discussed more fully below, some states have introduced a state conservation easement income tax credit, either on its own or in addition to the deduction.

Both Canada and the United States have made public policy choices to enhance the tax incentives for donations of ecologically sensitive property. In both countries, the additional tax advantages have increased land conservation initiatives and contributed greatly to the growth of the land trust community. In Canada, ecological gifts of both fee-simple interests in land and conservation easements have two added tax advantages beyond those available for most other charitable gifts: they are not subject to the 75 percent annual net income limit for charitable donations, and the donation does not trigger taxable capital gains.

The Canadian government's policy on capital gains taxation in respect of ecological gifts has changed since the inception of the EGP in 1995. Initially, the treatment was the same as that for other taxable dispositions of capital property. Then, beginning in 2000, the capital gains inclusion rate for ecological gifts was reduced to half of the normal inclusion rate (33.3 percent for February to October 2000 and 25 percent thereafter). In May 2006, the government amended the ITA to completely eliminate capital gains taxation for such gifts.<sup>55</sup> This policy change was exceptionally

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52 IRC section 170(b); Treas. reg. section 1.170A-8(a).

53 IRC section 170(b)(1)C(i); Treas. reg. section 1.170A-8(e).

54 This is because in states that impose an income tax, the state system usually tracks the federal income tax structure and deductions (Korngold, *supra* note 14, at 1050, footnote 45). Seven states currently have no income tax: Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming. Two states, New Hampshire and Tennessee, have only tax dividends and interest ([http://www.taxadmin.org/fta/rateind\\_inc.html](http://www.taxadmin.org/fta/rateind_inc.html)).

55 ITA paragraph 38(a.2). This provision was introduced as part of the May 2006 federal budget, at the same time as the elimination of taxable capital gains on gifts of publicly traded securities: Canada, Department of Finance, 2006 Budget, Notice of Ways and Means Motion To Amend the Income Tax Act, May 2, 2006. The amending legislation was enacted in the same year: SC 2006, c. 4, section 51(2), applicable in respect of gifts of property made after May 1, 2006. The elimination of taxable capital gains does not apply to ecological gifts of inventory land. A gift of land held as inventory will give rise to an inclusion in income of the fair market value of the property, although the resulting tax will be offset by a corresponding deduction or tax credit in respect of the donation.

important to the land trust community, which had viewed the capital gains tax provisions as a significant disincentive to land conservation.<sup>56</sup> Ecological gifts are now distinct from donations of other capital property, suggesting their importance to the government in achieving specific public policy objectives. Following the elimination of taxable capital gains in May 2006, there was an immediate upsurge in donations of land for conservation purposes.<sup>57</sup> Between the inception of the EGP in 1995 and December 31, 2005 (a period when ecological gifts were still subject to capital gains taxation), a total of 475 gifts were made through the program, with a combined value of about \$139 million and protecting 44,423 hectares (an average of 4,442 hectares each year). In contrast, in the following three years (January 1, 2006 to January 1, 2009), donations of ecologically sensitive land surged, surpassing the pace of the previous 10-year period: an additional 217 gifts were made, valued at about \$288 million and protecting 73,031 hectares (an average of 23,343 hectares each year).<sup>58</sup>

At the federal level in the United States, donations of conservation easements (qualified conservation contributions)<sup>59</sup> are a specific exception to a general rule disallowing donations for partial interests in property. Beginning in 2006, temporary provisions increased the annual contribution percentage limitation for conservation

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56 The non-taxation of capital gains for donations of certain types of appreciated property (cultural property, ecologically sensitive land, and publicly traded securities) is intensely controversial. For a summary of the criticism in the context of gifts of publicly traded securities, see Lisa Philipps, "Thinking Critically About the Taxation of Capital Gains on Donated Public Securities (or Looking Paragraph 38(a.1) in the Mouth)" (2003) vol. 51, no. 2 *Canadian Tax Journal* 913-24; and David G. Duff, "Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities: A Tax Expenditure Analysis" (2003) vol. 51, no. 2 *Canadian Tax Journal* 925-36. For a contrary view, see William I. Innes, "The Case for Tax Incentives on Gifts of Publicly Traded Securities" (2003) vol. 51, no. 2 *Canadian Tax Journal* 905-912. While we acknowledge the debate, we do not address it directly. Proponents of special tax treatment for gifts of ecologically sensitive land will find support in our discussion of the benefits of conservation easements and in Environment Canada's direct involvement in determining the eligibility and valuation of ecological gifts. Detractors will find support in the discussion of the limitations of conservation easements and the critique and report of abuses in the US literature.

57 Of course, there may be many factors contributing to this upsurge, including increased efforts by land trusts, greater public interest in environmental issues, and growing coverage in news reports of the effects of global warming. As well, before the exemption was introduced, donors may have been holding back their donations in anticipation of changes to the government's policy on the tax treatment of ecological gifts.

58 *Supra* note 13.

59 "Qualified conservation contribution" is defined in IRC section 170(h) and Treas. reg. section 1.170A-14. Sections 170(h)(2)(A) and (C) define a qualified real property interest to include "the entire interest of the donor other than a qualified mineral interest" and "a restriction (granted in perpetuity) on the use which may be made of the real property." Treas. reg. section 1.170A-14(b)(2) defines a perpetual conservation restriction as a restriction granted in perpetuity on the use that may be made of real property, including an easement or any other real property interest with similar attributes under state laws.

easements from 30 percent to 50 percent of AGI and extended the carryforward period from 5 to 15 years.<sup>60</sup> Qualified farmers and ranchers could claim the deduction generated by the conservation easement donation to the extent of 100 percent of their AGI.<sup>61</sup> These temporary provisions applied only to conservation easements and not to outright gifts of land. The enhanced incentives initially expired at the end of 2007 but were retroactively reinstated to apply through 2008 to the end of 2009.<sup>62</sup> Bills have been introduced in both houses of Congress to make the easement incentive permanent.<sup>63</sup>

Thirteen states currently provide a conservation easement donation tax credit that can be applied directly against state income tax liability.<sup>64</sup> In most states, the credit is a percentage of the easement's appraised fair market value, ranging from 25 to 100 percent.<sup>65</sup> States usually also cap the credit using some combination of an overall dollar limit, annual limit, per-easement limit, annual statewide limit, and restrictions on multiple easement donations. Some states provide for extended carryforward periods, ranging from 8 to 20 years.

Four states—Virginia, Colorado, South Carolina, and most recently New Mexico—allow a donor to transfer all or a portion of any unused state conservation tax credit to another taxpayer in the same state, who can then claim the credit against

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60 The incentive provisions were enacted as IRC section 170(b)(1)(E), effective for donations made in the 2006 and 2007 tax years. They were subsequently extended to the end of 2009: see *infra* note 62 and the accompanying text.

61 Qualified farmers and ranchers must derive more than 50 percent of their income from the business of farming in the year in which the easement donation is made: IRC section 170(b)(1)(E)(v). See Lindstrom, *supra* note 6, at 103-4.

62 The provisions were extended under section 15302 of the Food, Conservation, and Energy Act of 2008, Pub. L. no. 1104-234, enacted on May 22, 2008.

63 Representatives Mike Thompson (D-CA) and Eric Cantor (R-VA) recently introduced HR 1831, 111th Cong., 1st sess. (2009), and senators Max Baucus (D-MT) and Charles Grassley (R-IA) introduced S 812, 111th Cong., 1st sess. (2009), both with significant bipartisan support and cosponsorship. See Land Trust Alliance, "Working for a Permanent Easement Incentive" (<http://www.landtrustalliance.org/policy/taxincentives/federal>).

64 See Debra Pentz, *State Conservation Tax Credits: Impact and Analysis*, Conservation Resource Center Report (Boulder, CO: CRC, 2007), for a description of the conservation credit programs in 12 states: California, Colorado, Connecticut, Delaware, Georgia, Maryland, Mississippi, New Mexico, New York, North Carolina, South Carolina, and Virginia. Since the report was written, Massachusetts has enacted legislation to implement a tax credit program: the Land Conservation Incentives Act was signed into law on January 14, 2009, and applies to donations for tax years beginning January 1, 2011.

65 Some states also allow a deduction for the portion of the easement donation that does not qualify for the credit. For a discussion of state conservation tax credits, see Jeffrey O. Sundberg, *Measuring the Effect of State Income Tax Incentives on Land Conservation*, Lincoln Institute of Land Policy Working Paper (Cambridge, MA: Lincoln Institute of Land Policy, 2007). In several states, the taxpayer must reduce the amount of the state charitable deduction by the amount of the credit: see, for example, New Mexico section 7-2-18.10 (J) NMSA 1978. North Carolina allows a full deduction for a charitable contribution in addition to a 25 percent tax credit.

his or her own state income tax payable.<sup>66</sup> Virginia has an annual cap of \$100,000 per taxpayer and an overall \$100 million statewide cap on the credit amount;<sup>67</sup> New Mexico has a \$250,000 per-conveyance maximum; South Carolina limits the donation value to \$250 per acre; and Colorado has a \$375,000 annual credit cap (50 percent of the first \$750,000 of the easement's fair market value), with detailed rules restricting multiple easement donations in any one year. Colorado also allows a portion of the credit to be refunded in years in which there is a state budget surplus. The credit was refundable for tax years 2000, 2001, and 2005 but is not expected to be entitled to the refund in the near future.<sup>68</sup>

Credit transferability is often promoted as necessary to secure easement donations from conservation-minded, land-rich but cash-poor farmers and ranchers who would not otherwise be able to take meaningful advantage of the charitable conservation income tax credit. The donor generally receives a cash payment of 70 to 80 percent of the value of the tax credit transferred. Often a third-party broker facilitates the transfer for a commission. A 2007 research report on the impact of state conservation credits by the Conservation Resource Center (CRC) tracked changes in the number of easements donated and acres protected following the introduction of state credit programs, increases in credit amounts, and the introduction of credit transferability.<sup>69</sup> According to the report, the number of conservation easement donations generally rose when credit value caps were raised to over \$100,000; for example, North Carolina and New Mexico reported increases of 20 percent and 25 percent respectively.<sup>70</sup> The most dramatic rise in easement donations occurred after transferability was introduced, provided that the credit value did not include a substantial cap.<sup>71</sup> For example, in the four years following Virginia's adoption of

66 Massachusetts' new Land Conservation Incentives Act creates a nine-person commission to study all aspects of the transferability of the conservation tax credit (including its status and application in other states, potential fiscal impacts, and potential conservation benefits). The commission's report is to be filed by January 1, 2011.

67 Virginia's overall statewide cap effective January 2007 was a response to budget concerns that arose after the transferability provisions were enacted. See Eleanor Weston Brown, "Transferable Conservation Easement Tax Credits . . . The Virginia Experience," in Jacqueline Cottrell, Janet E. Milne, Hope Ashiabor, Lawrence Kreiser, and Kurt Deketelaere, eds., *Critical Issues in Environmental Taxation, International and Comparative Perspectives*, vol. VI (Oxford, NY: Oxford University Press, 2009), chapter 30, 693.

68 The partial refund is available to the original donor but not to transferees of the credit. For tax years beginning on or after January 1, 2000 and before January 1, 2003, the refund limit was \$20,000 per donation per tax year. The limit was increased to \$50,000 for donations made in tax years beginning on or after January 1, 2003. See Colorado Department of Revenue, Taxpayer Service Division, "Income Gross Conservation Easement Credit," *FYI—For Your Information* (Denver, CO: Department of Revenue, 2007) ([http://taxtransfer.net/pdf/income39\\_11-07.pdf](http://taxtransfer.net/pdf/income39_11-07.pdf)).

69 Pentz, *supra* note 64, at 10-14.

70 *Ibid.*, at 14.

71 For example, transferability did not increase easement activity in South Carolina. The report suggests that this is likely due to the combination of a \$250 per-acre credit cap, a shorter carryforward period, and a requirement for state approval: *ibid.*

transferable credits, the average number of donations doubled and the number of acres protected tripled.<sup>72</sup> In Colorado, which introduced transferable credits in 2003,<sup>73</sup> easement donation tax credit claims jumped from 2.3 million in 2001 to 85.1 million in 2005.

A working paper for the Lincoln Institute of Land Policy, also published in 2007, compared changes in easement donation activity between states with different types of income tax incentives.<sup>74</sup> Similar to the CRC report, the working paper found that transferability and credit values over \$100,000 had a statistically significant impact on the number of acres encumbered by conservation easements, whereas small credit amounts, usable only by the donor, did not affect donation rates.<sup>75</sup> The CRC report and the Lincoln Institute working paper both include caveats noting significant gaps in available data owing to incomplete record keeping for easements generally and conservation easement donations in particular.<sup>76</sup> Also, care must be taken when evaluating donation increases in a program's initial years, since such increases could represent an artificial upsurge by donors who held back donations in anticipation of the program. Nonetheless, transferable credits are generally considered to be a significant stimulus for easement activity.

### **Defining the Environmental Goals: What Are Eligible Conservation Purposes?**

Under Canada's incentive provisions, eligible conservation purposes are narrowly defined to focus on ecological services and biodiversity. In contrast, in the United States, conservation purposes are defined in IRC section 170(h)(4) to include not only the preservation of habitat, but also categories defined using non-ecological criteria; for example, land providing open space for outdoor recreation or education, and "scenic" open space defined by aesthetic rather than strictly ecological

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72 Ibid., at 13. See Brown, *supra* note 67, at 681, citing data from the Virginia Department of Taxation and the Virginia Outdoor Foundation, and stating that by 2006, "with the transferable tax credit in full swing with a well-developed market, not only had the number of donations increased remarkably to 445, representing 92,487 preserved acres, but 'large donations' [yielding a tax credit per donation of US\$1 million or more] increased to 55, representing 24,564 preserved acres, an increase to 12 per cent of donations and 27 per cent of preserved acres." See also McLaughlin, *supra* note 16, at 24.

73 Korngold, *supra* note 14, at 1059, citing K.C. Mason, "Lawmakers Want To Tighten Controls on Credit for Donated Land" (2007) vol. 44 *State Tax Notes* 146 (discussing Colorado House Bill 07-1361).

74 Sundberg, *supra* note 65. The working paper investigated the hypotheses that "if the incentives for easement donation are significant, the acreage under easement should grow faster in states with tax incentives compared to those without. In addition, the effect of credits should be larger when the available credit is large, and when credits are transferable so that the program is valuable to more landowners": *ibid.*, at 5.

75 Ibid., at 10.

76 Ibid., at 5; and Pentz, *supra* note 64, at 11.

qualities can qualify. Both countries give tax recognition only for easements in perpetuity. In the United States, the perpetuity requirement is explicit in IRC sections 170(h)(2)(C) and 170(h)(5)(A). The Canada Revenue Agency (CRA) takes the position that only easements granted in perpetuity qualify.<sup>77</sup>

To qualify under Canada's incentive provisions, land donated as an "ecological gift" (including an easement, servitude, or covenant) must be "ecologically sensitive land" that, in the opinion of the federal minister of the environment or the minister's designate, is "important to the preservation of Canada's environmental heritage."<sup>78</sup> This certification authority has been designated to a number of federal and provincial government officials. The administration of the EGP by Environment Canada also underscores the ecological orientation of Canada's incentive program. Environment Canada has developed a definition of ecological sensitivity based on national, provincial, and territorial criteria outlined in the EGP handbook.<sup>79</sup> Examples from the national and provincial criteria include "sites that have significant current ecological value," "lands that are zoned or designated for biodiversity objectives," "natural buffers around environmentally sensitive areas such as water bodies, streams or wetlands," "significant habitats," "sites with enduring geological features that contribute to biodiversity," and "areas of wildlife concentration."<sup>80</sup>

In the United States, the definition of conservation purposes in IRC section 170(h)(4) includes two purposes that mirror the Canadian concept of ecological sensitivity: "the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem" (section 170(h)(4)(A)(ii)) and "the preservation of open space . . . pursuant to a clearly delineated Federal, State, or local governmental conservation policy" (section 170(h)(4)(A)(iii)(II)). Examples in the Treasury regulations interpreting section 170(h)(4)(A)(ii) parallel the Canadian criteria, describing significant habitats and ecosystems for rare, endangered, or threatened species and natural areas that contribute to the ecological viability of parks, nature preserves, wildlife refuges, wilderness areas, or other conservation areas. On the other hand, examples in the Treasury regulations for section 170(h)(4)(A)(iii)(II) may or may not meet the Canadian criteria, depending on whether the delineated government conservation

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77 Atkins et al., *supra* note 24, at 96. CRA document nos. 2004-0106211E5, October 18, 2005 and 2002-0163405, March 11, 2003. See also ITA section 207.31, which imposes a special tax on municipalities or registered charities that receive ecological gifts and then dispose of them or change their use without the authorization of the minister of the environment or the minister's designate. The tax, which is 50 percent of the fair market value of the property at the time of the unauthorized disposition or change in use, is intended to ensure the long-term protection of ecologically sensitive land donated under the incentive program.

78 Definition of "total ecological gifts" in ITA subsection 118.1(1).

79 *Supra* note 30, at 5. See also the updated insert to the handbook: Environment Canada, Canadian Wildlife Service, "Improved Income Tax Treatment of Certified Ecological Gifts," 2006.

80 Environment Canada, Canadian Wildlife Service, "The Ecological Gifts Program: Ecosensitivity Criteria," *supra* note 30. Sites that have the potential for enhanced ecological value based on their proximity to other ecologically significant properties are also included.

policy is rooted in ecological criteria. For example, the preservation of a wild or scenic river or the protection of the “scenic . . . character of land” could constitute a valid conservation purpose.<sup>81</sup> In Canada, the river or scenic land would also need to have ecologically sensitive features in order to merit protection.

The other conservation purposes in IRC section 170(h)(4)—to preserve “land areas for outdoor recreation by, or the education of, the general public” (section 170(h)(4)(A)(i)), “open space . . . for the scenic enjoyment of the general public” (section 170(h)(4)(A)(iii)(I)), or “an historically important land area or certified historic structure” (section 170(h)(4)(A)(iv))<sup>82</sup>—would not likely qualify in Canada.<sup>83</sup> Scenic view easements under section 170(h)(4)(iii)(I) aim to preserve natural beauty and landscape aesthetics and are defined in subjective, non-ecological terms clearly outside the Canadian parameters.<sup>84</sup> The Treasury regulations contain a list of eight non-exclusive factors, ranging from the relatively objective “consistency of the proposed scenic view with a regional or local landscape inventory made pursuant to a sufficiently rigorous review process” to the clearly subjective “degree of contrast and variety provided by the visual scene” and “harmonious variety of shapes and textures.”<sup>85</sup> Although public access is required, this requirement can be met by visual (as opposed to physical) access to a significant portion of the property.<sup>86</sup>

Open space easements under IRC sections 170(h)(4)(iii)(I) and (II) must also “yield a significant public benefit.” The Treasury regulations set forth 11 non-exclusive

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81 Treas. reg. section 1.170A-14(d)(4)(iii)(A). This regulation section is mostly concerned with describing the criteria for a “clearly delineated” government policy. It states that a “general declaration of conservation goals by a single official or legislative body is not sufficient.” A program must involve a “significant commitment by the government with respect to the conservation project,” but this does not mean that the program must be funded, nor is there a requirement for “certification” of particular lands. Lindstrom, *supra* note 6, at 47, notes that this is “perhaps the most frequently used category of conservation purposes,” and although there have been no reported case challenges, reading the Treasury regulations, “it is clear that compliance is not a simple matter.”

82 The historic preservation purpose has an entire detailed subset of statutory requirements that are outside the scope of this article. For an overview of these provisions, including amendments aimed at curbing abuses involving donations of historical easements, see Lindstrom, *supra* note 6, at 55-60.

83 Some ecological and recreational uses might qualify under Prince Edward Island’s criteria, which recognize “areas wholly or partially adjacent to any nature, educational, or recreational trail in the Province”: Environment Canada, Canadian Wildlife Service, “The Ecological Gifts Program: Ecosensitivity Criteria,” *supra* note 30. Lindstrom, *supra* note 6, at 40-41, notes that in the United States, conservation easements for public recreation or education of the general public are not that common, in part because Treas. reg. sections 1.170A-14(d)(2)(i) and (ii) require substantial and regular use by the public, so that land for this purpose is more aptly the subject of a full fee-simple donation.

84 The scenic view easement has a long history in the United States, reportedly encouraged in the mid-1960s by Lady Byrd Johnson (the president’s wife). King and Fairfax, *supra* note 27, at 80-81.

85 Treas. reg. section 1.170A-14(d)(4)(ii)(A).

86 Treas. reg. section 1.170A-14(d)(4)(ii)(B).

factors germane to the public benefit requirement. These include the property's uniqueness, its relationship to the fulfillment of existing public or private programs, its potential contribution to the preservation of local or regional natural, scenic, or historic character, and its potential to preserve a landscape or resource that attracts tourism or commerce.<sup>87</sup> Examples include the preservation of a vacant downtown urban lot as a public garden; woodlands along a public highway; and undeveloped property between the highway and the ocean to preserve landscapes and scenic views.<sup>88</sup> It is unlikely that easements for any of these purposes would qualify under Canada's EGP.

Many individual states incorporate, by reference, the conservation purposes in IRC section 170(h) into their state income tax regimes. Several states use narrower definitions and include some specific prohibitions. For example, North Carolina requires wildlife habitat to exceed 25 acres, Connecticut requires forestry land to exceed 25 acres, California requires agricultural land to be "threatened by development," and California and Georgia exclude golf courses and other sports fields.<sup>89</sup>

### **Eligibility and Valuation: Upfront Certification Versus Post-Return Audit**

The efficient use of public resources devoted to conservation measures requires good choices in easement acquisition and fair valuation of the tax benefit. Canada and the United States take very different approaches to overseeing easement qualification and valuation determination. In Canada, each gift under the EGP is pre-certified by a government department for its environmental qualifications and fair market value.<sup>90</sup> In contrast, the United States relies for the most part on detailed regulations and penalty provisions to set the standards and encourage voluntary compliance, as well as conducting random post-tax filing audits to catch questionable transactions. Only a smattering of states use some form of pre-certification in their state tax incentive programs.

In Canada, before a donor can obtain the special tax benefits available under the EGP, Environment Canada, or its designate, first conducts an upfront qualification

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87 Treas. reg. section 1.170A-14(d)(4)(iv).

88 Treas. reg. section 1.170A-14(d)(4)(iv)(B).

89 Pentz, *supra* note 64, at 18-19 and 32-34. In addition, Delaware has its own definition of natural habitat; Connecticut includes promotion of orderly urban or suburban development; South Carolina excludes golf courses but not sports fields.

90 It is worth noting that the Canadian certification approach applies only to ecological gifts and gifts of "cultural property," both of which receive enhanced credit benefits. For other charitable gifts of property, Canada relies on post-return audits to pick up inflated valuations. This is another example of how ecological gifts are treated differently from other charitable gifts, recognizing both their special status and their unique character. See the discussion above, and Daniel Sandler and Tim Edgar, "The Tax Expenditure Program for Charitable Giving: Kicking a Gift Horse in the Teeth" (2003) vol. 51, no. 6 *Canadian Tax Journal* 2193-2214.

assessment of the conservation features of the land and easement, based on information submitted by the donor and assessed by the department's program staff, often through site visits.<sup>91</sup> Once the ecological sensitivity of the land has been established, and the recipient's eligibility has been verified, the minister of the environment (or his designate) will issue a "Certificate for Donation of Ecologically Sensitive Land" (or, in Quebec, a "Visa pour dons de terrains ou de servitudes ayant une valeur écologique"). The minister then determines the fair market value of the ecological gift through a rigorous appraisal review and determination process (ARDP) overseen by the Appraisal Review Panel. The ARDP requires donors to obtain professional appraisals that follow the EGP guidelines for appraisals. The appraisals undergo review by the Appraisal Review Panel, an independent body largely made up of senior members of the appraisal profession. The panel recommends a fair market value to the minister, who makes the determination taking the recommendation into account. The minister then issues a statement to the donor, certifying the value of the gift. The donor can request a redetermination of the value and, if still unsatisfied, can appeal to the Tax Court of Canada (or the Court of Quebec).<sup>92</sup> The ARDP provides important safeguards to ensure that tax credits accurately reflect the fair market value of gifts while at the same time ensuring that the review process is fair and includes prompt judicial review.

In the United States, a taxpayer's deduction will be questioned only if the taxpayer is audited within the statute of limitations period. As a practical matter, landowners donate properties with features that they think meet the income tax requirements and, together with the recipient organization, draft easement restrictions with careful attention to the detailed interpretive Treasury regulations and IRS notices.<sup>93</sup> IRC section 170(f)(11) contains the basic reporting and substantiation requirements for deductions for non-cash charitable contributions,<sup>94</sup> and Treas. reg. section 1.170A-14(h)(3) describes some factors that must be taken into account in fair market value appraisals of conservation easements. Easement appraisals are complex; for example, there are often no "market comparators," and an easement can

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91 See ITA subsection 118.1(1), the definition of "total ecological gifts," and subsections 118.1(10.2) to 118.1(10.4) (applicable to gifts made or proposed to be made after February 27, 2000). The certification procedure is described in the EGP handbook, *supra* note 30, at 12ff.

92 An application for judicial review must be filed within 90 days of the minister's confirmation or redetermination of the fair market value of the gift. See the EGP handbook, *supra* note 30, at 20.

93 Of course, the recipient organization cannot guarantee the tax benefit.

94 Taxpayers are required to obtain a qualified appraisal for donated property for which a deduction of more than \$5,000 is claimed (IRC section 170(f)(11)(C)). A "qualified appraisal" is defined in IRC section 170(f)(11)(E)(i). IRC section 170(f)(11)(E)(ii) defines a "qualified appraiser" as an individual who has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the secretary, who regularly performs appraisals for which the individual receives compensation, and who meets such other requirements as may be prescribed by the secretary in regulations or other guidance.

sometimes create amenities that enhance contiguous and non-contiguous property owned by the landowner or a family member. The Treasury regulations address these concerns.<sup>95</sup>

Most states follow the federal post-donation audit approach. Even Colorado, which allows credit transferability and has tighter conservation requirements effective 2008, does not require pre-certification of the easement's conservation purposes.<sup>96</sup> Virginia, another credit transfer state, requires certification by the Department of Conservation and Recreation if the credit is over \$1 million. Only a few states require pre-approval or pre-identification by a state or local agency.<sup>97</sup> Massachusetts, one of the first states to pass conservation easement enabling legislation (in 1956), has always required review by state officials and approval by the local government where the land is situated.<sup>98</sup> This requirement is continued in its new Land Conservation Incentives Act establishing a state conservation income tax incentive.

Until 2005, very few conservation easement transactions were audited, and those audits mostly concentrated on valuation issues. Critics in the United States question whether this unsupervised system produces easements that justify the public subsidy, citing examples of conservation easements claimed for golf course fairways or for amenities for wealthy neighbourhoods, as well as ad hoc decisions leading to "scattered green sprawl."<sup>99</sup> A series of investigative newspaper articles in 2003 prompted US Senate committee hearings and a targeted IRS audit program.<sup>100</sup> Subsequently,

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95 Treas. reg. section 1.170A-14(h)(3)(i) starts with a preference for a "comparable sales" method; however, if there is "no substantial record" on which to base a "meaningful or valid comparison," the regulation authorizes a "before and after" approach. The regulation also contains an "enhancement rule" requiring appraisers to reduce the value of a conservation easement if contiguous or non-contiguous property owned by the donor or a related party increases in value because of the easement.

96 However, Colorado has added a requirement that donors must file a statement with the Colorado Department of Revenue describing the specific nature of the easement.

97 In California, a wildlife habitat must be identified by the state or federal Endangered Species Act and certified by the Wildlife Conservation Board. Mississippi easements must be certified by the state streams stewardship program or the heritage program. In North Carolina, the Department of Environment and Natural Resources must certify that the property donated is suitable for one or more valid public benefits defined in the state legislation. See Pentz, *supra* note 64, at 32-34.

98 See King and Fairfax, *supra* note 25, at 71-72; and Pidot, *supra* note 14, at 11.

99 Pidot, *supra* note 14, at 15.

100 See, for example, Joe Stephens and David B. Ottaway, "Developers Find Payoff in Preservation," *Washington Post*, December 21, 2003, describing "questionable" easement transactions benefiting well-to-do subdivisions and golf courses; and a series of articles focusing primarily on transactions involving the Nature Conservancy in the United States: David B. Ottaway and Joe Stephens, "Nonprofit Land Bank Amasses Billions," *Washington Post*, May 4, 2003; Joe Stephens and David B. Ottaway, "How a Bid To Save a Species Came to Grief," *Washington Post*, May 5, 2003; Joe Stephens and David B. Ottaway, "Nonprofit Sells Scenic Acreage to Allies at a Loss," *Washington Post*, May 6, 2003; Joe Stephens, "Charity's Land Deals To Be Scrutinized," *Washington Post*, May 10, 2003; and Joe Stephens and David B. Ottaway, "Senate Panel Intensifies Its Conservancy Probe," *Washington Post*, November 10, 2003.

reports of unsupported and inflated values<sup>101</sup> and lax professional appraisal standards emerged. These events prompted changes in IRS policies and Treasury regulations, and new efforts on the part of national land trust organizations to bring higher standards to their members' conservation acquisition programs.

Treasury regulations now require donors to identify on IRS form 8283, "Noncash Charitable Contributions," the conservation purposes furthered by the easement; the value of the land before and after the transaction; permits, approvals, or contracts connected to the contribution; and any ownership interests in nearby property. In addition, if the value of the contribution exceeds \$500,000, the full appraisal must be submitted to the IRS.<sup>102</sup> New IRC section 6695A adds a series of penalties for "substantial and gross valuation misstatements"<sup>103</sup> if an appraiser knew, or reasonably should have known, that the appraisal would be used in connection with a return or claim for refund.<sup>104</sup> The penalty is the greatest of three amounts: 10 percent of the underpayment of tax flowing from the misstatement; \$1,000; and 125 percent of the gross income received by the appraiser. Given the high value of many easements, 10 percent of the tax underpayment can be considerable.

The combined effect of the new reporting requirements and third-party penalties aimed at appraisers is expected to assist the IRS in winnowing out easements for audit and in curbing inflated appraisals.

### **Qualified Recipients: The Donee's Stewardship Capacity**

In the search for a successful conservation easement incentive program, the donee organization plays a critical role. Because conservation easements are intended to be permanent encumbrances, the easement holder must have the commitment and capacity to maintain, monitor, and enforce the restrictions in the agreement. Over time, there can be considerable pressure from new landowners or surrounding urban development to modify or extinguish the easement.<sup>105</sup> Both Canada and the United States entrust charitable organizations and government entities with the responsibility for safeguarding the easement's environmental purposes in perpetuity. Legal challenges to conservation easements are still rare, although there have been reports of some very costly cases, and land trusts acknowledge that even one court case

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101 Migoya, *supra* note 20.

102 Treas. reg. section 1.170A-13(c)(4). Treas. reg. section 1.170A-13(f)(2) requires the receiving organization to acknowledge whether the donor received any goods or services in consideration for a contribution.

103 As defined in IRC section 6662.

104 In the absence of new regulations or amendments to Treas. reg. section 1.170A-14 taking into consideration the recent IRC amendments, the IRS has issued Notice 2006-96, "Guidance Regarding Appraisal Requirements for Noncash Charitable Contributions," providing transitional guidance with respect to these requirements and the requirements of a qualified appraiser.

105 Boyd et al., *supra* note 11, at 228.

involving an easement's violation, validity, or scope could impose a substantial burden on the trust's resources.<sup>106</sup>

Donee organizations range from large charities that have significant donor bases and are run by paid staff to small local land trusts that have limited resources and are staffed primarily by volunteers. Small local organizations have the advantage of being well placed to determine which easements can best serve the local community, but the disadvantages of small memberships and limited fund-raising capacity.

Conservation easement stewardship costs include tracking the land conditions, monitoring and enforcing the easement's restrictions, and sometimes defending the easement against legal challenges. Commentators raise concerns about the ability of some recipient organizations to appropriately screen the easements in the first place and to carry out ongoing compliance over time. Underfunding of stewardship costs is acknowledged as a persistent concern.<sup>107</sup> Land trust umbrella organizations recommend requesting or even requiring easement donors to make a contemporaneous cash contribution to the stewardship fund.<sup>108</sup>

Under Canada's EGP, registered charities must be approved by the minister of the environment, or the minister's designate, to receive an ecological gift. The EGP Web site<sup>109</sup> lists approved charities. In addition to meeting the requirements imposed on all registered charities to maintain their status, a charity qualifies for the list if one of its main purposes is the conservation and protection of Canada's environmental heritage. Each time an ecological gift is reviewed, the donee organization will also be examined to confirm that it is the appropriate recipient of that particular gift. This requirement gives the minister an opportunity to review and screen out organizations that made the list initially but do not have sufficient stewardship capacity for a particular gift. However, it is unclear to what degree the donee's stewardship capacity is currently reviewed. In this regard, Environment Canada introduced the requirement that, beginning April 1, 2008, recipient organizations must adopt the standards and practices of the Canadian Land Trust Alliance (CLTA), which includes among its guiding principles the commitment by member land trusts to have adequate human

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106 Byers and Ponte, supra note 14, at 159, noting that as of 2002, surveys indicated that a single easement violation had cost a land trust \$284,000 to deal with and that earlier surveys reported legal costs associated with easement violations ranging from \$5,000 to \$100,000, without taking into account staff time and resources.

107 See Korngold, supra note 14, at 1062; Pidot, supra note 14, at 18-19; and Katie Paris, *Land Trusts: Measuring the Effectiveness of Conservation Easement Programs* (Toronto: Nature Conservancy of Canada, May 20, 2004) ([http://www.stewardshipcanada.ca/files/scn/984\\_Land\\_Trust\\_Effectiveness\\_Paper\\_May\\_2004.pdf](http://www.stewardshipcanada.ca/files/scn/984_Land_Trust_Effectiveness_Paper_May_2004.pdf)). There are other concerns with stewardship of donated easements. For example, what happens to the easement if the donee organization ceases to exist? How much leeway should there be for extinguishing or amending easements? Both Canada and the United States address some of these issues; however, there is much room for improvement.

108 Byers and Ponte, supra note 14, at 123-31.

109 Supra note 4.

and financial resources for current and future stewardship obligations.<sup>110</sup> The CLTA's standard has the potential to exert a positive influence on the organizational capacity of member organizations; however, in the short run, it may not be effective to ensure stewardship capacity, since the CLTA does not yet have either an accreditation or an audit program to determine compliance by its member organizations. The US Land Trust Alliance has an extensive accreditation process, but it is still a voluntary program.<sup>111</sup>

In the United States, qualified organizations must meet the detailed requirements for all tax-exempt organizations and public charities.<sup>112</sup> Treas. reg. section 1.170A-4(c)(1) further requires that the organization have a commitment to protect the conservation purpose of the donation, and the resources to enforce the easement.<sup>113</sup> However, the regulation specifically states that this requirement does not mean that the organization must have funds set aside for protection and enforcement purposes. Public charities holding conservation easements must annually report on IRS form 990 their easement monitoring activities, including the number of easements physically monitored and the amount of money and staff time devoted to these tasks.<sup>114</sup> This relatively recent reporting requirement is intended to enable the IRS to more effectively audit the commitment and resource requirement.

## **THE LAND-RICH AND CASH-POOR TAXPAYER: COMPARING THE CURRENT CANADIAN TAX BENEFITS WITH LONGER CARRYFORWARD PERIODS, TRANSFERABLE CREDITS, AND REFUNDABLE CREDITS**

The subject of this section is the land-rich and cash-poor taxpayer with environmental motivations. Such individuals are often held out as the type of taxpayer

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110 Canadian Land Trust Alliance, *Canadian Land Trust Standards and Practices* (Smiths Falls, ON: Canadian Land Trust Alliance, December 2005) (updated June 2007) (<http://www.clta.ca/en/pdf/0607standardspractices.pdf>).

111 Land Trust Alliance, "Accreditation" (<http://www.landtrustalliance.org/learning/accreditation/2008-accreditation-indicator-practices>).

112 IRC section 501(c)(3) governs exempt organizations, and IRC section 509(a)(2) contains a public support funding test for public charities.

113 The threshold test under the regulation is not very high. This requirement is "considered to be met" if the organization is operated primarily or substantially for one of the four conservation purposes in IRC section 170(h)(4)(A).

114 Stewardship funding is a difficult issue. Recommendations of the 2005 Senate committee included revoking the tax-exempt status of organizations that fail to monitor their land holdings, establishing guidelines for monitoring programs, implementing an accreditation program to ensure that recipient organizations have the capacity to carry out their responsibilities as land stewards, limiting deductions for small donations, and providing for pre-approval of certain donations. See Nancy A. McLaughlin, "Conservation Easements—A Troubled Adolescence" (2005) vol. 26, no. 1 *Journal of Land, Resources, and Environmental Law* 47-56, at 54.

whom conservation organizations want to encourage to make gifts of land and conservation easements, but who may be stymied by inequities in the current Canadian income tax provisions. Using the example of a Saskatchewan farmer who earns a moderate income, table 1 compares the current Canadian provisions with three approaches modelled after Colorado's credit program:<sup>115</sup>

1. a 20-year carryforward period;
2. a transferable credit with a 5-year carryforward period; and
3. a refundable credit of up to \$50,000 per year with a 5-year carryforward period.

Under the third approach, each year the donor would choose to take either the usual conservation easement credit or the refundable credit, whichever was to the taxpayer's advantage.

*Taxpayer Profile*<sup>116</sup>

Jack has been involved in mixed farming on a couple of sections of land in the aspen parkland region of Saskatchewan for the last 32 years. Much of the land, which has been in his family for several generations, is in cultivation or used as hay land; however, two quarter sections remain in their original native prairie condition and include several aspen bluffs and wetlands. Ducks, geese, and other wildlife are abundant on this land. Jack currently uses these native quarter sections for grazing cattle. He takes special care to manage his land in an environmentally sustainable manner.

In speaking with a local land trust about proper habitat stewardship practices, Jack hears about the EGP. He decides to give the group a conservation easement on the two native quarter sections to protect the land from cultivation while maintaining moderate grazing rights as a sustainable management tool. The two quarter sections are in an urban-rural area where there is significant development pressure.

The land originally cost \$100,000 and was worth \$1.25 million prior to the imposition of the easement. The appraised value of the easement is \$1 million, so that with the easement, the land is valued at \$250,000. Jack's annual taxable income is \$40,000. Environment Canada has certified that the land meets its criteria regarding ecological sensitivity and that the fair market value of the conservation easement is \$1 million.<sup>117</sup>

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115 For this example, we did not impose the \$750,000 per-easement fair market value cap used in Colorado, because we wanted to isolate the effect of the three approaches. Also, a cap at the federal level may be viewed as a significant disincentive to large gifts. The cap would not have this effect at the state level in the United States because state tax rates are comparatively low. Also, as noted earlier, the Colorado refundable credit is available only if there is a state declared budget surplus (see *supra* note 68 and the accompanying text).

116 The facts in this example are based on a donation scenario described on the EGP Web site, *supra* note 4: "Donation and Income Tax Scenarios," developed by Karen Cooper for Environment Canada.

117 ITA subsection 118.1(12) provides that the fair market value of a gift of a conservation easement will generally be the amount by which the fair market value of the land is reduced by the giving of the conservation easement.

The calculations in the table are based on the following assumptions:

1. Jack's combined federal-provincial marginal tax rate is 26 percent. Since his income is barely over the lower limit, we have used the 2009 federal rate of 15 percent and the Saskatchewan rate of 11 percent.
2. Generally, the amount of the donation claimed for the non-refundable donation tax credit would be determined after taking into account the non-refundable tax credits that the taxpayer is entitled to claim that are not eligible to be carried forward. This example does not take into account any non-refundable tax credits to which the donor may be entitled, such as credits relating to the basic personal amount, Canada Pension Plan, or employment insurance contributions.
3. Jack chooses to apply the maximum value of the donation allowable to generate tax credits during the year of the donation. The amount available for carryforward is based on this assumption, even though the donor has the option of using less than the maximum amount in the year of the gift.
4. The adjusted cost base of the property is its acquisition cost. In reality, there may be a number of factors other than acquisition cost that affect a property's adjusted cost base for tax purposes.
5. The land does not meet the criteria for qualified farm property; accordingly, the capital gains deduction for such property is not available.<sup>118</sup>

The tax consequences to the donor and the cost to the government under each of the approaches shown in the table can be summarized as follows:

- *Current Canadian provisions.* Applying the current Canadian provisions, Jack does not pay tax in the donation year and receives relief from capital gains on the transfer to the land trust. If he continues to earn \$40,000 a year, he will not pay tax for the next five years. However, at the end of the six-year period, \$857,692 of the value of the donation will expire without providing any further tax benefit to Jack. The current treatment is the least costly to the government.
- *20-year carryforward.* Using a 20-year carryforward, Jack will not pay any tax for 21 years. The key advantage to Jack in this scenario is that, at the end of the longer carryforward period, he will have used \$531,600 of the donation value, leaving only \$218,400 unused.<sup>119</sup>
- *Transferable credit.* Jack's decision to sell a portion of his charitable donation credit requires tax planning to ensure that he retains enough of the donation credit amount to eliminate his taxes owed on the taxable income he earns

118 See ITA subsections 110.6(1), the definition of "qualified farm property," and 110.6(2).

119 The US federal carryforward of 15 years would allow Jack to use \$342,000, leaving \$408,000 unused.

**TABLE 1 Comparison of Current Canadian Tax Benefits of an Easement Donation and Benefits Under Three Alternative Approaches: A Hypothetical Example**

Benefits to the donor taxpayer	Current Canadian provisions	<i>dollars</i>		
		Alternative 1: 20-year carryforward	Alternative 2: transferable credit and 5-year carryforward	Alternative 3: refundable credit of up to \$50,000 per year and 5-year carryforward
Taxable income	40,000	40,000	40,000	40,000
Capital gains from gift of conservation easement <sup>a</sup>	920,000	920,000	920,000	920,000
Taxable capital gain	nil	nil	nil	nil
Income from credit sale <sup>b</sup>	nil	nil	240,000	nil
Taxable income	40,000	40,000	280,000	40,000
Income tax payable (federal and provincial)	10,400	10,400	123,200 <sup>c</sup>	10,400
Eligible charitable amount claimed	23,718	23,718	280,081	113,951
Donation tax credit <sup>d</sup>	10,400	10,400	123,200	50,000
Net tax payable	nil	nil	nil	nil
Charitable amount available for future years	976,282	722,282	19,919	886,049
Unused charitable amount after carryforward period expires <sup>e</sup>	857,692 (at the end of 6 years)	251,922 (at the end of 21 years)	nil (after 6 years)	316,294 (at the end of 6 years)
Cost to government in taxes forgone	62,400	218,400	439,892 <sup>f</sup>	300,000

(The table is concluded on the next page.)

**TABLE 1 Concluded**

- <sup>a</sup> Only a portion of the capital gain is attributed to the disposition of the conservation easement by virtue of a specific rule for partial dispositions of ecological gifts in ITA subsection 43(2). In this example, the capital gain of \$920,000 is calculated by first determining the proportion of the gift in respect of the value of the land ( $\$1,000,000/\$1,250,000 = 80\%$ ). The capital gain in respect of the gift of the conservation easement will therefore be 80 percent of the capital gain had the entire property been disposed of [ $80\% \times (\$1,250,000 - \$100,000) = \$920,000$ ].
- <sup>b</sup> Internal Revenue Service, Office of Chief Counsel, *Memorandum AM 2007-002*, January 11, 2007 and *Memorandum CCA 200211042*, March 18, 2002, state that the sale of a tax credit is a taxable event under IRC section 1001, generating ordinary income and not capital gain, and that the taxpayer's basis in the credit is zero, so that the entire amount received is taxable: see C. Timothy Lindstrom, *A Tax Guide to Conservation Easements* (Washington, DC: Island Press, 2008), 143. In contrast, the Virginia statute explicitly states that the credit transfer and its application against tax liability does not create a gain or loss for either the transferor or the transferee: Virginia Code section 58.1-513.E. See the discussion in Eleanor Weston Brown, "Transferable Conservation Easement Tax Credits . . . The Virginia Experience," in Jacqueline Cottrell, Janet E. Milne, Hope Ashiabor, Lawrence Kreiser, and Kurt Deketelaere, eds., *Critical Issues in Environmental Taxation, International and Comparative Perspectives*, vol. VI (Oxford, NY: Oxford University Press, 2009), chapter 30, 691. <sup>c</sup> We have used a combined federal-Saskatchewan marginal tax rate of 44 percent. <sup>d</sup> Calculated using a federal-Saskatchewan combined credit rate of 26 percent on the first \$200 and 44 percent on the remainder. <sup>e</sup> Assumes that taxable income remains the same. <sup>f</sup> Combined total of \$123,200 used by Jack in the current year and \$8,728 in future years plus \$307,964 used by the purchaser.

from the credit sale to a third-party taxpayer. To accomplish this, Jack sells \$700,000 of his \$1 million donated value (which would otherwise generate a federal-provincial credit of \$307,964 for Jack) to another taxpayer for \$240,000 (assuming an approximate 20 percent discount). The \$240,000 that Jack receives from the sale of the donated value (\$307,964 credit) is assumed to be treated as ordinary taxable income in keeping with the US treatment.<sup>120</sup> By retaining \$300,000 of donated value for his own use, Jack still has a tax credit sufficient to eliminate the tax payable on his income from the credit sale. Under this scenario, after the donation, Jack has a working farm and \$240,000 cash for investment. The taxpayer who purchases is assumed to use the entire tax credit. This scenario is the most costly to the government.

- *Refundable credit.* The refundable credit scenario eliminates Jack's tax liability in the first year and gives him \$39,600 of immediate cash. In each of the five subsequent years, Jack both eliminates his tax liability on his earnings and receives an additional cash refund of \$39,600.

120 Presumably, the proceeds from the sale of the tax credit is treated as ordinary income in the United States because property held for less than a year is treated as ordinary income. In Canada, the nature of the property determines whether it is on account of capital or income, and the length of time that the property is held is only one factor. Other issues that arise include how to determine the adjusted cost base, if any, and whether the sales proceeds constitute an advantage within the meaning of the proposed split-receipting amendments (see *supra* note 31).

In the next section, we draw on this example and the results outlined above to assess different policy options, bearing in mind that there is already some interest in Canada at the political level in adopting transferable income tax credits along the lines of the approach taken in several US states.

## **IMPROVING THE CANADIAN TAX INCENTIVE FOR CONSERVATION EASEMENTS AND THEIR ASSOCIATED ECOLOGICAL SERVICES**

The environmental effectiveness of any land conservation tax incentive should be measured by the number of acres protected, the quality of the habitat preserved, and the extent of the ecological services derived from the protected land. Canada's EGP already has important features that help to guarantee the quality of donated conservation easements and insulate the program from many of the criticisms levelled at the tax incentive programs in the United States. By situating the EGP within Environment Canada, using a pre-certification ecological assessment and appraisal evaluation process, and using more narrowly defined ecological objectives, Canada has a greater assurance than the United States that its tax incentive program delivers real environmental benefits. Further proposals to increase the incentives offered to conservation easement donors in Canada are less likely to attract the often-repeated criticism in the United States that easements are merely tools to "enhance the wealth of developers or protect the view shed of large landowners at public expense"<sup>121</sup> and at inflated values.

From a tax equity perspective, Canada's use of the highest marginal tax rate to calculate the value of the donation tax credit for all taxpayers compares favourably with the US deduction where the tax benefit depends on factors that are personal to the donor and divorced from the value of the conservation resources protected—for example, whether the taxpayer itemizes deductions, and the taxpayer's marginal tax rate.<sup>122</sup> Canada further facilitates easement donations for taxpayers at all income levels by completely removing the annual income limit imposed on other charitable gifts.

However, as the comparison in table 1 demonstrates, a longer carryforward period such as that provided in Colorado and in the current US federal provisions has the potential to achieve greater equity, over time, for moderate- and low-income Canadian taxpayers than is provided by the current Canadian credit. Credit transferability goes even further; it enables moderate- and low-income taxpayers to structure a conservation easement donation and credit sale transaction to both maximize the tax benefit and receive cash for any unused benefit. This puts such taxpayers on a more equal footing with high-income donors. Transferable credits may also increase

121 King and Fairfax, *supra* note 25, at 68.

122 Note that Canada uses the lowest marginal rate (15 percent in 2009) to calculate the value of the donation tax credit on the first \$200 of the donation amount. In the context of the high fair market values of conservation easements, this first-tier credit value has no real effect. For a discussion of the upside-down effect of the US incentive, see McLaughlin, *supra* note 16, at 29-31.

accessibility for moderate- and low-income taxpayers by providing funds to offset the significant transaction costs associated with conservation easement donations, such as surveys, appraisals, and fees for legal and tax advice.

It is interesting to compare longer carryforward periods with transferable credits. From a tax equity perspective, transferable credits seem more beneficial, since taxpayers from any income level could maximize the economic benefit from the donation of a conservation easement through a credit sale. Transferability also initially seems effective in achieving the tax incentive's environmental goals, since research in the United States tentatively demonstrates a significant boost in easement donations following its introduction.<sup>123</sup> However, several caveats are in order.

First, the assumption that there is a large contingent of environmentally motivated land-rich cash-poor donors stymied by the current system is anecdotal. It is just as likely that the taxpayers best situated to take advantage of transferable credits are high-income taxpayers with access to tax advisers and business planners, and with ready access to high-income acquaintances, family, and friends interested in purchasing tax credits at a discount.

Second, the US research that tracked increases in conservation easement donations after transferable credits were introduced is based on limited and incomplete data.<sup>124</sup> The research may not be sufficiently longitudinal to account for initial upsurges in donations by landowners who were waiting for proposed legislation to take effect before making a planned donation. The research also does not appear to have controlled for other, more local factors such as regional development pressures or local attitudes toward the need to protect rural lands from suburban development.<sup>125</sup> Nor did it consider the effect of longer carryforward periods.

Third, transferable credits come with a significantly higher fiscal expenditure commitment and the need for tighter definition and standards to avoid possible abuse. Policy makers would need to consider fiscal constraints and whether there should be per-easement or other types of caps, provisions dealing with multiple easements on the same property, and anti-abuse provisions to prevent property subdivision aimed at artificially creating multiple lots for multiple easement donations. After Virginia introduced transferability, the upsurge in easement donation credits caused budgetary concerns and prompted the legislature to institute an annual statewide cap.<sup>126</sup> Careful monitoring and tracking mechanisms would also be needed to prevent duplicate claims.

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123 Pentz, *supra* note 64. See *supra* notes 71 to 73 and the accompanying text.

124 Research limitations include incomplete statistical data from many of the state programs studied. Estimates were sometimes based on interviews with land conservation professionals. In some instances, the researchers appeared to use opinions of experts in one state to explain trends in other states. Pentz, *supra* note 64, at 14.

125 McLaughlin, *supra* note 16, at 24, commenting on the dramatic jump in the number of easement projects undertaken by the Virginia Outdoors Foundation since 1999.

126 Brown, *supra* note 67, at 693.

Fourth, transferability adds transaction costs and requires increased capacity within the land trust community. In the United States, two different choices emerged: in Colorado, for example, both for-profit brokers and non-profit entities are used to facilitate credit sale transactions and filing credit claims, while in Virginia most transactions are arranged by the Virginia Outdoors Foundation. Private brokers involve private benefits in the form of commissions and a possible increased incentive for inflated appraisal values. However, choosing a land trust as the broker requires a land trust community with sufficient resources and infrastructure to evaluate and document transactions; access to potential purchasers; and the ability to carefully monitor and avoid conflicts of interest involving sizable donations.

In addition to these caveats, allowing transfers of charitable credits to unrelated parties would be a significant departure from Canada's general prohibition against transferring tax attributes between unrelated persons. Currently, the ITA does not include any provisions allowing transfers of charitable donation tax credits or deductions—although paragraph 88(1)(e.6) permits any unused deductions by a subsidiary corporation to be transferred to the parent corporation upon the windup of the subsidiary. It is noteworthy that, in order to stop paragraph 88(1)(e.6) from being used to trade in charitable donations, ITA subsection 110.1(1.2) was introduced in the 2004 federal budget.<sup>127</sup> This provision reflects the general fiscal policy in Canada against the transfer of tax attributes between unrelated entities; in fact, the language of the provision mirrors the language used in subsection 111(5), the main provision of the ITA restricting the transfer of business or property losses. It is doubtful that the Department of Finance would be very receptive to a transferable tax credit or deduction in light of the strong fiscal policy evidenced by provisions such as the loss-transfer restrictions.

A longer carryforward period, on the other hand, has the advantage of being simple to institute without departing from the usual mode of recognizing charitable contributions. This fact alone may make this change more politically feasible. There

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127 Canada, Department of Finance, 2004 Budget, Notice of Ways and Means To Amend the Income Tax Act, March 23, 2004, resolution (24). This amendment was necessary because otherwise a corporation could transfer a charitable deduction to another non-arm's-length corporation through a series of complex corporate reorganization manoeuvres that relied upon the application of paragraph 88(1)(e.6). New subsection 110.1(1.2) provides that, notwithstanding the language in paragraph 88(1)(e.6), after a change in control of a corporation has occurred (generally as a result of a corporate reorganization), no deductions are available in respect of gifts made before the acquisition of control. The Department of Finance, *Draft Regulations and Explanatory Notes Relating to Income Tax* (Ottawa: Department of Finance, September 2004), clearly indicates that it "is not intended that the tax benefit from this deduction be made available, indirectly, to a person who could not otherwise use the resulting deduction." In case the Department of Finance's objection to the trading of the charitable donation deduction remained unclear, the provision contains anti-avoidance language that also denies a charitable donation deduction in respect of a gift "in circumstances where control of a corporation is acquired before a donation of property by the corporation, but in contemplation of that gift being made."

is recent precedent in the Canadian context with the extension of the loss carry-forward period to 20 years for most types of business and property losses.<sup>128</sup> Applying the ecological gifts credit against tax payable each year can reinforce and thereby motivate and sustain the ongoing relationship between the landowner and the easement holder for a longer period. This is more in keeping with the behavioural research on environmental financial incentives, which suggests that periodic reinforcement is important to sustain conservation behaviours.<sup>129</sup> By contrast, the immediate cashout from the sale of a transferable credit front-end loads the economic incentive and does not build the relationship. Again, the behavioural research suggests that this type of front-end loading is a poor design where the objective is to maintain a long-term or ongoing relationship such as a conservation easement.

Longer carryforward periods still have the obvious limitation that the credit expires on death, making the donation value uncertain. An intergenerational transfer of any unused credits to an inheriting landowner on the death of the donor would maintain the credit value. It would also provide the subsequent landowner with financial recognition of the ongoing ecological services provided by the land and an incentive to work with the easement holder to maintain the relationship. As discussed earlier, pressure by subsequent landowners to remove or constrict conservation easements on land that they inherit is a recognized problem.

One way to put cash in the hands of a land-rich cash-poor donor would be to use the proposed split-receipting amendments, which would allow the land trust to pay the donor a portion of the easement value in cash. Of course, this assumes that there are resources available to do so. In this regard, the Canadian government has a recent history of establishing grant programs to facilitate land conservation transactions.<sup>130</sup> This approach has the further advantage of allowing land trusts to seek out appropriate donors using a well thought out conservation plan rather than responding to donor initiatives.

Neither transferability nor longer carryforward periods address the persistent concern over donee stewardship capacity. Stimulating more easement activity, without at the same time addressing this issue, is likely to simply compound the stewardship problem. As noted earlier, Environment Canada is encouraging easement holders to operate in accordance with high standards and best practices by requiring ecological gift recipients to adopt CLTA standards and practices.<sup>131</sup> However, at this

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128 See, for example, ITA paragraph 111(1)(a) regarding non-capital losses. This amendment was introduced in the 2006 federal budget, *supra* note 55, and enacted by SC 2006, c. 4, section 57(1).

129 Stern, *supra* note 11, at 562.

130 In March 2007, the government signed a funding agreement with the Nature Conservancy of Canada (NCC) to provide \$225 million in matching funds for conservation initiatives led by the NCC. The NCC can subgrant \$15 million of these funds to other organizations. The funds will be used to support specific land-securement projects. See the Nature Conservancy of Canada, "Natural Areas Conservation Program" ([http://science.natureconservancy.ca/federalprogram\\_en.html](http://science.natureconservancy.ca/federalprogram_en.html)).

131 See *supra* note 110 and the accompanying text.

point, adopting the CLTA's standards is still an unenforceable pledge since the CLTA does not yet have any accreditation or audit program.

To ensure that ecological gifts are effectively maintained, the tax incentive program could promote stewardship funding concurrently with easement donations. It is tempting to require a concurrent cash donation by the easement donor. However, this could create an even greater barrier to moderate- and low-income landowners, unless the credit design produced some cash flowback or a monetary rebate.<sup>132</sup> For example, a limited refundable credit could provide funds for a cash stewardship donation. Alternatively, a limited carryback provision could, in many instances, generate a refund.

## CONCLUSION

Enhancing the tax incentives for conservation easement donations in order to stimulate easement activity is justified by essential and pressing environmental goals. Conservation is costly to landowners in terms of the opportunity costs of forgoing development. Tax incentives respond by partially addressing the persistent market failure to compensate landowners for positive externalities in the form of essential environmental goods and services. Conservation easements promote an efficient allocation of resources by dividing the personal and economic uses of land from the conservation uses. The simple approach of extending the carryforward period combined with some degree of intergenerational transfer deserves careful consideration. Allowing carrybacks for a limited period of time could achieve the equivalent of a cash subsidy rebate without having to create a separate refundable credit.

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132 There could be unanticipated effects on smaller conservation organizations that effectively use volunteer time and energy in lieu of cash funding to monitor and maintain easements.

