CONSERVATION EASEMENT VALUATION AND TAXATION IN CANADA

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FOREWORD

The private landowner in Canada is one of the most significant partners in national efforts to conserve Canada's natural heritage and a legacy built upon the use and appreciation of our renewable natural resources. The North American Wetlands Conservation Council (NAWCC) (Canada) and partner agencies are attempting to foster the cooperation of private citizens and corporations in retaining the biodiversity of these privately owned lands across Canada. Towards this end, the Council is publishing this report, its third since 1992 on policy and legislation for the use of conservation easements, covenants, servitudes and land donations in Canada.

This publication, preceded by *You Can't Give It Away: Tax Aspects of Ecologically Sensitive Lands* by Denhez (1992) and *Canadian Legislation for Conservation Covenants, Easements and Servitudes: The Current Situation* by Silver *et al.* (1995), have raised Canadians' level of awareness of the need to modify tax legislation and evaluation policy to favour biodiversity conservation in Canada. The Federal Government has responded to many of the recommendations in these reports through the federal Budgets of 1995, 1996 and 1997.

In these efforts, the NAWCC (Canada) has worked with partners such as the National Round Table on the Environment and the Economy, the Delta Waterfowl Foundation, the Canadian Wetlands Conservation Task Force, the James Ford Bell Foundation, and the Canadian Wildlife Service of Environment Canada.

As this report was going to press, the Federal Government was preparing the 1997 Budget. Numerous representations by many individuals were made to the Department of Finance on the issues addressed in this report.

On February 18, 1997, the Minister of Finance announced the new federal Budget. This Budget includes proposals to improve the methods for valuing ecological gifts and to facilitate gifts of capital property to charities. The Minister made the following specific announcement in the *Budget Plan*:

> *"To reinforce the 1995 Budget measure to encourage donations of ecologically sensitive lands, it is proposed that a provision be introduced to change the method of valuing donations of easements, covenants and servitudes in respect of such land. Easements, covenants and servitudes protect ecologically sensitive lands by preventing development now and in the future. Normally, the value of a donation is determined to be what a purchaser would pay for the property on the open market. As there is no established*

market for such restrictions, the fair market value determined under this method is often minimal. It is proposed that the value of the donation now be deemed to be the greater of the fair market value of the restriction otherwise determined, and the amount by which the fair market value of the land to which the gift relates is decreased as a result of the gift. This would reflect the amount of the donation more accurately. This measure would be effective for donations made after February 27, 1995."

This report will be of significant assistance in ensuring the implementation of these measures.

Kenneth W. Cox
Executive Secretary
Secretariat
North American Wetlands Conservation Council (Canada)

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Introduction

Land acquisition to move private properties into conservation ownership is a growing voluntary stewardship practice in Canada. This has traditionally involved the simple donation to or purchase of the property by a conservation organization. However, until recently, conservationists have lacked one of the key acquisition tools that their counterparts in the United States and Great Britain have used to great advantage: the private conservation easement.

Conservation easements are a key, and relatively new, stewardship technique in the conservation toolbox. Conservation easements are essentially agreements which set out conservation obligations for a property and are then registered on the land title. As a result, landowners agree to be legally bound to these conservation obligations, which then can be enforced against current and future landowners by the holder (usually a conservation charity or government agency). As examples, an easement might restrict the subdivision of or building on land, the cutting of trees, or require the maintenance of fences to keep cows out of a stream. In this report, the term "conservation easement" primarily refers to agreements authorized by statute and designed for this specific purpose, but can also include other legally registrable agreements, common law easements and covenants, and civil law servitudes.

There has been extensive and expanding use of such agreements by both public bodies and private organizations in the United States. As of 1994, some 1 100 land trusts held nearly 300 000 hectares (over 740 000 acres) in conservation easements and covenants in that country; this represents an increase of two-thirds from 1990 and now exceeds the area owned in fee simple by land trusts. Interest in this land conservation technique has also grown dramatically in Canada, creating a cascade of legal reforms and an increasing number of agreements signed.

For a number of years, conservation easements have been effectively used in Ontario and Prince Edward Island, and now conservation easement use is expanding rapidly in British Columbia and Nova Scotia after passage of new legislation. Reforms elsewhere will allow most other provinces to soon follow suit.

A variety of tax benefits can flow to the landowner from agreeing to enter into a conservation easement, and such benefits will often encourage landowners to use this new tool. The foundation for obtaining such tax benefits is the appraisal — essentially, a supportable estimate of value. Income and property tax rules can then be applied based upon the appraised value. Appraisals can also be applied to assess the compensation that should arise from expropriation of land, support a price a purchaser is prepared to pay, or document the value for grants, or for insurance, mortgage, lien or other financial security purposes. In this context, then, the ability to appropriately value and determine associated tax benefits from conservation easements is essential in order to seize expanding opportunities to secure some of Canada's most important lands through this technique.

However, in Canada appraisals have rarely specifically considered the particular purposes, legal interests or limited markets for conservation easements. Federal and provincial taxation legislation generally does not fully appreciate nor accommodate these interests. Conservation charities, landowners and their professional advisors, and agency staff remain largely unfamiliar with valuation issues concerning conservation easements. This report thus examines concepts and applications of the valuation of conservation easements in Canada, primarily through appraisal methodologies and applied within income and property tax regimes.

Appraisal Approaches

Land is generally appraised at its fair market value, and such value is often the basis for determining income and property taxes. The fair market value may not be limited to the current use of the land, but involves a consideration of its potential "highest and best use" — its most physically and legally probable and profitable use.

Over time, appraisal methodology has been developed and largely standardized, and applies to the estimate of the value of a conservation easement as much as it does to any other real property. Regardless of who pays for and who retains the appraiser, "landowners should expect analysis, not advocacy, on the part of their appraiser, who is bound ethically and legally to render a [thorough], disinterested, objective, supportable estimate of value." The analysis will necessarily pay careful attention to each of the terms in the conservation easement and their effects on value.

Appraising the value of a conservation easement remains difficult for several reasons. First, conservation easements are a new tool throughout Canada, and thus there are few examples of sold or donated easements, or lands subject to easements, with which to compare values. Second, easement terms will vary considerably depending upon the land features, and owner and holder needs, and thus will be difficult to compare. Third, other interests (such as common law easements, covenants and leases or utility rights-of-way) have most often been used for different purposes with different conditions and value implications, thus limiting their usefulness in providing comparable values. Fourth, and of considerable significance, there is rarely a conventional "market" for them, but rather are most often donated to governments or conservation charities. Finally, once easements are acquired, they are usually intended to be held in perpetuity and not subsequently transferred. As a consequence of these difficulties, appraisal methodology must be adapted to these circumstances.

While these characteristics of conservation easements present considerable challenges, appraisal methodology uses a number of means to estimate an easement's value. Across North America, appraisers regularly use three traditional approaches to determining the market value of a property: the comparable sales, cost and income approaches. A fourth blend of the traditional cost and income approaches is the subdivision or cost of development approach. Each of these methods has its own strengths, weaknesses and particular applications, although adapting the comparable sales method may be most appropriate for open space easements.

Because there is usually not a well-developed easement market to allow comparison sales, the indirect "before-and-after" method of determining value is often used. The before-and-after method is essentially two appraisals in one: it determines the value of the property before a conservation easement is put in place, and then assesses the value of the property subject to the easement. The difference is then taken to be the value of the easement itself. A number of variations on this approach have also been used.

An appraiser will determine the highest and best use for the property, next usually apply more than one of the traditional approaches to a particular property (for both before and after values), and then compare, appropriately weigh and reconcile the resulting values produced to report one final appraised value. In appraising an easement property, an appraiser must also consider any value enhancement or decrease that might occur on the "larger parcel," namely that portion of a property or adjacent properties under the same ownership and use.

Federal Income Tax

Federal income tax implications are often a substantial factor in determining whether a landowner decides to grant a conservation easement; they also have implications for the holding organization. For example, capital gains tax will be levied on an easement's increase in value; if given to a government entity or a registered charity, a tax receipt can be issued and used to claim credits or deductions to reduce income tax. Calculations of undepreciated capital cost, other aspects of real estate taxation, or calculation of a charity's "disbursement quota" may also be involved. Consequently, a number of tax consequences, depend upon an accurate estimate (i.e. appraisal) of the conservation easement's value.

Unfortunately, there are only a few general guideposts in the vast realm of federal income tax law and policy that assist landowners and acquiring organizations in determining and claiming conservation easement values. This is in contrast to much more specific directions in the United States *Internal Revenue Code and Regulations*.

A conservation easement is an enforceable right to do and prevent others from doing specified things and thus fits the definition of "property" within the *Income Tax Act* (ITA). A 1990 letter from Revenue Canada to Prince Edward Island's Island Nature Trust has privately confirmed this situation.

The computation of the adjusted cost base ("ACB" — essentially the acquisition cost) is a critical factor in determining the size of any taxable increase in property value (i.e. its capital gain). It may be feasible to appraise an easement at the time of disposition, but it is virtually impossible to appraise what it might have been worth as a distinct component when the property was originally acquired. Regardless, section 43 of the ITA sets out the general principle that the ACB of a partial disposition is "such portion of the adjusted cost base to the taxpayer at that time of the whole property as may reasonably be regarded as attributable to that part." In discussing this section, Revenue Canada's Interpretation Bulletin IT-264R provides little further guidance on the subject, but does declare departmental policy that there is no capital gain where

an easement covers no more than 20 percent of the total property area and is valued up to 20 percent of the total property's ACB. While there are challenges in determining the easement's ACB, two reasonable formulae have been proposed: the fair market value at time of acquisition, and the relative fair market value at time of disposition.

The federal *Income Tax Act* has not encouraged donations of ecological lands including easements because (unless making less attractive adjustments) the landowner had to pay a tax on the land's capital gain, even though the landowner gave away the land and received no money for it. After much lobbying, the federal 1995 and 1996 Budgets addressed key barriers to private conservation, particularly raising from 20 to 100 percent the cap on income tax credits (usable against taxable income) for donations of federally-recognized "ecologically sensitive lands" given to municipalities and qualified environmental charities, or lands given on death or that increase in value. The 1995 and 1996 Budget changes to the ITA will enhance tax benefits for landowners, put land donations largely on par with those given to the federal and provincial governments, and encourage donations of easements and supporting funds to conservation organizations and municipalities.

In order to obtain tax deductions or credits for donations under the ITA, proof of the gift must be made by filing a receipt containing prescribed information. The determination of fair market value can be made by any person "competent and qualified to evaluate the particular property being transferred," although professional, experienced opinions will carry the most weight if challenged. A variety of consequences for misinterpreting or breaching income tax rules are specified in the ITA.

Revenue Canada has recently raised a fundamental problem with determining the fair market value of gifts of conservation easements. In a private advanced tax ruling for a donated easement, Revenue Canada has stated its opinion that there is no current market for the easement, and thus its value is nominal.

There are several problems raised by Revenue Canada's interpretation. Despite there being a limited market now, conceptually any lack of actual, current markets for most conservation easements should not preclude their full valuation and recognition as "fair market value" and the acceptance of their "conceptual value." The results of Revenue Canada's interpretation are *also* problematic. First, it would have the effect of removing a tax incentive that encouraged the donation of conservation easements. Second, this interpretation deviates from the Department's past policies, practices and correspondence accepting substantial appraised values of donated conservation easements. Other problems arise concerning inequities between taxpayers and Revenue Canada's decreased ability to tax capital gains on the property subject to an easement.

This situation needs to be clarified and resolved quickly before an easement donation "chill" sets in. It is hoped that the Finance Minister will propose legislative changes to resolve this question in the 1997 federal Budget, through amendments to the *Income Tax Act* or other administrative measures.

The income tax law concerning conservation easements in the United States has been structured around specific provisions in the *Internal Revenue Code* (IRC) and associated pages of *Treasury Regulations* that allow for tax deductions for donations of qualified conservation easements. The value of the contribution is the fair market value of the restriction, determined through comparable sales where "there is a substantial record of [comparable] sales," or otherwise generally through the application of the before-and-after method. Other valuation methodologies are also prescribed for certain circumstances.

A variety of trends have been established in United States income tax valuation cases concerning conservation easements. These include the acceptance of the before-and-after valuation method, the determination of highest and best use of the property as a significant aspect of its fair market value, and the preference of appraisers with local and easement experience, although the courts are prepared to substitute their own opinions based upon the evidence presented. Substantial easement values have been upheld by the United States courts, as well.

Provincial and Local Property Taxes

Property taxation is largely a provincial responsibility, and consequently varies from province to province. Generally, provinces tax real property on the basis of its market value, or a percentage thereof, following the traditional appraisal methodologies outlined earlier. This is intended to create a uniform standard and thus equity among taxpayers, although in practice this is not always followed and most legislation provides for preferential treatment in certain circumstances (e.g. agriculture, forested, conservation and charities' lands).

While the assessment of conservation easements in particular has rarely been contemplated in law in Canada, a few focused provisions do exist. Prince Edward Island exempts property taxes for landowners who register a restrictive covenant on provincially-designated natural areas. Assessors in British Columbia are specifically directed to "give consideration to any terms or conditions contained in a [conservation] covenant" in determining the "actual value" of the property. British Columbia has also exempted from land transfer tax the registration of conservation covenants in favour of conservation organizations or the Province.

Besides these few examples specifically relating to conservation easements, a few provinces have a direction in their property taxation statute that the assessed value of land subject to easements and covenants in general should be reduced according to the actual impact of the easement or covenant's terms. The terms used in such directions usually contemplate only common law easements and covenants (i.e. those requiring *appurtenant* (nearby) lands). Consequently, complicated statutory interpretation is required, with little guidance from case law, and the results are not always clear nor supportive of a reduction in assessment when an easement is put on a property.

If a landowner defaults in paying property taxes, a municipality usually may sell the land to recapture these taxes, subject to elaborate procedures. Most property tax legislation provides that land so sold will not affect easements or covenants attached to the land, although this is

often phrased within the language of common law easements and covenants and their associated requirements to have appurtenant land. Interpretation uncertainties would again arise for conservation easements. However, conservation easements in Saskatchewan are specifically protected from such extinguishment in a tax sale.

It is apparent, then, that property taxation statutes which have not explicitly contemplated conservation easements in gross (without nearby lands) can produce uncertain, unintended and internally inconsistent results. Drafting language varies, but in all cases it points to the need to approach such sections with full recognition of the presence and application of (and preferably incentives for) conservation easements in gross.

A conservation easement will restrict the types of uses allowed for a certain property, and this will usually alter the "highest and best use" that is legally possible on the property, often resulting in a lower property value. Theoretically, with a decrease in fair market value, the property's assessed value would be correspondingly lowered. Statistics are not available in Canada, but United States studies have reported a wide range of values of conservation easements but more limited effects on property taxation. Essentially, the extent of the reduction in value corresponded to the degree of restriction on uses of the property, the easement's terms, and the property's particular characteristics.

Despite such a theoretical lower assessment under some conservation easements, there are a number of reasons why this is unlikely to occur to any large extent. First, a number of commentators and studies have noted that reduced property assessment is less likely to occur due to assessors' uncertainties in whether or how to address easements, that uniform valuation is rarely achieved, and landowners may be reluctant to seek reassessment or pursue tax appeals. Further, in the few cases available and with unclear legal requirements, Canadian courts and tax tribunals appear reluctant to grant tax reductions for easements.

Second, if easement terms match the zoning restrictions or if there is no foreseeable market demand for the development an easement restricts, assessment value would likely not be substantially decreased since highest and best use would remain unaffected. Third, various environmental, aesthetic and recreational benefits are regularly used to market properties and are well known to raise property values and assessment. A conservation easement "almost always enhances the value of adjoining parcels to some degree," and thus could at least be tax neutral or potentially increase overall property assessment in the municipality through conserving these assets. Fourth, conservation easements can also help reduce municipal costs by restricting, directing or avoiding development pressures and demands, thus reducing tendencies toward urban sprawl and associated infrastructure and servicing costs.

In the United States, more than half of those states which have enacted conservation easement legislation have provided that such restrictions shall affect the property tax valuation of the burdened land. These states require assessors to consider the effect on value by conservation easements, exempt easements from assessment outright, or provide for reduced assessment to current use (or through percentages or a point system) when a qualified easement is placed on

the property being assessed. The courts are also prepared to accept substantial devaluations of properties from conservation easements, and to overrule reluctant assessors who may attempt to limit easement valuations and tax applications.

The United States experience suggests that substantial integration of legislation enabling conservation easements and associated tax benefits has occurred. Such a situation occurs where there is a coherent and concerted land conservation strategy in place that has fully examined the interplay between property and tax means to involve private landowners in conservation activity. Indeed, some states with easement-tied tax incentive programs have seen significant growth in the use of easements.

Conclusions

Conservation easements have proven to be an attractive and effective mechanism for land conservation in many countries, and are seeing growing interest and use in Canada. However, existing federal income tax and provincial property tax legislation largely fails to contemplate and encourage such easements, although in some cases they may roughly accommodate them. Interpretation questions abound, and uncertainties mostly have been administratively overlooked given that only a few easements have been entered to date.

This situation is changing. Provincial enabling legislation for conservation easements recently has been reformed in most jurisdictions, and conservation organizations are actively promoting and using this new authority. More taxpayers will be attempting to obtain available, and sometimes substantial, tax benefits. Consequently, legal uncertainties and barriers along with valuation methodologies will receive increased attention and scrutiny by all interested parties.

Clarifications for conservation easements in federal income tax legislation are needed. Revenue Canada's interpretation that the lack of markets for easements results in a nominal fair market value is conceptually troublesome, hurts conservation, and represents a departure from past practice and Parliament's recent tax reforms. Administrative and, where necessary, legislative interpretations of the *Income Tax Act* need to address these concerns promptly. The methods to appraise and claim the value of conservation easements have been largely standardized in the United States through *Internal Revenue Code* provisions. Canada could benefit from such clearer directions at the national level.

Many state property taxation statutes in the United States explicitly recognize the effects of conservation easements on property values (especially as an interest in gross, i.e. without benefitting nearby land), and some even provide particular direct incentives to encourage landowners to enter into easement agreements. However, the effects on overall municipal assessment appear to be limited and counterbalanced by other financial benefits.

Canada's legislation again is less clear, and in some cases the effect of the drafting of assessment directions for common law interests can preclude their use for conservation easements in gross. In all but a few cases, the property tax legislation does not provide a direct, positive incentive

for entering easements. There is thus a strong need to review property taxation statutes' provisions for assessing easements (especially those in gross) to eliminate unclear, unintended and internally inconsistent results.

Besides the legal arena, there are other activities which could enhance the valuation and understanding of tax mechanisms for conservation easements. These may include: focused materials, training and possibly standards and certification for appraisers; exchanges with or reviews by experienced domestic or American appraisers; the development of a common list of appraisers familiar with conservation easements; and maintaining a registry of properties, general easement terms and values, as do some United States land trusts.

The expanding ability to enter conservation easements in Canada has progressed much more quickly than has recognition of easements within Canadian tax legislation. The country is thus experiencing a lag period filled with many procedural, mathematical and legal uncertainties. A few measures are beginning to emerge in Canada, and examples and experience are available in the United States.

It is now the task of all interested participants in this field — taxpayers, conservation organizations, appraisers, other land professionals, and governments — to help examine, revise and elaborate a more comprehensive and clear Canadian framework for assessing the value of easements. By addressing difficulties and uncertainties, the use of conservation easements will thus become more straightforward and widespread, leading to enhanced conservation of Canada's rich natural and cultural heritage.

I. INTRODUCTION

The conservation of Canada's natural heritage is at a crossroads — between largely government-directed and more privately-driven paths. In the past, governments had more staff and funds to offer, and were prepared to regulate activities, control land use and develop conservation initiatives. As one result, parks and other protected areas have been established and remain a significant, but small, percentage of the landscape. However, they do not offer the full "100 percent solution" that involves conserving the surrounding, often private, lands. The widening conversion of land uses, increased number of endangered species, and science of conservation biology suggest that more needs to be done.

These changing circumstances and continuing needs present opportunities. Today, as our population ages, the country is experiencing the largest transfer of land and other wealth in its history. In response, many conservation organizations and private landowners across Canada are directing these assets towards stewarding a remnant woodlot, a patch of prairie or a family farm.

Voluntary stewardship of lands by private owners and organizations in Canada is critical to the conservation and sustainable use of land and the variety of life ("biodiversity") it holds. This is particularly true in the southern portion of the country where much of the land base and a rich suite of plants and animals are held in private hands. Regulatory means have been, and continue to be, appropriately used to advance conservation efforts, but often encounter resistance and misunderstandings. In contrast, voluntary approaches enable individuals to select the methods, timing and partnerships most appropriate to their needs, and thus open discussions to wider and more positive possibilities for conservation.

Voluntary stewardship of lands by private owners and organizations in Canada is critical to the conservation and sustainable use of land and biodiversity.

Land acquisition to move private properties into conservation ownership is a growing voluntary stewardship practice in Canada. This has traditionally involved the simple donation to or purchase of the property by a conservation organization. Management agreements or long-term leases may be used to enable local involvement while still retaining title with larger organizations or governments. However, until recently, conservationists have lacked one of the key acquisition tools that their counterparts in the United States and Great Britain have used to great advantage: the private conservation easement.

Conservation easements, covenants, servitudes and similar interests that run with the land (generally, "conservation easements" or "easements" in this report) are a key, and relatively new, stewardship technique in the conservation toolbox. Conservation easements are essentially agreements which set out conservation obligations for a property and are then registered on the land title. As a result, landowners agree to be legally bound to these conservation obligations, which then can be enforced against current and future landowners by the holder (usually a conservation charity or government agency). As examples, an easement might restrict the subdivision of or building on land, or cutting of trees, or require the maintenance of fences to keep cows out of a stream.

Conservation easements, covenants, servitudes and similar interests are a key, and relatively new, stewardship technique in the conservation toolbox.

There has been extensive and expanding use of such agreements by both public bodies and private organizations in the United States. As of 1994, some 1 100 land trusts held nearly 300 000 hectares (over 740 000 acres) in conservation easements and covenants in that country; this represents an increase of two-thirds from 1990 and now exceeds the area owned in fee simple by land trusts.[1] Interest in this land conservation technique has also grown dramatically in Canada, creating a cascade of legal reforms and an increasing number of agreements signed.

For a number of years, conservation easements have been effectively used in Ontario and Prince Edward Island to secure legal protection of private, ecologically important lands, while allowing their owners to continue owning and using their land. Now, conservation easement use is expanding rapidly in British Columbia and Nova Scotia after passage of new legislation, and reforms elsewhere will allow other provinces to soon follow suit. These and related developments are discussed in the North American Wetlands Conservation Council (Canada)'s report, *Canadian Legislation for Conservation Covenants, Easements and Servitudes: The Current Situation.*[2]

Growing private conservation interest, legal changes and government downsizing are creating opportunities and enhanced interest across the country in conservation easements, particularly because they provide a means for a conservation partnership between a landowner and a

[1] Land Trust Alliance, *1994 National Land Trust Survey — Summary* (Washington, D.C.: Land Trust Alliance, 1995b), pp. 4 and 6. These figures do not include the extensive area under easement held by federal and state agencies, or such national conservation organizations such as The Nature Conservancy, Trust for Public Land or American Farmland Trust.

[2] Thea M. Silver, Ian C. Attridge, Maria MacRae and Kenneth W. Cox, *Canadian Legislation for Conservation Covenants, Easements and Servitudes: The Current Situation* (Ottawa: North American Wetlands Conservation Council (Canada), 1995).

conservation-minded organization. A variety of tax benefits can flow to the landowner from agreeing to enter into a conservation easement, and such benefits will often encourage landowners to use this new tool.

The foundation for obtaining such tax benefits is the appraisal — essentially, a supportable estimate of value. Income and property tax rules can then be applied based upon the appraised value. Appraisals can also be applied to assess the compensation that should arise from expropriation of land, support a price a purchaser is prepared to pay, or document the value for grants, or for insurance, mortgage, lien or other financial security purposes.

Appraisal methodology has evolved from considerations of ordinary, full "fee simple" transfers of property and the occasional evaluation of railway, utility and access rights-of-way or property leases. However, in Canada it has rarely been applied towards nor specifically considered the particular purposes, legal interests or limited markets for conservation easements.

Related to appraisal questions are other issues surrounding the valuation of conservation easements. Provincial and federal taxation legislation rarely fully appreciates or accommodates these interests. Conservation charities, landowners and their professional advisors, and agency staff remain largely unfamiliar with valuation issues concerning conservation easements. Finally, municipalities have raised concerns, largely unfounded as discussed later in the report, that any widespread use of conservation easements could lead to substantial decreases in municipal revenues.

In this context, then, the ability to appropriately value and determine associated tax benefits from conservation easements is essential in order to seize expanding opportunities to secure some of Canada's most important ecological lands through this technique. This report thus will examine concepts and applications of the valuation of conservation easements in Canada. This approach will explore valuations made primarily through appraisal methodologies and applied within income and property tax regimes. The focus will be upon the particular situation in Canada, but necessarily will look beyond our borders to developments elsewhere. While existing methods will be documented, alternative approaches will also be considered in order to more fully support the growing use of conservation easements across Canada.

The ability to appropriately value and determine tax benefits from conservation easements is essential to secure some of Canada's most important ecological lands.

II. NATURE AND BENEFITS OF CONSERVATION EASEMENTS

Conservation easements are relatively new in Canada. This report begins with a definition of conservation easements and their associated benefits and disadvantages.

A. Description of Conservation Easements

As noted at the outset, conservation easements are agreements registered on the land title to restrict the uses of land, usually over a long period of time. They are legally-binding agreements entered voluntarily between a landowner and a qualified organization (the "holder") which conserves the land by placing conditions on its use. In this report, the term "conservation easement" is used to mean a range of similar conservation restrictions which can be registered on and run with the land title. These primarily include agreements authorized by statute and designed for this specific purpose, but can also include other legally registrable agreements, common law easements and covenants, and civil law servitudes.

Conservation easements are registered on the title to the land, and thus will bind current and any future owners to the terms of the agreement.

Once negotiated, conservation easements are written up and then registered on the title to the land, and thus will bind current and any future owners to the terms of the agreement. A conservation easement usually has two main parts: a covenant that requires the landowner to do or not do something, such as cutting trees or building houses, and an easement allowing the holder to enter onto the property to monitor and enforce the covenant's conditions.

Conservation easement holders normally monitor the property on at least an annual basis, and easement terms may be enforced in court when violations are not otherwise resolved. Except for recreational access in some cases, conservation easements ordinarily do not give the holder of the agreement the right to occupy or use the land, but only the right to monitor and enforce the agreement's terms.

B. Benefits and Disadvantages of Conservation Easements

One of the chief advantages of conservation agreements is that they are quite flexible in their terms. Thus, conditions may be strict or allow broad uses, be short-term or forever, be negotiable or standardized across many properties, be tailored to the features on the property and to the parties' wishes, cover all or only part of the property, and conserve all or only particular aspects of its natural or cultural attributes (e.g. agricultural lands, natural areas or connections, valleys, views, heritage buildings, etc.). This gives sufficient room for landowners and holding organizations to negotiate appropriate terms to meet both of their interests. In addition, it is a

voluntary rather than imposed method of ensuring conservation, and thus is more attractive to landowners.

For the public, governments and conservation interests, the principal benefit of conservation easements is that properties' important values are conserved, even when the title changes hands in the future. Further, as an interest in land, agreements tend to be more permanent, can be managed separately yet complement other mechanisms such as land use planning, and can transfer conservation responsibilities to the private (and often charitable and voluntary) sector at lower public cost. On this latter point, private voluntary organizations' activities for public benefit can reduce the acquisition and maintenance costs for governments. The land would be registered on the municipal tax rolls, although tax implications are not entirely certain.

The principal benefit of conservation easements is that properties' important values are conserved, even when the title changes hands in the future.

While conservation should be the primary motivation for using conservation easements, easements could also hold the rights to restrict development over the short or medium term and thereby retain within them any future development values. They thus provide a means for easement holders, such as a municipality or government agency, to control such development premiums (and possibly later realize them through releasing the easement), rather than estimate now the potential development values through a current (and likely lower) determination of price for outright sales of land. For example, if an agency sold off lands while retaining easements, program needs and development pressures in the future might lead to releasing such easements to the landowners in exchange for their new development value, and the agency then using such funds for other, more effective conservation purposes.

For the landowner, the primary benefit is the ability to continue using, living, working and providing good stewardship on the land. Creative, flexible arrangements can be made through these agreements, either in a general fashion or tailored to the particular objectives or needs of the landowner, and the features of the property. Income tax and property tax benefits may result, as discussed in the sections below.

While conservation agreements have the many advantages noted above, it is important to be aware of some of their disadvantages in order to determine their appropriate use. The most pertinent disadvantages include that they are unfamiliar to many land professionals and landowners; drafting them to cover all future contingencies is a challenge, while leaving restrictions flexible may make appraisal difficult; there are monitoring and enforcement costs, although these may be transferred; and management and enforcement may be simpler if ownership is consolidated, especially where there is formal public and recreational access over private lands.

III. LEGAL AUTHORITY FOR CONSERVATION EASEMENTS

Since the expanded use of conservation easements is largely dependent upon statutory reforms to remove historic legal limitations, this section presents a discussion of the provincial and territorial laws which govern their use. It outlines legal authority under the common law and conservation easement acts, and then describes other statutes of potential application.

A. Common and Civil Law Easements, Covenants and Servitudes

Easements and covenants are legal concepts established by judges' decisions (i.e. the common law) over the last several hundred years, beginning in Britain, while servitudes arise under civil law in Quebec with a tradition stretching back to Roman law. An easement is the right of someone, or the obligation of a landowner to allow that person, to go on to or use specific land for a particular purpose. A covenant is the obligation to do (i.e. "positive") or not do (i.e. "negative" or "restrictive") something on your own land. Servitudes combine these common law notions of easements and covenants. Easements, covenants and servitudes have a special quality that makes them different from other agreements: unlike ordinary agreements or contracts which only legally bind the people who sign them, when easements and covenants are registered on the land title, they will bind the subsequent landowners who did not sign the original document. Thus they are said to "run with the land."

Common law easements and covenants are frequently used today for various purposes, such as providing a right-of-way or view over another's property, or preventing inappropriate activity next door. An elaborate form is often used in so-called building schemes, where a developer places restrictions and access arrangements on the title of parcels in a subdivision, thereby enabling neighbours and other parties to enforce property standards and to maintain services.

However, common law covenants and easements are subject to several limitations for conservation:

- there must be land nearby (the "dominant tenement") which benefits from the easement or covenant on another property (the "servient tenement");
- the benefit must be recognized by the courts (and it is unclear whether conservation would be so recognized);
- covenants can only be restrictive, not positive; and
- the interest in an easement cannot be assigned or passed along to anyone else.[3]

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[3] See the detailed discussion in David Loukidelis, *Using Conservation Covenants to Preserve Private Land in British Columbia* (Vancouver: West Coast Environmental Law Research Foundation, 1992).

In Quebec, the *Civil Code* sets out a comprehensive list of the types of interests in land. These interests include servitudes, and, among other limitations similar to those for common law interests, the *Civil Code* requires that there be dominant land that benefits from servient land, with both parcels being owned by different persons, in order to create a valid servitude.[4] A comprehensive review of servitude law and a proposal for statutory modifications has been produced by the Quebec Environmental Law Centre in conjunction with many individuals in Quebec's legal and land trust communities.[5]

These limitations in the common and civil law can only be overcome by passing a statute to change these rules. Because the requirement to own nearby land is rarely met or would require more complicated arrangements, conservation covenants and easements authorized by statute are often preferred, and thus is the focus of this report.

B. Statutory Covenants, Easements and Servitudes

Most provinces and territories have historic or archaeological easement laws, or allow for various agreements to be registered on title towards such ends. Many of these are also applicable to conserving open landscape values for natural, agricultural or scenic purposes.

Nonetheless, much of the previous (and some current) legislation gave only governments the authority to hold conservation easements. Yet governments have limited resources and priorities, and cannot match the numerous volunteer and local efforts that can be harnessed by land trusts. Some governments have been reluctant to creatively apply, or allow others to use, this flexible legal tool. Further, some jurisdictions do not have any broad purpose easement laws at all. And for those with legislation, much of it has had limited scope, contained cumbersome procedures, or did not adequately address certain issues.

Governments have limited resources and priorities, and cannot match the numerous volunteer and local efforts that can be harnessed by land trusts.

[4] *Civil Code of Quebec*, S.Q. 1991, c.64, Article 1177 (and see also Articles 1178-1194 governing servitudes).

[5] Benoit Longtin, in collaboration with Michel Bélanger and Marie-Odile Trépanier, *Vers une nouvelle servitude de conservation et une réforme de la fiscalité des espaces naturels: outils de protection des caractéristiques patrimoniales du Québec* (Montreal: Quebec Environmental Law Centre, 1995).

This situation had led to almost no use of conservation easements in Canada (except a few in Ontario and Prince Edward Island), and thus legal reform was necessary. Today, while still somewhat limited in some jurisdictions, most provinces and territories have recently passed or are considering legal reforms to enable conservation easements.[6] However, despite some proposals for reform, New Brunswick, the Northwest Territories and Quebec do not yet enable statutory conservation easements that overcome the limitations noted above, and thus must rely on common law easements or civil law servitudes to create long-term conservation agreements.

Where they have occurred, reforms have focused on tailoring this tool to a broader spectrum of purposes (including conservation) and to non-government players. Now, in British Columbia, Nova Scotia and Newfoundland, such easements may be held by private groups, but only after receiving a discretionary government designation on the land or of the organization. Ontario, Yukon, Alberta, Saskatchewan, Manitoba and Prince Edward Island have taken a less bureaucratic approach, with all enabling qualified private organizations to hold these interests in land. The latter three also allow individuals to hold these same interests.

Other types of registrable conservation agreements exist under provincial law, although they are rarely used.[7] Often the legislation enables only government agencies to enter and register these agreements, and provide very little procedural guidance. Each of these laws may provide authority for certain conservation or mixed purposes, and can complement or augment the authority found in the principal conservation easement Acts noted above.

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[6] See: *Environment Act*, S.Y. 1991, c.5, ss.76-80; *Land Title Act*, R.S.B.C. 1979, c.219, s.215; *Environmental Protection and Enhancement Act*, S.A. 1992, c.E-13.3, ss.22-22.3; *The Conservation Easements Act*, S.S. 1996, c.C-27.01; *Heritage Resources Act*, C.C.S.M. c.H39.1, s.21; *Conservation Land Act*, R.S.O. 1990, c.C.28, s.3; *Ontario Heritage Act*, R.S.O. 1990, c.O.18, ss.7, 10, 22 and 37; *Conservation Easement Act*, S.N.S. 1992, c.2; *Natural Areas Protection Act*, R.S.P.E.I. 1986, c.N-2, s.5; and *Historic Resources Act*, R.S.N. 1990, c.H-4, s.30. For a fuller discussion of conservation easement legislation and use in Canada, see: Silver *et al.*, supra note 2.

[7] Among others, see the following statutes for the registration of agreements with potential conservation applications: *Crown Lands Act*, C.C.S.M. c.C340, s.13.1; *Agricultural Research Institute of Ontario Act*, R.S.O. 1990, c.A.13, ss.3, 4, 4.1 and 9, as amended by S.O. 1994, c.27, s.5, and proposed for re-enactment in the Ministry of *Agriculture, Food and Rural Affairs Statutory Law Amendment Act, 1996* (Bill 46), Schedule B, introduced for First Reading on 2 May, 1996; *Forestry Act*, R.S.O. 1990, c.F.26, ss.2-3; *Game and Fish Act*, R.S.O. 1990, c.G.1, s.6; *Ministry of Government Services Act*, R.S.O. 1990, c.M.25, s.10; *Planning Act*, R.S.O. 1990, c.P.13, ss. 41(10) and 51(26); *Public Lands Act*, R.S.O. 1990, c.P.43, s.46; *Museum Act*, R.S.P.E.I. 1988, c.M-14, s.11; *Fish and Game Protection Act*, R.S.P.E.I. 1988, c.F-12, s.32.1; *Heritage Places Protection Act*, R.S.P.E.I. 1992, c.31, s.10; and *Planning Act*, R.S.P.E.I. 1988, c.P-8 (see the *Land Identification Regulations*, P.E.I. EC710/77).

In addition to provincial law, many federal statutes enable federal agencies to acquire lands or interests in lands for a multitude of purposes. This mandate must then be coupled with the procedures in the *Federal Real Property Act* (Canada)[8] and, by practice, the provincial rules for registering documents on title. "Real property" under the *Federal Real Property Act* includes a "lease, easement, servitude or any other estate, right, title or interest in or to the land, and includes the rights of a lessee therein." Thus, the authority for federal agencies to acquire conservation agreements is independent of provincial law, but does follow many of the same procedures.

As the legislation changes to allow or streamline procedures for conservation easements, interest in the applied use of this mechanism across the country has been invigorated. A handful of private conservation easements have now been approved in Nova Scotia, a dozen or more are completed and others are under negotiation in each of Prince Edward Island and Ontario. British Columbia is very active with numerous easements registered and more are on the way.

With new and updated conservation easement legislation across the country, Canada's private sector will be better legally equipped to respond to conservation opportunities. The challenge now is for Canadian conservation organizations to use these mechanisms in each jurisdiction, and to promote and elaborate their application based upon experience elsewhere. A clear understanding of tax benefits and their foundation, the appraisal, can contribute to this process and ultimately enhance the use of this technique.

IV. APPRAISAL APPROACHES

A. Introduction to Appraisals

The appraisal of the value of land, or a component such as a conservation easement, is an art practised by following certain appraisal approaches. Different appraisers may come to different conclusions about a property's value using these approaches. This section introduces these approaches and emphasizes the professional procedures and standards of the Appraisal Institute of Canada and the *Uniform Standards of Professional Appraisal*

An appraisal by a qualified appraiser who follows USPAP standards is particularly important to substantiate claims to governments concerning income and property taxation.

[8] *Federal Real Property Act*, S.C. 1991, c.50.

Practice (USPAP).[9] An appraisal by a qualified appraiser who follows such standards will be particularly important to substantiate claims to governments concerning income and property taxation.

Land is generally appraised at its fair market value, and such value is often the basis for determining income and property taxes. For appraisal purposes, "market value" is defined as the:

> "most probable price which a property should bring in a competitive and open market under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus."[10]

This definition implies certain conditions: a sale where the buyer and seller are typically motivated, both parties are well informed or well advised and acting in what they consider their best interests, a reasonable time is allowed for exposure in the open market, payment is made in cash in Canadian dollars or comparable financial arrangements, and the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.[11] As elaborated below, many of these assumptions do not hold for the disposition and acquisition of conservation easements, and thus determining a market value for these interests is particularly difficult. The fair market value may not be limited to the current use of the land, but involves a consideration of its potential "highest and best use,"[12] based on the notion that a buyer is prepared to pay for the potential value of the property.

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[9] The Appraisal Foundation, *Uniform Standards of Professional Appraisal Practice* ("USPAP") (Washington, D.C.: The Appraisal Foundation, 1996), incorporating the 1996 USPAP Canadian Supplement provided by the Appraisal Institute of Canada.

[10] USPAP Definitions, "Market Value," p.10.

[11] USPAP Definitions, "Market Value," p.10.

[12] USPAP, Standards Rule 1-3. "Highest and best use" has been defined to be "the reasonably probable and legal use of vacant land or improved property, which is physically possible, appropriately supported, financially feasible, and that results in the highest value;" see Leland T. Bookhout, "Land Subdivision Analysis: Valuation Through Projected Land Development," 7(4) *Exchange* (Land Trust Alliance, Fall 1988).

In developing a real property appraisal, appraisers are directed to:

> "consider easements, restrictions, encumbrances, leases, reservations, covenants, contracts, declarations, special assessments, ordinances, or other items of a similar nature; [and] consider whether an appraised fractional interest, physical segment, or partial holding contributes pro rata to the value of the whole."[13]

The appraiser may be hired by the landowner granting or by the organization acquiring the easement. For a donation, it is the landowner's responsibility to report property values for tax purposes and thus this person may wish to hire the appraiser. The donor will likely want to know in advance what the tax consequences will be. However, while a donor might actually pay for the appraisal, a donee organization will want to ensure good appraisals through involvement or oversight for several reasons. There is an ethical responsibility to enter into honest transactions, it makes for satisfied donors when they receive expected tax benefits, it thereby builds the donee's reputation and goodwill, provides for supportable issuing of tax receipts, and avoids costly court battles and other legal complications.[14] Accordingly, a purchasing or donee organization may wish to retain (although not necessarily pay for) the appraiser itself: to control the quality of the appraisal and correct mistakes, as one way to regulate the timing of the appraisal (to follow the registration of the interests because landowners may cancel a deal if they do not like the appraisal numbers),[15] and to establish an ongoing relationship and help develop expertise, especially with new approaches like conservation easements.[16] Regardless of who pays for and who retains the appraiser, "Landowners should expect analysis, not advocacy, on

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[13] USPAP, Standards Rule 1-2, (c) and (d).

[14] In the United States, one donor sought reconveyance of the easement where a tax deduction was largely denied, leading the donee to agree to pay for the taxpayer's expert witness and the Internal Revenue Service to then seek (unsuccessfully) to revoke the organization's charitable status because it enabled a private benefit in the transaction (*McLennan v. United States*, 24 Cl. Ct. 102). In another case, when a deduction was disallowed, the taxpayer threatened to sue the donee for misrepresentation. See the discussions in Goldman, at pp.1-2, and in Diehl and Barrett, at p.41.

[15] However, donations are voluntary, and donee organizations will want to ensure contented donors. Another approach could be to structure within the agreement how the value will be determined, such as sharing an appraisal and then commissioning a second appraisal and averaging the two if there is no agreement. This gives the donor recourse should there be a problem or disagreement with the donee's appraisal. James Catterton, Walden Associates Inc., personal communication, 25 October 1996; Alan Ernest, Conservation Support Services, personal communication, 12 November 1996.

[16] James Duncan, Conservation Easement Coordinator, Nature Conservancy of Canada, personal communication, 3 October 1996.

the part of their appraiser, who is bound ethically and legally to render a [thorough], disinterested, objective, supportable estimate of value."[17]

Some real estate agents appraise the value of land, but the most qualified appraisers who are held to the high professional standards of USPAP are those who are members of the Accredited Appraisers of Canada Institute (AACI). Nonetheless, not every appraiser or member of AACI will be familiar with appraising easements or the local market, and thus a qualified, experienced appraiser should be sought.

Involving an appraiser early in the process can prevent any financial surprises in a land transaction. Providing information to the appraiser can also save appraisal time and expense.[18] An appraiser will often review the draft terms of an easement and provide a draft opinion, and then follow this with a final opinion based upon the final agreement. In the appraisal, the appraiser will typically provide an introduction and summary of important facts and conclusions, a description of the property and its neighbourhood,[19] analysis of highest and best use, approaches to value, and the final value reconciliation.[20] The analysis will necessarily pay careful attention to each of the terms in the conservation easement and their effects on value.

The appraiser should also note what are the retained rights or may be *allowed* by the easement, since this would accurately portray the manner in which the property would be marketed to potential buyers, with the seller or broker accentuating the positive.[21] Examples of the types

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[17] James L. Catterton, "Appraising Conservation Easement Gifts: A Primer for Landowners," Summer 1990 *Exchange* 4-7 at p.4, reproduced in James L. Catterton, "Advanced Appraisal Issues" (Topic 6J), *National Rally '96 Workbook* (Washington, D.C.: Land Trust Alliance, 1996).

[18] Such information might include deeds, surveys, tax rolls, current zoning, comparable sales, or details of the property's features and capabilities. James L. Catterton, supra note 17, at p.6.

[19] An appraiser may need help with identifying the existence, type, location, extent and significance of wetlands and other natural or cultural features affecting value, because they may not necessarily be well-versed in these fields, but only in ascribing values once these features are known.

[20] National Trust for Historic Preservation and the Land Trust Alliance. *Appraising Easements: Guidelines for Valuation of Historic Preservation and Land Conservation Easements,* Second Edition. (Washington, D.C.: 1990) at p.18, and see USPAP, Standards Rule 2.

[21] Patrick W. Hancock, "A Question of Value: Appraising for Farmland Preservation," *Farmland Preservation Special Report* (Street, Maryland: Bowers Publishing, 1992), reproduced

of information included in an appraisal of conservation easements are found in Appendix B to this report and Appendix C has five appraisal examples.

B. Particular Difficulties in Appraising Easements

Over time, appraisal methodology has been developed and largely standardized, and applies to the estimate of the value of a conservation easement as much as it does to any other real property. However, appraising the value of a conservation easement remains difficult for several reasons, and thus appraisal methodology must be adapted to these circumstances. The first reason is that conservation easements are a new tool throughout Canada, and thus there are few examples of sold or donated easements, or lands subject to easements, with which to compare values. Second, even among the few that have been signed, easement terms will vary considerably depending upon the land features, and owner and holder needs, and thus will be difficult to compare. Third, other interests (such as common law easements, covenants and leases or utility rights-of-way) have most often been used for different purposes with different conditions and value implications for both the subject and any benefitting dominant tenement, thus limiting their usefulness in providing comparable values.

There is a fourth and significant characteristic of conservation easements that challenges traditional valuation techniques, namely that there is rarely a conventional "market" for them. Rather than being sold, easements are most often donated to governments or conservation charities. Such an essentially unilateral act avoids determining a mutually agreed value through the usual settlement on price between a seller and purchaser. The value may well be secondary to a donor's main motivations to ensure appropriate care of the property and its attributes through a conservation easement.

Unlike most markets, easement holding organizations generally do not compete among themselves to acquire easements, but rather cooperate in finding an appropriate match for the landowners' needs. Any "competition" among these groups may be determined according to the least stringent endowment requirements, or the track record and competence to manage and enforce the easement over the longer term, but not in the form of financial returns to the landowner. Such returns are usually provided as broad tax benefits for at least a class of easements and holders, and thus are not dependant upon a particular holding organization. However, there is competition between potential easement holding organizations and development pressures to acquire interests in land. Although the above discussion assumes the usual practice of easement donation rather than purchase, the ability to pay a premium price for a purchased easement would create more competition and a more traditional market situation.

Other characteristics of easement law and practice further complicate a market analysis of the transactions. Once easements are acquired, they are usually intended to be held in perpetuity and not subsequently transferred. Even where there may be a transfer, this would often be an

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as Appendix C in: Brighton and Cable, 1992.

assignment of the interest at a nominal value. Most provincial law enabling statutory conservation easements establishes only a limited class of governments and conservation charities which are qualified to enter and register on title such agreements. This limitation constrains who may participate in any market that might develop for easements. While limited access may create a premium on easement values in other circumstances, the fact that governments and charities have legal mandates (and public and moral responsibilities) to operate for the public benefit generally prevents speculation and trading in easements. However, easements could conceivably be expropriated, released or altered to enable development, with the resulting value compensated to the holding organization for application towards other projects within its mandate. While this may not result in an easement remaining on the land subsequent to a release, it nonetheless provides a potential market and value while it is in place.

While these characteristics of conservation easements present considerable challenges, appraisal methodology uses a number of means to approach property valuation, and by doing so is able to estimate an easement's value.

C. Appraisal Approaches

Across North America, appraisers regularly use three traditional approaches to determine the market value of a property: the comparable sales, cost, and income approaches.[22] Each of these methods has its own strengths, weaknesses and particular applications, although the comparable sales method may be most appropriate for open space easements. An appraiser will determine the highest and best use for the property, next apply (usually) more than one of these approaches to a particular property, and then compare, appropriately weigh and reconcile the resulting values produced to report one final appraised value.

The **comparable sales** or **market data approach** examines recent sales of similar properties in the same or comparable markets as the land in question, based on the concept that buyers and sellers will each compare prices in the vicinity and try to obtain the best price possible. This data may be available from property owners in the area, real estate brokers, lending institutions, declarations of value at title registry offices, property tax rolls, and appropriate land interest associations (e.g. farmers', hiking, or woodlot owners' associations).

To compare properties, adjustments in value on a lump sum, per unit area or percentage basis can be made to take into account variations in comparable properties' characteristics. These variations might involve: size, location, condition, access (roads and utilities), highest and best use, topography and other physical features (e.g. water supply), productivity, view, dates of sale, recent appreciation or depreciation (especially in an area where real estate values change quickly), the relationship between the buyer and seller, and unusual motivations or financing

[22] These three traditional approaches to value are reflected in the requirements to collect data under USPAP, Standards Rule 1-4.

terms behind the sales.[23] For example, a comparison might involve three properties with similar features to the one being appraised, where one is a bit smaller, another sold several years ago when the market was different, and the third has somewhat steeper topography and more wetland. When making adjustments from comparable sales, it is important that the appraisal demonstrate that such factors were analyzed, that it focus on sales that were actually made (rather than on mere contracts or offers), and that comparable sales do not differ too greatly in price from the property under consideration.

The comparable sales method is the most reliable approach when there are frequent sales of and a well-established market for comparable properties, including those of somewhat superior and inferior quality.

> "While the before and after method takes the perspective of a developer, the direct comparison method takes the perspective of a preservationist. ... At [market] discount rates typically ranging from 12 percent to 20 percent ... a premium is placed on short-term opportunities and a great discount is placed on longer term benefits."[24]

In contrast to profit-oriented investors, conservationists have different motives and different time priorities, placing more value on ensuring long-term protection for future generations. This may create a near-zero discount rate; when this is applied to the present value of prospective development, high prices are paid by preservationists. High prices may also have been paid by government agencies when required to relate prices to market value or buying wholesale assemblies at retail prices, although non-government organizations may be more prudent in their bargaining.[25]

However, due to the factors noted earlier, there is rarely a direct market in conservation easements, and due to the few properties involved to date, insufficient data may be available to determine the value of the remainder interest in the burdened property. Direct comparisons of easements, or properties subject to conservation easements, may be inappropriate because they may not reflect the specific damages or benefits imposed on this remainder interest.[26]

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[23] The Trust for Public Land, *Doing Deals: A Guide to Buying Land for Conservation* (Washington, D.C.: Land Trust Alliance and The Trust for Public Land, 1995), p.134; and Warren Illi, "Appraising Conservation Easements," in: Russell L. Brenneman and Sarah M. Bates (eds.), *Land Saving Action* (Covelo, California: Island Press, 1984), p.206.

[24] Bret P. Vicary, "Trends in Appraising Conservation Easements," 62 *The Appraisal Journal* 138 (1994), at pp.141-2.

[25] Vicary, at pp.141-2.

[26] *Appraising Easements*, supra note 20, p.24.

While there may be limitations in direct comparison sales of easements, comparisons may be made to determine the before and after values of the property, and thus indirectly value the easement. Comparable sales with other physical or legal encumbrances can be used to estimate values of easement-encumbered lands. These restrictions can include rights-of-way, power line or other utility easements; lands with physical limitations from topography, water supply, rockiness or flooding;[27] being landlocked or a poor configuration or size; or zoning, deed restrictions and other legal controls that present similar constraints on development as are found in the easement's terms.

The second method of valuing land, the **cost approach**, examines the cost to replace or reproduce the "improvements" on a site and adds to them the market value of the land. These improvements are usually structures, and thus this approach may not be very useful for open space easements. This technique tends to set the upper limit of a property's value, since a potential purchaser is not likely to pay more for the improved land than what it would take to reproduce it. Data on building, other infrastructure, labour and depreciation costs can be routinely assembled and calculated, and thus this approach often is easier to prepare and provides a more strongly supportable value, within its capabilities, than the other two methods. One question that arises, however, is whether the most appropriate calculation is based upon the reproduction (exact replica using similar materials) cost or the replacement (recreating the same functionality) cost.[28] This question is particularly important for buildings of historic or scenic interest; replacing or restoring ecological functions on an improved or managed property or site can be attempted but is rarely completely achieved.

The cost approach has a number of limitations for valuing conservation easements.[29] For lands with endangered species, other particular ecological attributes or buildings of historic significance, the cost approach does not incorporate a value or bonus based upon the irreplaceable nature of the property; these must necessarily be determined using the other methods.[30] Further, it tends to value land as if it were vacant. If the highest and best use of the land involves demolishing existing buildings or improvements (e.g. a pine plantation or constructed pond or wetland), then these improvements may contribute little to the property's value and removal of these improvements may actually become a cost subtracted from the value of the land. Valuation of improvements separate from the land itself can also fail to recognize

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[27] While useful for comparisons, many physical constraints may not be permanent and can be overcome by current or future technology, whereas conservation easements are usually intended to be held in perpetuity. Brighton and Cable, at p.6.

[28] Lonnie Goldman, "Conservation Easement Appraisal Methodologies and Their Acceptance by the Courts," 6(1) *The Back Forty* 1 (1995), at p.5.

[29] *Appraising Easements*, supra note 20, at pp.26-27.

[30] *Appraising Easements*, supra note 20, at p.27.

the synergistic values of the land and improvements as they mutually enhance each other.[31] A conservation easement that prevents development and resultant demolition of improvements may *enhance* their value in the after assessment of a property's value (see the before-and-after method section which follows), since they then have a viable use.[32]

Third, the **income approach** involves an assessment of the net income that could be generated from a property, and reduces this amount to a present value using a discount figure. Thisapproach is best applied to properties such as farms, resource or recreational lands, retail or commercial buildings, rental dwellings or hotels, where income determinations are key and can be based upon reliable market data (e.g. commodity production rates and prices, rents, occupancy rates, and operating expenses).[33]

Two methods can be used to calculate the tangible net income or return to the land under this approach.[34] The *Cash Rental Approach* analyzes cash rental rates paid for land with similar physical features, location and highest and best use, and such rents reflect a return on the land and an amount for property taxes and management fees. With an adequate sample size, this method can be quite reliable for determining the productive value of an agricultural parcel. The more complex *Build-Up Approach* examines typical income potential (from crop rotations, yields and commodity prices), minus variable and fixed expenses and management costs, to determine the net income. This method requires extensive knowledge of the particular operation and industry (e.g. agriculture) being considered.

Accurate calculation and future projection of net income and determining an appropriate capitalization rate are two inherent yet challenging tasks using this method.[35] Information from trade associations, owner and neighbouring property records and commodity markets may be used for income in conjunction with estimates of future vacancy rates, local trends, competitive properties and expected competitive supply.

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[31] *Appraising Easements*, supra note 20, at p.27.

[32] Hancock, at p.5.

[33] Goldman, at p.5. It is the approach used to assess use values for farm and forest land property assessment by the Vermont Current Use Advisory Board; Brighton and Cable, at p.7.

[34] Serecon Valuation and Agricultural Consulting Inc. (Edmonton), *Appraising a Conservancy Easement and a Profit à Prendre.* (Stonewall, Manitoba: Ducks Unlimited Canada, 1995), at p.37. See also pp.14-20 which examine approaches to determining fixed costs and capitalization rates.

[35] Goldman, at p.5.

The capitalization rate is the market-based opportunity cost of capital (i.e. what you could earn if you put your money elsewhere), and is affected by market conditions, investment risk and liquidity, among others. Different methods of determining this rate can be used, including: a weighted average of the yield for the lender on the mortgage debt and the owner's equity ("band-of-investment"); market comparisons from similar properties' sales price and net operating income data; and the yield of other investments with similar risk. In agricultural areas in the Canadian West, these rates would be three to eight percent, while in areas with a rural residential and recreational highest and best use, a capitalization rate of six to 10 percent would be appropriate.[36] Net operating income can then be divided by the capitalization rate ("direct capitalization method"), or a market-derived discount rate can be applied to estimates of net operating income for each year during the holding period, to produce a "present value."

Applying the income approach to conservation easements suggests that the capitalization rate consider the reduced and possibly uncertain future income stream, the reduced value of the reversion, lost flexibility to respond to economic changes due to easement conditions, and artificially extended economic life of the property.[37] Conditions in an easement that could affect the income-producing capacity of the property need to be carefully noted and evaluated. Additional costs in maintaining or operating a property that result from conditions in the easement such as higher insurance rates, management fees or limitations on production methods (e.g. prohibitions on pesticides or selective tree cutting) also need to be assessed.

The income approach must be applied with care. An income approach valuation is often lower than the value of a property subject to a conservation easement since the approach does not account for the market's motivation for purchase and retained property interests such as water, hunting, recreation rights and pride of ownership.[38] It is not a useful method for personal use properties (e.g. residences), where income is foregone in the present for an expectation of increased value on resale, but may be helpful for personal recreational properties that are regularly rented to others.[39] The approach may be inaccurate as well where farm incomes are used but this has little relationship to the market value in an area of significant development pressure.[40] That sale prices of lands subject to easements exceed estimated values using the income approach has been repeatedly demonstrated in American locations such as New Jersey,

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[36] Serecon, supra note 34, at p.38. Also see the discussion on pp.17-20 of the opportunity cost of capital, cash flow or net cash returns, and land appreciation as considerations in the capitalization process for rural farm properties.

[37] *Appraising Easements*, supra note 20, p.28.

[38] Brighton and Cable, at p.7.

[39] *Appraising Easements*, supra note 20, p.28.

[40] Hancock, at p.4.

Long Island, the Hudson Valley and Lancaster (Pennsylvania), and thus the use of at least one other valuation approach is recommended.[41]

A fourth blend of the traditional cost and income approaches is the **subdivision or cost of development approach.** Here, the appraiser estimates all direct and indirect costs and entrepreneurial profit and deducts these from projected gross sales prices of finished lots for development. The estimated net sales proceeds are then discounted at a market-derived rate over the development and sale period to indicate current value of the land.[42] Estimations of all of these factors are difficult, and should be backed up with "raw" land sales wherever possible.[43]

D. Before-and-After Method and Enhancement Effects

While frequent transactions in a well-developed market allow comparison sales for single-family residences and undeveloped land, as noted above such conditions generally do not arise for conservation easements or easement-burdened parcels and thus another means of determining value must be adopted. Consequently, the indirect "before-and-after" method of determining value is often used, derived from expropriation valuation methodology where there are unique properties and no comparable sales.

The before-and-after method is essentially two appraisals in one: it determines the value of the property before a conservation easement is put in place, and then assesses the value of the property subject to the easement. The difference is then taken to be the value of the easement itself. A variation on this approach is to estimate the after value by taking the before value and deducting from this the value of the easement determined through other approaches (e.g. by purchase price). The before-and-after method can involve any of the traditional comparable sales, cost, income or subdivision approaches to valuation to determine the before and after values of the property.

The before-and-after method is essentially two appraisals in one: it determines the value of the property before a conservation easement is put in place, and then assesses the value of the property subject to the easement.

Another variation on this method favoured by one author is the *Value in Place* method, which assesses the before value of the land and then analyzes how the easement's restrictions impact

[41] Hancock, at p.5.

[42] American Institute of Real Estate Appraisers, *Dictionary of Real Estate Appraisal* (Second Edition), 1989.

[43] Hancock, at p.4.

on the landowner's so-called "bundle of rights" in the land.[44] The value of the easement is the value of impacts on such rights, and can be estimated using an impact matrix methodology (the methodology used by Ducks Unlimited Canada is given in Appendix A). These impacts include those affecting the tangible or profit-making portion of the land, and more intangible effects on residual rights (such as those of ownership, to sell or dispose of the land, to mortgage the land's value, and to have privacy and generally enjoy the property).[45]

The before-and-after method has been endorsed by Revenue Canada in correspondence with Prince Edward Island's Island Nature Trust:

> "The restriction of land use normally devalues the property. The restrictive covenant could therefore be assigned a value equal to the difference between the property's value before the restrictive covenant is registered against the land and the property's value after the restrictive covenant is registered against the land."[46]

In appraising an easement property, an appraiser must also consider any value enhancement or decrease that might occur on the "larger parcel,"[47] namely that portion of a property or properties with contiguity and unity of ownership and use. An easement on a portion of a larger parcel, or next to property owned by the same owner or his/her family, may enhance the value of this "larger parcel," such as by retaining open space, views, recreational access, privacy and seclusion, or diminish the value by blocking access or utility easements, creating a nuisance from public access, or restricting some future use.[48] This is a particularly difficult and subjective aspect of the easement's value to assess, and such an enhancement windfall or diminishment may not be immediately captured by tax authorities until such time as the property is sold with a modified value and associated capital gain (or loss).[49]

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[44] Serecon, supra note 34, at p.36.

[45] Serecon, supra note 34, at p.39.

[46] Revenue Canada (Director, Business and General Division, Specialty Rulings Directorate). Letter to Island Nature Trust of Prince Edward Island re: Gifts of Restrictive Covenants, 13 July 1990, at p.2.

[47] See USPAP, Standards Rule 1-2 (d), quoted on p.11 of this report.

[48] M. Eugene Hoffman, "Appraising Deductible Restrictions," in: Russell L. Brenneman and Sarah M. Bates (eds.), *Land Saving Action* (Covelo, California: Island Press, 1984), p.203; and Catterton, p.6.

[49] Catterton, at p.6.

"Good appraisals will help to maintain landowner confidence, will provide answers to questions raised by legislators and the public, withstand scrutiny by [tax authorities] in the case of land trust programs, and maintain integrity of a [purchase of development rights] or other land conservation program. To function at its best, the appraisal process requires competent appraisers and reviewers as well as an informed user of appraisal services."[50]

V. FEDERAL INCOME TAX

Federal income tax implications are often a substantial factor in determining whether a landowner decides to grant a conservation easement, but also have implications for the holding organization. For example, regardless of whether an easement is sold or donated, capital gains tax will be levied on its increase in value, subject to available adjustments. If the interest is given to a government entity or to a registered charity, a tax receipt for its value can be issued and used to claim credits or deductions to reduce income tax. Calculations of undepreciated capital cost and other aspects of real estate taxation may also be involved. Once given to a charity, the land value may be used to calculate the charity's "disbursement quota." Consequently, a number of tax consequences, particularly capital gains and donation credits or deductions, depend upon an accurate estimate (i.e. appraisal) of the conservation easement's value.

Federal income tax implications are often a substantial factor in determining whether a landowner decides to grant a conservation easement.

Unfortunately, there are only a few general guideposts in the vast realm of federal income tax law and policy that assist landowners and acquiring organizations in determining and claiming conservation easement values. This is in contrast to much more specific directions in the United States *Internal Revenue Code Regulations*, as discussed in the later section on the United States experience.

A. Property and Capital Gains for Easements

A conservation easement is an enforceable right to do and prevent others from doing specified things. It thus fits the definition of "property" within the meaning of subsection 248(1) of the *Income Tax Act* (ITA).[51]

[50] Hancock, at p.8.

[51] *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.).

> "*property* means property of any kind whatever whether real or personal or corporeal or incorporeal and, without restricting the generality of the foregoing, includes (a) a right of any kind whatever, a share or chose in action, ..."

That such an interest would be considered property and, upon donation, claimable for income tax benefits has been assumed for many years.[52] A 1990 letter from Revenue Canada to Prince Edward Island's Island Nature Trust has privately confirmed this situation:

> "Since a restrictive covenant registered against land is a right it would be considered a property. Consequently a donation of a restrictive covenant registered against the land to Her Majesty or to a registered charity could be considered a gift for purposes of section 118.1 or 110.1 of the *Income Tax Act*. The Island Nature Trust (a registered charity) may issue receipts respecting donated restrictive covenants providing the donation qualifies as a gift."[53]

Nonetheless, it is interesting to note that Revenue Canada treats the cost of acquiring an easement as an "eligible capital expenditure" (and by implication, as *not* an interest in land). This position is of questionable validity and inconsistent with the treatment given for the granting of easements.[54] In Quebec, the federal *Income Tax Act* deems a property interest subject to a servitude to be beneficially owned by the property owner.[55] While this may suggest that a servitude might not be considered an interest in land for federal income tax purposes,

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[52] Samuel Silverstone, "Open Space Preservation Through Conservation Easements," 12 *Osgoode Hall Law Journal* 105 (1974), at pp.122-3; Donna Tingley, F. Patrick Kirby and Raymond D. Hupfer, *Conservation Kit: A Legal Guide to Private Conservancy* (Edmonton: Environmental Law Centre, 1986), at pp.49-50; Ron Reid, *Bringing Trust to Ontario: A Study on the Role of Nature Trusts, Phase 1* (Washago, Ontario: Bobolink Enterprises, 1988), pp.121-124.

[53] Supra note 46, at p.2. "Restrictive covenant" is the term used under Prince Edward Island's *Natural Areas Protection Act* to create a statutory conservation easement.

[54] Michael J. Atlas, *Taxation of Real Estate in Canada* (Scarborough, Ontario: Carswell, updated 1996), at p.2-18. See interpretation of "eligible capital expenditure" as a deduction from business or property income in Interpretation Bulletin IT-143R2, para.29, and ITA ss.14(5) and 20(1)(b), and the treatment of granting easements in Interpretation Bulletin IT-264R, para.2. Atlas proposes a "more conceptually valid" approach to the treatment of the cost of an easement, including as an addition to the cost of the land benefitting from the easement where the purpose of acquisition is to enhance future use of the land. However, this still does not address easements in gross that have no dominant tenement.

[55] ITA, s.248(3).

administrative policy of both Revenue Canada and Revenue Quebec consider a servitude to be a disposition of land for tax purposes.[56]

When a property is sold, gifted or otherwise transferred, the amount received is called the "proceeds of disposition." Even though a donor receives no money in the transaction, a gift of property during one's lifetime will result in a deemed receipt of proceeds of disposition equal to the fair market value of the property.[57] The partitioning of undivided interests, such as jointly owned land divided to create a conservation easement and the remaining fee simple property, also has particular rules that deem proceeds of disposition during such division.[58]

The excess of any such proceeds of disposition over the "adjusted cost base" ("ACB" — essentially, the acquisition cost) and disposition outlays and expenses is the taxpayer's gain from the disposition of the property; if the proceeds of disposition are less than the ACB and expenses, then this is the taxpayer's loss from the disposition.[59] With a number of exceptions,[60] three quarters of such gains or losses become the taxpayer's taxable capital gain or allowable capital loss for the year of disposition,[61] and are included into the taxpayer's income for tax purposes. The acquisition cost is also important in calculating the capital cost of depreciable property, such as buildings or fences subject to an easement.

A number of tax planning opportunities exist for capital gains, a few of which may be mentioned as they relate to conservation easements. The first is a number of monetary value exemptions which could be used to offset tax liability for capital gains on sales or donations of easements. There is a lifetime capital gains exemption of $500 000 for qualified farm property, such as real property used by the taxpayer or family in the course of carrying on the business of farming,

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[56] See the discussion in Longtin, at p.139. Note that under the Quebec *Civil Code*, articles 1177-94, a servitude may be either personal or real (i.e. an interest in land).

[57] ITA, s.69(1)(b).

[58] See ITA subsections 248(20) and (21); Treasury Ruling 13; *1981 Conference Report* (Toronto: Canadian Tax Foundation, 1982), answer to question 54 in "Revenue Canada Round Table"; and discussed in Atlas, supra note 54 at pp.5-40 to 5-42. This type of scenario would be very rare, especially because in most provinces private individuals and non-charitable corporations are not able to hold conservation easements, and thus is not further discussed in this report.

[59] ITA, s.40(1).

[60] ITA, s.39.

[61] ITA, s.38.

and an easement on such a property could be applied towards this deduction.[62] The 1994 federal Budget phased out the individual lifetime capital gains exemption of $100 000. Part of this exemption may still be available for taxpayers who have filed the appropriate election.[63] The second opportunity, transfers of a "principal residence," are also exempt from capital gains, so long as the property is a housing unit and any immediately contiguous land that reasonably contributes to the use and enjoyment of the unit as a residence (up to an area of half a hectare).[64]

A few other tax planning opportunities are available. For a gift of a conservation easement or any other land, the value claimed for the gift may be chosen anywhere between the fair market value and its ACB, thus reducing the extent of the capital gain (but also correspondingly reducing the value of the charitable receipt), possibly down to zero.[65] Donating a series of easements over time, comprised of either a variety of restrictions or covering portions of the property, could be used to effectively extend the ability to claim the charitable receipt against the donor's income beyond the usual five-year carryforward period.[66] Other tax benefits relating to gifts are discussed in the section "Gifts of Conservation Easements."

1. *Calculation of Original Cost of an Easement*

Obviously, the computation of the original cost, (i.e. adjusted cost base), is a critical factor in determining the size of any taxable capital gain. Section 53 of the ITA prescribes the types of costs for calculating the ACB, but this presumes a known original cost at the time of acquisition. The purchase price of a property is a clear indication of this aggregate value, but does not exist for the distinct component of the property which only now comprises a conservation easement. It may be feasible to appraise an easement at the time of disposition, but it is virtually impossible to appraise what it might have been worth when the property was originally acquired.[67] This is particularly so if there is a long time period between acquisition of the land

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[62] ITA, s.110.6(2).

[63] ITA, s.110.6(19) -(30), and *Income Tax Application Rules, 1971*, S.C. 1970-71-72, c.63, as amended, s.26(29).

[64] ITA, ss.40 and 54(g).

[65] ITA, ss.110.1(3) and 118.1(6).

[66] See Silverstone, at pp. 122-3. Note that total appraisal costs under such a scheme could become substantial.

[67] Marc Denhez, *You Can't Give It Away: Tax Aspects of Ecologically Sensitive Lands*, Issues Paper, No. 1992-4 (Ottawa: North American Wetlands Conservation Council (Canada), 1992), at p.19.

and disposition of an easement, since there could well be substantial changes in improvements, markets, development pressures, zoning, municipal infrastructure and the like.

Regardless of this difficulty, section 43 of the Act sets out the general principle for determining the ACB of a partial disposition:

> "...For the purpose of computing a taxpayer's gain or loss for a taxation year from the disposition of a part of a property, the adjusted cost base to the taxpayer, immediately before the disposition, of that part is such portion of the adjusted cost base to the taxpayer at that time of the whole property as may *reasonably be regarded as attributable to that part* [emphasis added]..."

In discussing this section, Revenue Canada's Interpretation Bulletin IT-264R provides little further guidance on the subject. It does, however, declare departmental policy that the cost of the easement can equal its proceeds of disposition where: (a) the area of the portion of the property that was expropriated or in respect of which an easement or right of way was granted is not more than 20 percent of the area of the total property; and (b) the proceeds of the compensation received is not more than 20 percent of the amount of the adjusted cost base of the total property.[68]

To avoid capital gains through use of this administrative policy, landowners could enter easements covering only 20 percent of their property area. Where easements cover a greater area, no such Revenue Canada assurances to ignore capital gains exist, and the mechanics involved in accurately calculating adjusted cost base and resulting capital gains on easements are arguably unworkable.[69] Revenue Canada apparently did not invoke a deemed capital gain for the limited number of early easements in Canada,[70] although a taxpayer has reported a capital gain for an easement more recently.[71]

Notwithstanding the appraisal and calculation challenges of determining the easement's ACB, two reasonable formulae have been proposed: the fair market value at time of acquisition, and the relative fair market value at time of disposition.[72] In the first and more theoretically valid

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[68] Interpretation Bulletin IT-264R, para. 2.

[69] Denhez, supra note 67, at p.20.

[70] Denhez, supra note 67, at p.20. Denhez has queried whether this is a result of departmental largesse, an unwillingness to tackle the mathematics, an unwillingness to adventure into uncharted areas, or mere oversight.

[71] Alan Ernest, Conservation Support Services, personal communication, 9 October 1996.

[72] Atlas, supra note 54, at pp. 5-37 to 5-39.

method, the value paid for the partial interest could be calculated by subtracting the value of the residual property at the time of acquisition (i.e. without the easement interest) from the total amount paid for the original, entire property at that time (i.e. with all rights, including the easement).

Using the second approach, the adjusted cost base or capital cost is determined by multiplying the whole property's cost value by the following fraction: proceeds from portion sold divided by proceeds from portion sold plus value of portion retained after partial disposition. In other words,

$$\text{Whole Property's Original Adjusted Cost Base} \times \frac{\text{Proceeds from Portion Sold}}{\text{Proceeds from Portion Sold + Value of Portion Retained after Partial Disposition}}$$

While this latter method must appropriately allocate proceeds between the land or building components (or both), it is the most commonly used approach and is normally accepted by Revenue Canada.[73] This is due to the fact that, as noted, the value of the easement at the time of acquisition may be difficult to determine, and the second method will often result in a higher cost determination (and lower immediate capital gain) because partial interest dispositions frequently coincide with the emergence of special buyers or conditions which create a proportionally higher value for that interest than at any time in the past.[74]

There is no section equivalent to section 43 of the ITA specifying how to determine the capital cost of a partial disposition of depreciable property (e.g. an easement covering buildings), but Revenue Canada and taxpayers have generally assumed that the same principles in section 43 apply.[75] This calculation is necessary to be able to assess how much of a depreciable property's proceeds of disposition are to be applied to decrease the undepreciated capital cost of the appropriate class of property for capital cost allowance purposes.

Similarly general directions are provided in section 46(2) for determining the adjusted cost base and deemed proceeds of disposition of a partial disposition of personal use property (e.g. a residence or cottage, book or bicycle). This section helps minimize taxpayer record-keeping for small items, since when both actual cost and actual proceeds on disposition are less than $1 000,

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[73] Atlas, supra note 54; and Interpretation Bulletin IT-418, para. 5.

[74] Atlas, supra note 54, at p.5-39.

[75] Interpretation Bulletin IT-418, para.2; see also Atlas, supra note 54, at pp.5-36 to 5-37. At p.5-39, Atlas notes that the same principles would likely also apply to a partial disposition of real estate inventory.

the transaction does not give rise to capital gains.[76] These partial disposition rules have little relevance for conservation easements, given the nature and value of the properties involved.

2. *Fair Market Value Issues*

Beyond the calculation challenges, Revenue Canada has recently raised a more fundamental problem with determining the fair market value of gifts of conservation easements. In a private advanced tax ruling for a donated easement on an Alberta ranch, Revenue Canada has stated its opinion that there is no current market for the easement, and thus its value is nominal.[77] This interpretation would extend to other easements, and seems to hinge on the use of the phrase "amounts each of which is the fair market value of a gift" in sections relating to corporate deductions and individual credits for donations of any kind of gift.[78]

"Fair market value" is a frequent expression in the ITA, but with a few exceptions is generally undefined in the Act.[79] The term is particularly relevant here for determining the amount of an easement gift, since the donation of conservation easements has been the primary acquisition

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[76] In this situation, the minimum ACB is deemed to be $1 000, and thus there is no gain above this value. To prevent taking unfair advantage of this rule when disposing of part of a property, the section allocates the $1 000 amount to the ACB of any part of personal use property disposed in the proportion to its value relative to the whole of the property (e.g. a set of furniture). Subsection 46(3) deems the set to be a single property where it has an aggregate fair market value in excess of $1 000 and ordinarily would be sold together. Vern Krishna, *The Fundamentals of Canadian Income Tax*, 4th ed. (Scarborough, Ontario: Carswell, 1993), at pp.488-490.

[77] James Duncan, Nature Conservancy of Canada, personal communication, 3 October 1996. Other senior Revenue Canada officials have affirmed their opinion that there is value in conservation easements, and one easement's value was accepted at 60 percent of the value of the fee simple property; Alan Ernest, Conservation Support Services, personal communication, 9 October 1996.

[78] ITA, ss.110.1 and 118.1.

[79] These exceptions relate to: work in progress or inventory property, resource output disposed to or acquired from the Crown, shares of a deceased taxpayer, or mortgaged property held in trust for the benefit of a spouse. See the ITA, ss.10(4), 69(8) and (9), and 70(5.3) and (8)(a), respectively.

method to date, although it does relate to other value calculations (such as a charity's disbursement quota).[80]

There are several problems raised by Revenue Canada's interpretation. It suggests that only those interests with an *actual, current* market can have "fair market value." Even accepting such an approach, there is a current, albeit limited, market for easements in Canada: some have been purchased from landowners,[81] and a few have been assigned. This purchasers' market involves competition between those who may wish to develop the land and those who wish to conserve it. That such an easement market could exist is recognized in the United States *Treasury Regulations*, and actually does exist in that country, particularly in regions within the states of Vermont, New York, New Jersey and Utah, and where comparable "transfer of development rights" or "purchase of development rights" programs are in place.[82] Substantial valuations of easements have also been upheld by the United States courts.[83] Further, a conservation agency or charity holding a conservation easement could also have expropriated from it, or release or be ordered by a court to release, the interest in an actual exchange for value (e.g. money or additional conservation lands), and apply the proceeds or lands towards its greater conservation objectives.

"Fair market value" is particularly relevant for determining the amount of an easement gift.

However, any lack of actual, current markets for most conservation easements should not preclude their full valuation and recognition as "fair market value." Appraisal of land relies in large part on assessing the "highest and best use" of the land, which usually is not the current or actual use and may depend upon an analysis of opportunities to achieve zoning changes or government approvals in the future. The undoubtedly regular acceptance by Revenue Canada

[80] Revenue Canada has more discretion with determining the fair market value for disbursement quotas of charitable foundations, given the authority in ITA s.149.1(1.2)(b) to "accept any method for the determination of the fair market value of property or a portion thereof that may be required in determining the prescribed amount."

[81] Alan Ernest, Conservation Support Services, personal communication, 9 October 1996, concerning purchases of easements along the Bruce Trail in Ontario, using funds from the provincially-sponsored Niagara Escarpment Land Acquisition and Stewardship Program.

[82] United States *Treasury Regulation* s.1.170A-14 (h)(3); Vicary, supra note 24; Brighton and Cable, at p.6; and Judith S. H. Atherton, An Assessment of Conservation Easements: One Method of Protecting Utah's Landscape, 6 *J. Energy L. and Pol.* 55, at pp.74-76, describing purchase programs by the State of Wisconsin, the U.S. Fish and Wildlife Service and Bureau of Reclamation, among other agencies.

[83] Goldman, supra note 28.

of appraisals based upon this standard methodology to indicate fair market value supports the argument that only a "conceptual" or "equivalent" value is necessary for tax purposes. In other spheres of enterprise, some products, inventions, shares or other "property" do not have immediate applications, or require subsequent conditions or approvals to occur before they can be realized and marketed. However, that they have value or potential value can be determined and accounted for within the marketplace, and thus for tax purposes. Conservation easements should be accorded similar treatment and their "conceptual value" accepted.

Revenue Canada's interpretation would have the effect of removing a tax incentive that encouraged the donation of conservation easements to public-spirited agencies and charities.

The results of Revenue Canada's interpretation are also problematic. First, it would have the effect of removing a tax incentive that encouraged the donation of conservation easements to public-spirited agencies and charities, thus drastically limiting the number of any future gifts of these interests. Such a result would contrast sharply with Parliament's recent express support in Bill C-36 for enhanced tax claim limits for donations of ecologically sensitive lands, specifically "including a servitude for the use and benefit of a dominant land, [and] a covenant or an easement."[84]

Second, this interpretation deviates from the Department's past policies and practices of accepting appraised values of donated conservation easements[85] and its private but well-known correspondence with the Island Nature Trust acknowledging that easements are property with value, as noted above. All implementation discussions of Bill C-36 have presumed value in conservation easements, and its specific reference to servitudes, covenants and easements as property eligible for enhanced claim limits also assumes that at least some easements will have sufficient value to benefit from such higher claim limits. Interpretation Bulletin IT-264R further states Revenue Canada's administrative practice concerning the adjusted cost base of easements greater or lesser than 20 percent of the fee simple value of the property, thus implying that Revenue Canada also continues to accept that easements have some value which may exceed this 20 percent figure. To now depart from these positions creates broader uncertainty in tax planning.

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[84] *Income Tax Budget Amendment Act*, 1996, S.C. 1996, c.21, ss.20(1) [amending ITA s.110.1] and 23(2) [amending ITA s.118.1].

[85] The Ontario Heritage Foundation has entered over a dozen natural heritage conservation easements, and has not experienced any problem with having its easement donation receipts, based on appraised values, accepted by Revenue Canada. While this corresponds to the experience elsewhere, it may also relate to the nature and credibility of this Ontario Government agency. Jeremy Collins, Acquisitions and Dispositions Coordinator, Ontario Heritage Foundation, personal communication, 25 September 1996.

A third problematic result is that such a reversal in departmental practice also introduces questions of inequity between previous and prospective donors, and between American and Canadian residents donating easements in Canada.[86] Fourth, if there is no current tax value in a conservation easement and the property under easement is later sold, the market will ordinarily produce a lower sale value resulting in a decreased capital gain at minimum, and likely a capital loss, for the taxpayer. In such a scenario, Revenue Canada will have foregone the opportunity to tax the full capital gain in the principal property, and possibly the capital gains in other properties now being offset by any claim of a capital loss.[87] The taxpayer may also be able to defer any capital gains tax until the property sale date, rather than paying part of it at the time of an earlier disposition of the easement.

This situation needs to be clarified and resolved quickly before an easement donation "chill" sets in. Presuming that Revenue Canada supports the use of easements and their sometimes substantial value (and is not trying to reduce charitable claims), the Department can resolve this issue in several ways without amending the Act:

- abandon its interpretation that gifted easements have no true fair market value; or,
- adopt an administrative or enforcement policy that recognizes value in donated easements, either on a temporary or more permanent basis (such a United States Treasury Ruling in 1964 initiated the development of the more comprehensive easement rules present today in the *Internal Revenue Code* and *Regulations*).

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[86] American residents donating easements in Canada become eligible for U.S. tax benefits at sometimes substantial appraised values, whereas Canadians (or U.S. residents with Canadian income) donating such easements here would receive no similar recognition of value.

[87] As a hypothetical example, a farm was purchased in 1972 for $50 000 (its ACB). In 1995, a development-restrictive easement was donated and appraised at a value of $120 000, and the residual farm soon sold for $30 000. Subsequent to reporting the easement's capital gain of $80 000 [$120 000 (current appraised value) - $40 000 (being $120 000/$120 000 + $30 000, or 80 percent of the ACB)], Revenue Canada audited the tax return and determined that the easement had nominal value. There was thus no capital gain on the easement, and no value in the charitable receipt.

This then produced a capital loss of $20 000 [$30 000 (current farm price) - $50 000 (total ACB since none attributable to the easement)]. The taxpayer used this capital loss against capital gains realized on the stock market and thus further reduced the income tax payable. While the taxpayer benefitted financially, because of the indirect nature of the benefit and that the easement was not easily recognized as valuable, the gift was not publicized and the donation of other easements was not encouraged. Revenue Canada did not receive any taxes on the capital gains in the appraised values, especially the $20 000 gain in the residual farm interest (still taxable even if the value of the easement was elected to be equal to its ACB). It should be noted that any capital gains tax on the easement would have been partly offset by the charitable credits associated with the donation.

It is hoped that the Minister of Finance will propose legislative changes or other administrative measures to resolve this question in the 1997 federal Budget.[88] The exact nature of any such amendments to the *Income Tax Act*, and whether they are retroactive to cover 1996, or even easement-related donations under the 1995 "Ecologically Sensitive Lands" amendments (that explicitly refer to easements), remains to be seen.

B. Gifts of Conservation Easements

Many conservation organizations are registered charities, and as such, are exempt from federal income tax.[89] Charities also have the ability to issue tax receipts to donors. As noted earlier, it is this latter ability which has encouraged donations of land, including conservation easements, to charities.

However, the federal *Income Tax Act* has not encouraged donations of ecological lands because the landowner had to pay a tax on the land's increase in value (the capital gain), even though the landowner gave away the land and received no money for it. Until now, landowners did receive a tax credit usable over six years against up to 20 percent of their net income for donations to charities and municipalities. They also had the option of choosing to value the donation between the market price and the ACB. However, with a modest income, any tax credits would usually give only partial tax relief. Sadly, the result of this tax system has been to discourage many willing landowners across the country who, for tax reasons, could not afford to donate their valuable lands to conservation charities.

Presuming that Revenue Canada supports the use of easements and their sometimes substantial value (and is not trying to reduce charitable claims), the Department can resolve this issue in several ways without amending the Act.

After much lobbying, the federal 1995 and 1996 Budgets removed key barriers to private conservation, particularly the 20 percent cap on income tax credits (usable against taxable income) for donations of federally-recognized "ecologically sensitive lands" given to municipalities and qualified environmental charities.[90] Taxpayers making gifts to the federal

[88] James Duncan, Nature Conservancy of Canada, personal communication, 19 December 1996.

[89] ITA, s.149(1)(f).

[90] ITA, ss. 110.1 and 118.1. The 1995 Budget announcements were incorporated by the *Income Tax Budget Amendment Act*, S.C. 1996, c.21, ss.20, 23, 53 and 54. The details of the "ecologically sensitive lands" provisions are outlined in Canadian Wildlife Service, *Donation of Ecologically Sensitive Land in Canada: Procedures for Implementing New Provisions of the Income Tax Act of Canada,* Information Circular No. 2 (3 January 1997).

or provincial governments, or their agencies, retain the ability to claim the gifts' value against 100 percent of their income. Charities designated as Crown agencies can benefit from this 100 percent Crown gift claim limit.

The 1995 federal announcement, following similar Quebec 1994 income tax measures,[91] removes the 20 percent cap on the use of credits for gifts to charities and municipalities, and allows a claim limit of 100 percent of net income for qualified donations (including qualified conservation covenants, easements and servitudes). Working with the provinces, the federal Minister of the Environment has set up a process to certify broad categories of "ecologically sensitive lands," designate qualified charities which have a conservation purpose, and approve post-donation changes in land use or ownership. Implementing agreements to designate provincial and, in some cases, non-government officials to administer this process are in place or pending in five provinces, while federal officials currently administer the process in the other jurisdictions.

"The federal 1995 and 1996 Budgets removed key barriers to donations of federally-recognized "ecologically sensitive lands."

The 1996 Budget announced further measures useful for conservation donations. More donations of money or other gifts to conservation charities will be encouraged since they will now qualify for credits or deductions of up to 50 percent of the donor's income, up from the previous 20 percent cap. Of particular importance for conservation easements, all donations to charities of property that appreciate in value over time (e.g. land or stocks), and any gifts given in the year or preceding year of death, will qualify for tax credits or deductions usable against 100 percent of the donor's income. For such gifts of appreciated property, any tax on the often large increase in value (capital gain) of donated lands will be countered by enhanced tax credits or deductions usable at higher limits in the year of donation, a new alternative to usually spreading the use of such tax credits over six years.[92]

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[91] 1994 Quebec Budget, 12 May 1994.

[92] The 100 percent claim limit applies to the taxable capital gain element of appreciated capital property. It is achieved through the new 50 percent cap for all donations to charities and municipalities, plus a claim "bonus" of 50 percent of any taxable capital gains arising in respect of gifts of capital property included in the donor's taxable income for the year. *Notice of Ways and Means Motion to Amend the Income Tax Act*, 6 March 1996 (re: 1996 Federal Budget), Resolution 8: Charitable Donations. See Gordon Floyd, "1996 Federal Budget: Impact on Charitable Donations," *Issue Alert Memorandum*, 8 March 1996 (Toronto: Canadian Centre for Philanthropy, 1996).

Many older landowners are now considering the future ownership, and possible transfer, of their properties. The 1995 and 1996 Budget changes to the ITA will enhance tax benefits for landowners, put land donations on par with those given to the federal and provincial governments, and encourage donations of ecologically sensitive lands to conservation organizations and municipalities. This will support land stewardship at the local level, where often the most tangible conservation work is done as citizens advance creative initiatives and become actively involved.

C. Value Substantiation and Penalties

Whether property is donated, purchased or sold, there are general rules for substantiating the value of property for income tax purposes. Certain penalties or other consequences can ensue should claims be unreasonable, and participants in conservation easement transactions need to be aware of such implications.

Reported values and calculations for property can be subject to audit and reassessment by Revenue Canada. Consequently, it is important to have sufficient evidence of property value and associated calculations prepared in advance of completing a tax return. Where there has been a previous purchase of property, this can be documented through agreements of purchase and sale or land transfer tax declarations from the time of purchase. Such a "before" value is relatively straightforward, but the calculation of "after" value for a conservation easement is much more complicated and thus requires more detailed documentation. This is ordinarily obtained through an appraisal report.

There are generally no rules as to who can appraise property. So long as the data is supportable and the number is reasonable, people can conduct comparison sales research and determine the value themselves.[93] However, having a professional designation (such as a member of the Accredited Appraisers of Canada Institute, designated by "AACI") carries more weight, although is not proof of competence to appraise easements. Indeed, in tax appeals the tribunals have demonstrated their preference for appraisers who are expert in the particular interests and market under scrutiny.[94] In a tax appeal, the taxpayer has the onus to prove that the Minister of

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[93] Dean Thantrey, Audit Department (North York, Ontario), Revenue Canada, personal communication, 7 October 1996.

[94] For example, *Barker v. Minister of National Revenue (M.N.R.)* (1979), 79 D.T.C. 700 (T.R.B.) — appraiser's personal knowledge of transactions in the area during the relevant period, and the opposite side's appraiser not having knowledge of the oversupply of land for subdivision; *Northern Garage and Holdings Ltd. v. M.N.R.* (1982), 82 D.T.C. 1419 (T.R.B.) — appraiser's qualifications and 34 years' experience in the local market; *Goodwin Johnson (1960) Ltd. v. The Queen* (1983), 83 D.T.C. 5417 (F.C.T.D.) — appraiser's persuasive testimony and experience as a knowledgeable consultant in the industry.

National Revenue's valuation was incorrect, and cannot do so by introducing hearsay evidence.[95]

For appraisals of gifts, Revenue Canada Interpretation Bulletin IT-297R2 states:

> "The person who determines the fair market value of the property must be competent and qualified to evaluate the particular property being transferred by way of a gift."[96]

In order to obtain tax deductions or credits for donations under the ITA, proof of the gift must be made by filing a receipt containing prescribed information.[97] This information includes, for non-cash properties, the date the donation was received, a brief description of the property, and "the name and address of the appraiser of the property if an appraisal is done."[98]

A variety of consequences for misinterpreting or breaching income tax rules are specified in the ITA, and a comprehensive review of these is beyond the scope of this paper. Nonetheless, a few should be highlighted. Taxpayers who incorrectly determine or calculate their taxes can be reassessed or audited,[99] bringing their affairs under close scrutiny. While ultimately it is the taxpayer's responsibility, donee organizations will want to assist donors in ensuring appropriate valuations and reporting of conservation easement transactions. This will prevent any surprises of additional taxes for the taxpayer, and avoid resulting dissatisfaction with the donee organization and the conservation easement technique.

In serious situations, the ITA provides for certain penalties. False or deceptive statements in a document, alteration or falsification of records, and wilful evasion or attempt to evade payment of taxes, can result in fines of between 50 to 200 percent of the tax sought to be evaded plus imprisonment for up to two (and, on indictment, five) years.[100] Where the nature of transactions (such as including over-inflated appraisals of donated property) ought to have alerted the taxpayer, this can be held to be evidence of gross negligence and absence of good faith, and

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[95] ITA, s. 152(8); *Price v. M.N.R.* (1978), 78 D.T.C. 1375 (T.R.B.).

[96] Interpretation Bulletin IT-297R2, para.6.

[97] ITA, sections 110.1(2) and 118.1(2).

[98] Income Tax Regulations, C.R.C. 1978, c.945, s.3501(1)(e.1).

[99] ITA, s.152.

[100] ITA, subsections 239(1) and (2).

thus merit the imposition of penalties of additional taxes.[101] In extraordinary situations of non-compliance with the Act, charities could be deregistered and thus lose their tax-free and receipt-issuing privileges.[102]

D. Law and Experience in the United States

The income tax law concerning conservation easements in the United States has been structured around specific provisions in the *Internal Revenue Code* (IRC) that allow for tax deductions for donations of qualified conservation easements. This section of the report cannot explore the full realm of this aspect of United States law, but the basic provisions and case law can be sketched. In doing so, the contrast with the relatively unclear and undirected situation in Canada becomes apparent.

After a period of revenue rulings, *United States Treasury Regulations* and temporary enactments,[103] the 1980 *Tax Treatment Extension Act* codified and gave permanent authority for charitable deductions of federal income, estate and gift taxes for conservation easements.[104] A "qualified conservation contribution" means a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. For the purposes of this report, the definition includes the frequent situation of a "restriction (granted in perpetuity) on the use which may be made of the real property" donated to a charity recognized under IRC s.501(c)(3). This must be made for "conservation purposes," defined in s.170(h)(4) to mean:

(i) the preservation of land areas for outdoor recreation by, or the education of, the general public,
(ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem,
(iii) the preservation of open space (including farmland and forest land) where such preservation is —
  (I) for the scenic enjoyment of the general public, or

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[101] *Arvisais v. M.N.R.* (1992), 93 D.T.C. 506 (T.C.C.). In this case, Mr. Arvisais and his family repeatedly purchased art works at 25 percent of their appraised and reported price, and then proceeded to donate them to art museums to obtain a charitable deduction. That he was a bank portfolio manager and thus informed and familiar with transactions, had sought advice only from his family rather than from independent sources, and had falsified the date of the reported purchase contributed to the court's finding of a lack of good faith and credibility.

[102] ITA, s.149.1.

[103] See Denhez's summary, supra note 67, at p.18, footnote 28.

[104] *Tax Treatment Extension Act*, P.L. 96-541, codifying the provisions into the *Internal Revenue Code*, s.170(f)(3)(B)(iii), with "qualified conservation contribution" defined in s.170(h).

(II) pursuant to a clearly delineated federal, state, or local governmental conservation policy, and will yield a significant public benefit, or

(iv) the preservation of an historically important land area or certified historic structure.

Subsection (5) provides that "[a] contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity."

Several pages of the *Treasury Regulations* elaborate these IRC provisions in considerable detail.[105] The paragraphs under subsection (h)(3) for "perpetual conservation restrictions" are of particular interest because they set out the rules for the valuation of conservation easements. The value of the contribution is the fair market value of the restriction, determined through comparable sales where "there is a substantial record of sales of easements comparable to the donated easement (such as purchases pursuant to a governmental program)," or otherwise generally through the application of the before-and-after method.

Other valuation methodologies are prescribed for certain circumstances under this subsection. Where a restriction covers a portion of a contiguous property owned by the donor and the donor's family, the before-and-after method is to be applied to the whole of the contiguous parcel (equating to the expropriation technique of examining the "larger parcel" which includes unburdened lands of the same owner; see discussion of this concept on page 19). Where a restriction has the effect of increasing the value of property, contiguous or not, owned by the donor or a related person, the contribution is reduced by this amount. Similarly, if a restriction can reasonably be expected to create financial benefits for a donor or related person, no deduction will be allowed (except to the extent that the public benefit may exceed the private benefit). In addition, no deduction will be allowed if a conservation restriction has no material effect on, or enhances, the value of the property.

If before-and-after valuation is used for a conservation easement, the fair market value of the property before it is restricted must take into account a number of factors, which are part of standard appraisal methodology: current use; objective assessment of remoteness and likelihood that the property would be developed; and any effect from zoning, conservation, or historic preservation laws that already restrict the property's highest and best use. The effects of any development and the amount of access that may be allowed by the easement must be accounted for in determining the after value. Along with reductions in highest and best use, any permitted uses that will increase a property's fair market value above its current use must be accounted for in an appraisal. Finally, the value of the easement will not be reduced by reason of transfer restrictions designed solely to ensure that the conservation restriction will be dedicated to conservation purposes.

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[105] *Treas. Reg.* s.1.170A-14, *"Qualified conservation contribution."* For an extensive discussion of these provisions by their author, see Stephen J. Small, *The Federal Tax Law of Conservation Easements*; and *1995 Second Supplement* (Washington, D.C.: Land Trust Alliance, 1985 and 1995).

As is the case in Canada's income tax system for the "adjusted cost base," the rules for allocating the "basis" of a conservation easement are quite general. The retained property's basis must be adjusted to eliminate "that part of the total basis of the property that is *properly allocatable* to the qualified real property interest granted" [emphasis added]. This amount allocatable to an easement or other interest must be in the:

> "same ratio to the total basis of the property as the fair market value of the qualified real property interest bears to the fair market value of the property before the granting of the qualified real property interest."[106]

Where an easement involves a structure where deductions are taken for depreciation, the reduction of the basis must be allocated between the structure and the land. The *Treasury Regulations* also provide 12 examples of calculations of the deductions involved in a qualified conservation contribution.

In the United States, record keeping and the form of appraisals for income (as well as estate) tax purposes are prescribed in these *Treasury Regulations*. Where a deduction is claimed, the taxpayer must maintain written records of the fair market value of the underlying property before and after the donation, and of the conservation purpose furthered, and must state such information in the taxpayer's income tax return if required in the return's instructions. An Appraisal Summary (Form 8283) must also be signed and dated by the appraiser and the donee. The timing and content of an appraisal is prescribed, and the criteria for who may be a "qualified appraiser" are set out in the regulations.[107] Appraisers and landowners are subject to stiff penalties for over-valuation of a property.[108] Where a transaction and conservation easement terms are complex enough or the donor has no need for a charitable deduction, a landowner may choose not to obtain an appraisal due to the costs involved in obtaining a qualified appraisal to meet these substantiation requirements.[109]

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[106] *Treas. Reg.* s.1.170A-14(h)(3)(iii).

[107] These criteria include holding oneself out as an appraiser, being qualified for that type of property, not being a party to the transaction, and not being a party to an agreement with the owner to determine the property's value in excess of its fair market value.

[108] IRC s.6071(d), concerning the aiding and abetting the understatement of tax liability. Apparently, Vermont assessors ("listers") have been skeptical about using income tax-oriented appraisals for property tax assessment because they fear an overvaluation of easements for tax purposes, but this fear fails to acknowledge the appraisers' professionalism and such stiff IRC penalties as deterrents; Brighton and Cable, at pp.8-9.

[109] This has occurred for at least one easement in Michigan: Barry Lonik, Executive Director, Potawatomi Land Trust, Ann Arbor, Michigan, personal communication, 30 September 1996.

A variety of trends have been established in United States income tax valuation cases concerning conservation easements.[110] Because there is rarely a market for easements to determine the fair market value, the before-and-after method will be accepted. Fair market value is determined according to the highest and most profitable use for which the property is adaptable and needed or likely to be needed in the reasonably near future. The valuation of property is a question of fact, and the taxpayer bears the burden of proving a particular valuation. When presented with expert testimony, the court need not choose one valuation over another, but may take and extract relevant conclusions from all such expert evidence and even undertake its own analysis of appraisal methodology and substitute its own judgement when appropriate. The evidence of a well qualified, experienced and prepared expert appraiser will carry significant weight in valuation challenges. The cases further "reflect judicial preference for large samples of comparable properties to small samples as well as preference for objective data to subjective speculation."[111] Finally, the courts in the United States are prepared to uphold substantial values for conservation easements, sometimes into the millions of dollars.

In United States income tax valuation cases, the before-and-after method will be accepted. The taxpayer bears the burden of proving a valuation.

VI. PROVINCIAL AND LOCAL PROPERTY TAXES

Along with federal income tax provisions, property taxation is among the most significant processes for valuing interests in land, including conservation easements. However, there is a significant conceptual difference between federal income tax valuation, which seeks to determine the value of the easement itself upon a disposition, and property tax assessment that attempts to measure the value of the land that is subject to the easement.[112]

Along with federal income tax provisions, property taxation is among the most significant processes for valuing interests in land, including conservation easements.

[110] Goldman, at p.6.

[111] Goldman, at p.14.

[112] Daniel C. Stockford, "Property Tax Assessment of Conservation Easements," 17 *B.C. Envtl. Aff. L. Rev.* 823 (1990), at p.833.

Property taxation is largely a provincial responsibility, and consequently varies from province to province. The following discussion is necessarily a summary of this subject. As for federal income tax, there are only a few very general guideposts for valuing conservation easements under property taxation law and policy across the various jurisdictions.

At the provincial level, property taxes can affect the ability of landowners and conservation organizations to hold property in conservation uses. For example, revenue-generating activities (e.g. forestry or housing development) may be required on the land in order to meet high property tax levels, with potential consequences for the protected values and provisions of a conservation easement. If taxes get too high and revenue-generation is restricted (by an easement, zoning or otherwise), a landowner may be forced to sell all or a portion of the property, leading to a new relationship and transitional arrangements to ensure that existing easements are understood and respected.

A. Property Taxation Law

Generally, provinces tax real property on the basis of its market value, or a percentage thereof.[113] While the terms used in the property taxation statutes vary among expressions such as "market value," "actual value," "fair actual value," "fair value" and "at value,"[114] the concepts are relatively equivalent and equate to the USPAP appraisal definition of "fair market value" noted on page 10 of this report.

This approach to valuation of land recognizes more than its value in its present use, particularly in an area that is experiencing expanding development. The fair market value of that property will reflect its "highest and best use," namely the most profitable, likely and legal use, assuming that a prospective purchaser is prepared to pay for the property's potential value. Use of this criterion for comparing and assessing properties has the advantage of creating a uniform standard and thus equity among taxpayers, although in practice this is not always followed and most legislation provides for preferential treatment in certain circumstances. The determination of fair market value follows the three appraisal methodologies outlined earlier, although the Supreme Court of Canada has also endorsed standard practice by accepting a recent open sale

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[113] Stanley Makuch, *Canadian Municipal and Planning Law* (Toronto: Carswell, 1983), at pp.88-89.

[114] Makuch, supra note 113; and see for example: *Assessment Act*, R.S.O. 1990, c.A.31, s.19(1) and *Assessment Act*, R.S.N.S. 1989, c.23, s.42(1); *Assessment Act*, R.S.B.C. 1979, c.21, s.26; *Municipal Taxation Act*, R.S.A. 1980, c.M-31, ss.9 and 10; *Urban Municipality Act*, R.S.S. 1978, c.U-10, s.311; and *Municipal Assessment Act*, C.C.S.M. c.M226, s.17(1).

of the property or recent open sales of identical properties in the same neighbourhood and market.[115]

A conservation easement will restrict the types of uses allowed for a certain property, and this will usually alter the "highest and best use" that is legally possible on the property, often resulting in a lower property value. Theoretically, with a decrease in fair market value, the property's assessed value would be lowered correspondingly.

Statistics are not available in Canada,[116] but a Massachusetts study reported that conservation restrictions caused assessors to reduce assessments by between 13 and 95 percent of the properties' prerestriction value, while a Maine review of federal tax appraisals showed reductions in fair market value of between five to 90 percent.[117] The extent of the reduction in value corresponded to the degree of restriction on uses of the property, the easement's terms, and the particular characteristics of the property. In a Vermont study, the effect of putting a conservation easement on an 80-hectare (200-acre) property resulted in an increase of between four and 77 cents on property taxes of an average-value house in the towns examined.[118] Other reported values range from 13 percent (hunting, fishing, trapping and drainage access), 50 percent (scenic easements), 30 to 60 percent (pothole wetlands), to 80 or even 90 percent (agriculture and nature conservation) of the fee simple value.[119]

The earlier appraisal methodology section identified difficulties in using traditional approaches to valuing conservation easements and thus the underlying property subject to taxation. Beyond

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[115] *Sun Life Assurance Co. v. City of Montreal* (1950), [1950] S.C.R. 220. In this case, the court also held that the assessor must take into account what the current owner would be willing to pay for the property if the landowner were entering the market.

[116] Nonetheless, the growing number of conservation covenants in British Columbia have had a neutral effect on individual property's assessment, with several advance tax rulings determining that there is no reduction in assessment. Bill Turner, Real Estate Consulting, personal communication, 17 November 1996.

[117] "Pursuing Open Space Preservation: The Massachusetts Conservation Restriction," 4 *Envtl. Aff.* 481 (1975), and Maine Coast Heritage Trust, "Conservation Easements and Property Taxes," in: *Technical Bulletin* No. 104, pp. 3-4 (1989), both reported in Stockford, supra note 112 at pp. 835-836.

[118] Deb Brighton and Judy Cooper, *The Effect of Land Conservation on Property Tax Bills in Six Vermont Towns* (Montpelier, Vermont: Vermont Land Trust, 1994), at p.2.

[119] Atherton, at pp.74-76, mostly referring to government agency easement purchase programs, which may increase the valuation of the easements to some extent.

these challenges, other obstacles exist for landowners seeking to have property assessments reduced. These include:

- assessors may be reluctant to recognize the full value of easements due to concerns about a decreasing tax base;
- assessors may be unclear about whether or how to address easements and determine their value in preparing tax rolls;
- in reality, uniform valuation is rarely achieved due to changes in property values over time (and infrequent reassessment), and municipal undervaluations in fear that increased assessments could produce a taxpayer backlash;
- landowners may be reluctant to seek reassessment because of potential higher overall valuation of the full property out of proportion to nearby lots, which have not been recently assessed; and
- tax assessment appeals may be complicated, expensive and time-consuming, and landowners may be unwilling or unable to afford to pursue such appeals.[120]

While the assessment of conservation easements in particular has rarely been contemplated in law in Canada, a few focused provisions do exist. Prince Edward Island provides that property taxes are exempted for landowners who register a restrictive covenant on provincially-designated natural areas.[121] Assessors in British Columbia are specifically directed to "give consideration to any terms or conditions contained in a [conservation] covenant" in determining the "actual value" of the property.[122] Conservation easements in Saskatchewan are specifically protected from extinguishment in the event of a sale of the land for unpaid taxes.[123] In the different but related context of property transfer tax, British Columbia has also exempted from land transfer tax the registration of conservation covenants in favour of conservation organizations, or land sold subject to a covenant in favour of the province.[124] It is interesting that Alberta provides extensively for assessing "linear property" (e.g. rights-of-way and pipelines),[125] but did not

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[120] Stockford, at pp.839-842; Brighton and Cooper, supra nota 118 at pp. 22-23.

[121] *Real Property Tax Act*, R.S.P.E.I. 1988, c.R-5, s.3(k), for all real property designated as a natural area under the *Natural Areas Protection Act*, R.S.P.E.I. 1988, c.N-2.

[122] *Assessment Act*, R.S.B.C. 1979, c.21, s.26(3.5), as amended by the *Land Title Amendment Act, 1994*, S.B.C. 1994, c.44.

[123] *The Conservation Easements Act*, S.S. 1996, c.C-27.01, s.15, which adds a new clause 27(a.1) to *The Tax Enforcement Act*, R.S.S. 1978, c.T-2.

[124] *Property Transfer Tax Act*, R.S.B.C. 1979, c.15, s.5.2.

[125] *Municipal Government Act*, S.A. 1994, c.M-26.1.

include appropriate provisions in recent reforms enabling conservation easements for private organizations.

Besides these few examples specifically relating to conservation easements, a few provinces have a direction in their property taxation statute that the assessed value of land subject to easements and covenants in general should be reduced according to the actual impact of the easement or covenant's terms. The terms used in such directions usually contemplate only common law easements and covenants, i.e. those requiring appurtenant (nearby) lands (the "dominant tenement"). For example, in Ontario:

> "Where an easement is appurtenant to any land, it shall be assessed in connection with and as part of the land at the added value it gives to the land as the dominant tenement, and the assessment of the land that, as the servient tenement, is subject to the easement shall be reduced accordingly."[126]

The authorizing legislation for conservation easements in Ontario deems these interests to be restrictive covenants,[127] and thus a convoluted statutory interpretation may bring such conservation easements within the scope of this assessment provision, unlike the situation in other provinces. While this may benefit easement use and landowners generally, it does not assist assessors with the mechanics, since there is no property to which to assign and assess the value of the easement.

Two scenarios suggest themselves: either decrease the value of the property to the extent of the easement's value, and only assess the property at that decreased value; or do the same but also assess the holder of the easement at its own value (assuming that the easement qualifies as property subject to taxation, which is not always the case).

A third possibility exists: being to assess the increase in value against properties in the vicinity, given that they are likely to benefit from proximity to easement-protected lands. Although it may be an unintentional effect, the drafting of Manitoba's *Municipal Assessment Act* provisions appear to allow for this third approach. Land that enjoys the benefit of an easement or right-of-way receives an increased assessment,[128] and assessors shall:

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[126] *Assessment Act*, R.S.O. 1990, c.A.31, s.9(1). A restrictive covenant running with the land is also deemed to be an easement within the meaning of this section; see subsection 9(2).

[127] *Conservation Land Act,* R.S.O. 1990, c.C.28, s.3(10).

[128] The wording does not require the land enjoying the benefit of the easement or right-of-way to be appurtenant, and thus by implication, it is not required to be the dominant tenement. Thus, the provision may encompass, and does not preclude, a conservation easement in gross.

> "decrease the assessed value of land upon which the easement or right-of-way is situated by an amount that represents the loss in value of the land, if any, resulting from the presence of the easement or right-of-way on the land."[129]

Assessors in Saskatchewan shall take into consideration "the present use [of land]... and any other condition or circumstance affecting its value."[130] In Nova Scotia's *Assessment Act*, a reduction in value for any encumbrance on title is precluded except as otherwise provided. Since the associated direction to account for easements or rights-of-way is expressed only to include those with appurtenant land, one could interpret the combination of these provisions to prevent preferential assessment of conservation easements in gross (i.e. the usual form that does not legally attach to nearby land).[131]

There is little case law on the interpretation of these or general easement assessment provisions, and most cases do not directly consider the issues of concern here.[132] While the cases are limited and at times quite old, such treatment by these tribunals demonstrates a reluctance to apply the law in a manner that reduces assessment for lands subject to easements. A number of the decisions are reviewed below.

Private, contractual agreements that include easements have been held not to reduce assessment in some provinces. A private restrictive covenant between landowners led the British Columbia Assessment Appeal Board to state that "the assessor's obligation is to value all interests in the property and it would therefore be inappropriate for him to account for the negative influence of the restrictive covenant."[133] However, more recent legislative changes would override this decision and require consideration of the effects of conservation "covenants," although there may be no effect on the actual assessed value depending on the covenant's terms and existing zoning.[134]

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[129] *Municipal Assessment Act*, C.C.S.M. c.M226, s.17(10).

[130] *Urban Municipality Act,* 1984, S.S. 1983-84, c.U-11, s.238(4)(a), and *Rural Municipality Act,* 1989, S.S. 1989-90, c.R-26.1, s.283(4)(a).

[131] *Assessment Act*, R.S.N.S. 1989, c.23, subsections 44(1) and (2). This is despite recent enactment of the enabling *Conservation Easement Act*, S.N.S. 1992, c.2.

[132] See the cases described below, and also: *Reach Co. v. Gosland* (1919), 45 D.L.R. 140 (Ont.S.C.); and *Re B.A. Oil Co.* (1964), 48 D.L.R. (2d) 493 (Ont.H.C.).

[133] *Holler v. Assessor of Area 09: Vancouver* (1987), (B.C.A.A.B.), cited in *Lepage c. Boischatel (Municipalité) et M.R.C. la Côte de Beaupré.*

[134] See supra note 121; Bill Turner, Real Estate Consulting, personal communication, 17 November 1996, referring to recent private tax rulings and a British Columbia Assessment

Similarly, where a taxpayer created a restriction on his property concerning low rental units, the municipality was not obligated to subsidize the property in comparison to other similar but unrestricted property.[135] Where land is encumbered by a lease, this fact will "not affect its value for purposes of assessment, although it will, of course, affect the selling value of what the owner of the reversion has to give."[136]

There are no explicit provisions concerning the impact of servitudes on property taxes in Quebec.[137] However, as in the cases above, the Quebec Court of Appeal has, in effect, held that it is necessary to take account only of servitudes imposed by the law and to ignore the impact of voluntary or contractual servitudes in determining property assessment.[138] In a more recent case following this principle, the Quebec's Bureau de Révision de l'Évaluation Foncière (Property Assessment Review Board) held that a public utility servitude must be taken into account in valuing the assessed property.[139] Such interpretations appear to make unnecessary distinctions and do not make sound policy, particularly when Quebec income tax law encourages the donation of ecological lands, including contractual servitudes.

In one Ontario case, utility right-of-way easements did not result in a reduction in assessment, with the tribunal holding that there would not be inequity among taxpayers since all properties with easements in the area would be assessed at the same rate.[140] In another, a clause in a

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Authority Memorandum.

[135] *Consolidated Shelter Corp. v. Fort Gary (Municipality)* (1965), 49 D.L.R. (2d) 565 (Man.C.A.). This was an agreement between the Crown and the company that restricted the use of land, and to which the municipality was not a party although it had land use regulation authority.

[136] *Bennett v. Dartmouth (City)* (1965), 2 N.S.R. 655 (N.S.S.C. App. Div.). Nonetheless, unlike easements, a lease is a possessory but not (usually) a permanent encumbrance on the land, and it is thus usually assessed against the lessee who has actual use and benefit of the land at the time.

[137] Longtin, at p.148 see the *Loi sur la fiscalité municipale*, R.S.Q., c.F-2.1.

[138] *La Compagnie du marché central métropolitain Limitée c. Montréal (Ville)*, [1976] C.A. 59. Referring to Article 43 of the *Loi sur la fiscalité municipale*, Longtin at p.149 contests this interpretation.

[139] *Lepage c. Boischatel (Municipalité) et M.R.C. la Côte de Beaupré* (19 March 1993), B.R.E.F., File No. Q-930253.

[140] *Magee v. Regional Assessment Commissioner, Region No. 27, and Windsor (City)* (1975), [1975] O.M.B. Decisions #5068 (O.M.B., File M.74184). However, while other properties were assessed in the same fashion and thus a claim of inequity was unfounded, the board

deed that gave free right of access of purchasers to streets and commons was held not to be an easement at common law because of vagueness and lack of a clear servient tenement land which was subject to it; consequently the reduced assessment provision did not apply.[141] This latter analysis is supportable for common law interests, but sheds little light on statutory conservation easements, which are legally valid without a dominant tenement.

If a landowner defaults in paying property taxes, a municipality usually may sell the land to recapture these taxes, subject to elaborate procedures. Most property tax legislation provides that land sold for arrears in taxes will not affect easements or covenants attached to the land.[142] These are similar to provisions relating to Saskatchewan's conservation easements, noted above. However, in other provinces this is often phrased within the language of common law easements and covenants and their associated requirements to have appurtenant (nearby) land.

The traditional property tax system based on an assessor's determination of highest and best use (i.e. its potential likely use rather than present use) creates the economic incentive and sometimes necessity to develop properties.[143] Particularly as near urban areas begin to experience increasing development, property values will rise as assessors recognize potential higher prices and the likelihood of zoning changes to accommodate such uses. A landowner's personal income and revenue from the land may not have changed, but extrinsic forces and reassessments of such properties at new market values will put financial pressure on these taxpayers. In recognizing the burdens that the assessment systems can impose, particularly on rural landowners and the rural features they maintain, most provinces provide exemptions, reductions or rebates on property taxes. These may be made to particular kinds of landowners

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dismissed and did not appear to apply the provision calling for decreased assessment for easements.

[141] *Lorne Park Estates Association v. Regional Assessment Commissioner, Region No.15, and Mississauga (City)* (1979), 23 O.R. (2d) 628, 97 D.L.R. (3d) 181 (H.C.J.). This case also raises a question of procedure; the court held that it, not the Assessment Review Court, County Court nor Ontario Municipal Board, had jurisdiction to determine whether the easement existed, but did not have authority to alter the assessment. Does this then require an easement to be proven in court before assessment is separately appealed, or only when the assessment authority challenges the easement's validity in such appeals? Given the statutory nature of most conservation easements (and lengthy court dockets), validity challenges should be rare and assessment appeals should proceed before the assessment tribunal.

[142] For example, the *Municipal Tax Sales Act*, R.S.O. 1990, c.M.60, s.9(5), and the *Assessment Act*, R.S.N.S. 1989, c.23, s.44(3).

[143] "The California Land Conservation Act of 1965 and the Fight to Save California's Prime Agricultural Lands," 30 *Hastings Law Journal* 1859 (1979), at p.1864, cited in Stockford, p.842.

(e.g. farmers or non-profit organizations) or on certain kinds of lands (e.g. farms, forests or those with conservation value). These programs include:

- assessment of land at values as a farm (i.e. not development prices) where owners meet criteria as bona fide farmers in British Columbia, Manitoba, Ontario, New Brunswick and Prince Edward Island;
- Saskatchewan's fixed rates for agricultural land, and fixed agricultural rates tied to soil productivity in Alberta;
- tax exemptions for agricultural land in Nova Scotia and Newfoundland;
- exemptions from taxation for forest land in Alberta, Saskatchewan, Manitoba and Prince Edward Island;
- Ontario's farm, forest and conservation land tax rebate programs;
- an agricultural tax ceiling, forest management rebate and non-profit organization exemption in Quebec; and,
- exempt or reduced assessment for non-profit organizations and prescribed tax rates for woodlots in New Brunswick, Nova Scotia and Newfoundland.[144]

Of these preferential tax programs related to agricultural and conservation purposes, only Prince Edward Island's exemption for designated natural areas (either under a restrictive covenant or in fee simple) appears to include conservation easement-type considerations.[145]

It is apparent, then, that property taxation statutes that have not explicitly contemplated conservation easements in gross can produce uncertain, unintended and even perverse results, such as being unclear whether easements are caught by the provisions or, as in Nova Scotia, likely preventing reduced assessment. Drafting language varies, but in all cases it points to the need to approach such sections with full recognition of the presence and application of (and preferably incentives for) conservation easements in gross.

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[144] For a summary of such property tax programs across Canada, see: Denhez, supra note 67, at pp.22-38, and Harry M. Kitchen, *Property Taxation in Canada*, Canadian Tax Paper No.92 (Toronto: Canadian Tax Foundation, 1992), at pp.28-34. A more detailed review and analysis is presented in Julian Greenwood and Jennifer Whybrow, "Property Tax Treatment of Agriculture and Forest Land in Canada: Implications for Land Use Policy," *Property Tax Journal* 159 (June 1992), and in Monique Ross, *Forest Management in Canada* (Calgary: Canadian Institute of Resources Law, 1995).

[145] See supra, note 121.

B. Impacts of Easements on the Local Tax Base

As considered above under benefits of conservation agreements, the impact of conservation agreements on property taxation is uncertain, and depends upon numerous factors. It is understandably a concern for increasingly stretched municipal governments and taxpayers for two reasons: in the short term, land protection may result in land value being removed from the tax rolls and the taxes then are shifted to other taxpayers; and in the long term, protected land cannot be developed into something which would pay more taxes than open space, e.g. a commercial business, which would help reduce other taxpayers' bills.[146]

The impact of conservation agreements on property taxation is uncertain, and depends upon numerous factors.

The value of the land will relate to patterns of buyer preference, the value on protecting existing amenities, and the availability of similar amenities nearby. Most easements will create a lower land value and thus, theoretically, a lower assessment. This has not been the Canadian experience to date.

Despite such a theoretical lower assessment under some conservation easements, there are a number of reasons why this will unlikely occur to any large extent. First, it is dependent upon assessors responding to the easement's valuation effects, and being required to do so by law, and otherwise on landowners making appeals. The law is largely unclear or unfavourable in Canada, and assessors and landowners appear reluctant to seek a reduced assessment. Despite being required to do so in Vermont, accounting for easements' devaluative impacts has rarely occurred and thus there has been little effect on the tax rolls there.[147]

Second, if easement terms match the zoning restrictions or if there is no foreseeable market demand for the development an easement restricts, assessment value would likely not be substantially decreased since highest and best use would remain unaffected. Such low value easements have been appraised in some American states.[148] Many easements may well enable some development, or only cover a portion of a property allowing other parts to be built upon, and thus will not have substantial impacts on property assessment. In reality, protecting a few

[146] Brighton and Cooper, at p.1.

[147] Brighton and Cooper, at p.8. The maximum potential impact, as yet unrealized, for an 80-hectare (200-acre) easement was a four to 77 cents increase in taxes on an average-value home.

[148] Hancock, at pp.5-6.

parcels of land will likely redirect rather than preclude development, thereby influencing its pattern and location rather than its amount or type.[149]

Third, various environmental, aesthetic and recreational benefits are regularly used to market properties and are well known to raise property values and assessment.[150] A conservation easement "almost always enhances the value of adjoining parcels to some degree,"[151] and thus could at least be tax neutral or potentially increase overall property assessment in the municipality through conserving these assets. As ex-urbanites take an interest in certain areas, many will value the long-term security of preserved amenities, privacy, views, access to trails and hunting, and reduced possibilities of development and disturbance next door. Farmers would be able to continue farming and also would appreciate the lack of further subdivision, which thereby reduces the number and proximity of ex-urban neighbours who may complain about traditional farm practices. A value increase has been demonstrated in some locations in the United States, particularly where scenic, lifestyle and recreational assets are present along with considerable development pressure and lower availability of rural lands.

Fourth, besides possible contribution to higher assessment values and thus revenues for municipalities, conservation easements can also help reduce municipal costs. Easements can restrict and avoid development pressures and demands, thus reducing tendencies toward urban sprawl and associated infrastructure and servicing costs:

> "In general, tax bills are higher — not lower — in towns with more people and in towns with more commercial/industrial development. It may be just as accurate to look at land conservation as protecting the town from development which is expensive to service as it is to look at conservation as precluding development which would bring in tax revenues."[152]

With clear and stable rules, additional municipal costs of frequent administration and assessment of planning applications will also be reduced, particularly given an increasingly complex and public planning environment and reduced capability for levying development charges. Several United States studies and the 1996 *Report of the Greater Toronto Area Task Force* have demonstrated that controlling diffuse development with its expensive infrastructure and servicing

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[149] Brighton and Cooper, at p.21.

[150] For example, United States National Park Service, *Economic Impacts of Protecting Rivers, Trails, and Greenway Corridors: A Resource Book*, 4th Ed., (Washington, D.C.: United States National Park Service, Rivers, Trails and Conservation Assistance, 1995); Land Trust Alliance, *Economic Benefits of Land Protection* (Washington, D.C.: Land Trust Alliance, 1994).

[151] Catterton, at p.6.

[152] Brighton and Cooper, at p.21.

costs is actually more cost effective for a municipality and its taxpayers than is unbridled development.

A program for property tax abatement for easements can include measures to further limit any impacts upon the municipal tax base. These measures might include: penalties or rollback taxes in the circumstance that an easement is violated or the easement's term expires, criteria to ensure that easements fall within the realm of public interest to merit special tax treatment (possibly accompanied by government approvals, although this encumbers the process), and perhaps a method of recognizing increased value on properties neighbouring a lot subject to an easement.[153]

Property tax implications for municipal treasuries are likely to be small,[154] although they are somewhat uncertain. As open space is converted in near-urban areas, the value of lands protected under easement will increase as they remain in open space uses and provide amenities for and value in nearby properties. Rural lands in an urbanizing society are less likely to hold development value. As a result,

> "protecting land through conservation easements results in the smallest tax shift of all the other options ... it is the cheapest option for town property taxpayers ... the conclusion of the report is *not* that towns should discourage growth and development. Rather, townspeople should make decisions about where development and conservation take place based on their goals and vision for the future of their communities — not on perceptions of property tax impacts."[155]

C. Law and Experience in the United States

More than half of the American states which have enacted conservation easement legislation have provided that such restrictions shall affect the property tax valuation of the burdened land.[156] Similar to some Canadian legislation but specific to easements, Colorado, Missouri, Michigan and Maine require assessors to consider the effect on value of conservation easements and their

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[153] Stockford, at pp. 851-852.

[154] Denhez, supra note 67, at p.37.

[155] Brighton and Cooper, at pp.9 and 21 [emphasis in the original]. The alternative conservation options considered were: federal ownership, state ownership, municipal ownership, ownership by a conservation organization, and a conservation easement.

[156] Stockford, at p.830.

restriction of future uses of the property.[157] Reduced assessment is available for Minnesota's registered conservation easements where the property is used in accordance with the easement's conservation purpose.[158]

In Vermont, state-, municipality- or approved charity-owned easements are taxed "only upon the value of those remaining rights or interests" retained after an easement is entered.[159] The Vermont legislature has thus exempted qualified conservation easements from property taxation, with a court interpreting this to mean that assessors' ("listers") role was not to research, identify and tax all the holders of various interests and to adjust and assign appraisal values.[160]

While these assessment directions provide an indirect incentive through downward market valuation of land subject to conservation easements, some states provide more directly supportive measures.[161] The State of Washington allows counties to grant bonus points for conservation covenants, used towards tax reductions of 20 to 90 percent of land values. Maine provides for specific valuation reductions for land under easements enrolled in the current use program, with reductions of 20 percent for general open space, 30 percent more for permanent protection, and a further 20 percent (i.e. a total of 70 percent) if the land will remain "forever wild."[162] Permanent conservation covenants that restrict development in Maryland can result in a 15-year property tax credit equal to the full assessment on such properties. New Hampshire sets a limit on assessed value of lands under a permanent easement at no greater than the values used for current use assessment purposes.[163] California and Florida similarly have differential tax

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[157] Stockford, at p.831; and Thomas Grier, "Conservation Easements: Michigan's Land Preservation Tool of the 1990s," 68 *University of Detroit Law Review* 193 (1991), at p.207.

[158] Stockford, at p.831.

[159] 10 V.S.A. Chapter 155, s.6306.

[160] Brighton and Cable, at pp.3-4; *Lyndonville (Village) v. Burke (Town)*, 146 Vt. 435 (1985). Vermont also has a current use assessment program whereby owners of lands subject to a conservation easement may enroll and receive a reimbursement based upon the difference between the use value tax and the fair market value tax.

[161] See Calvin Sandborn, *Green Space and Growth: Conserving Natural Areas in B.C. Communities* (Victoria: Commission on Resources and Environment, 1996), at p.167.

[162] Me.Rev.Stat.Ann. Title 36, para.1106-A, discussed in Janet E. Milne and Susan Hasson, *Environmental Taxes in New England: An Inventory of Environmental Tax and Fee Mechanisms enacted by the New England States and New York* (South Royalton, Vermont: Vermont Law School, 1996), at p.50.

[163] N.H.Rev.Stat.Ann. s.79-B:3; Milne and Hasson, supra note 162, at p.51.

provisions applicable to properties burdened with conservation easements, thereby taxing properties upon their current, rather than highest and best, use.[164]

Some cases in the United States support the use of conservation easements to reduce assessment of burdened properties. In one, a conservation easement was held to surrender "elements of value" by the taxpayer to the public at large, and thus entitled the taxpayer to a property tax exemption.[165] A North Carolina State Property Tax Commission ruling that the "true" or market value of wilderness property was reduced by 45 percent through a donated conservation easement has been upheld by the state's Court of Appeals.[166] Even when land is subject to a common law restrictive covenant and public access is denied, local assessors must account for the covenant's devaluative effect.[167] In a Michigan case where assessors refused to account for such devaluative effect, the court ruled that there was such an effect on the tax payable and rebuked the assessors by ordering them to pay the costs of the court action.[168]

In the United States experience courts are prepared to accept substantial devaluations of properties from conservation easements, and to overrule reluctant assessors who may attempt to limit easement valuations and tax applications.

The American experience suggests that substantial integration of legislation enabling conservation easements and associated tax benefits has occurred. Such a situation occurs where there is a coherent and concerted land conservation strategy in place that has fully examined the interplay between property and tax means to involve private landowners in conservation activity. Indeed, some states with easement-tied tax incentive programs have seen significant growth in the use of easements.[169] The courts are prepared to accept substantial devaluations of properties from conservation easements, and to overrule reluctant assessors who may attempt to limit easement valuations and tax applications.

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[164] Stockford, at p.845.

[165] *Village of Ridgemoor v. Bolger Foundation*, 104 N.J. 337, 517 A.2d 135 (1986).

[166] *Rainbow Springs Partnership v. County of Macon*, 79 N.C. App. 335, 339 S.E.2d 681 (1986).

[167] *Lochmoor Club v. Grosse Pointe Woods*, 10 Mich. App. 394, 159 N.W.2d 756 (1968). See also *Hayes v. Gibbs*, 110 Utah 54, 169 P.2d 781 (1946).

[168] Barry Lonik, Executive Director, Potawatomi Land Trust (Ann Arbor, Michigan), personal communication, 30 September 1996.

[169] Land Trust Alliance, supra note 1.

VII. CONCLUSIONS

Specialized real estate arrangements and tax incentives set the context for many private landowners' decisions and organizations' activities to conserve land. Other factors will obviously affect such private actions, such as philanthropic tendencies, plans for transfers of property to family members, financial means to maintain or develop the property, and competition for funds within the voluntary/charitable sector. Legal mechanisms and private decisions, and the partnerships which link them, will need to coincide more frequently in order to achieve conservation of private lands throughout southern Canada.

Conservation easements have proven to be an attractive and effective mechanism for land conservation in many countries, and are seeing growing interest and use in Canada. However, the existing federal income tax and provincial property tax legislation largely fail to contemplate and encourage such easements, although in some cases they may roughly accommodate them. Interpretation questions abound, and uncertainties mostly have been administratively overlooked given that only a few easements have been entered to date.

This situation is changing. Provincial enabling legislation for conservation easements has been reformed in most jurisdictions, and conservation organizations are actively promoting and using this new authority. More easements during an unsettled financial period means that more taxpayers will be attempting to obtain available, and sometimes substantial, tax benefits. Consequently, legal uncertainties and barriers along with valuation methodologies will receive increased attention and scrutiny by all interested parties.

The methods to appraise and claim the value of conservation easements have been largely standardized in the United States, both through *Internal Revenue Code* provisions and their interpretation by the courts. Canada could benefit from such clearer directions at the national level, and certainly could examine the United States provisions as a model.

Clarifications for conservation easements in income tax legislation are needed.

Other clarifications for conservation easements in federal income tax legislation are needed. Revenue Canada's interpretation that the lack of markets for easements results in a zero fair market value is conceptually troublesome, hurts conservation and represents a departure from past practice and Parliament's recent tax reforms. Administrative and, where necessary, legislative interpretations of the *Income Tax Act* need to address these concerns promptly. On a somewhat different note, the recent federal tax reforms enabling enhanced claim limits entrench current Quebec provincial law by specifically requiring servitudes to benefit nearby land. Active proposals to amend provincial law to allow servitudes (in gross) to operate like conservation easements would, upon enactment, thus not have access to such federal tax incentives until subsequent federal amendments could be advanced. This will slow Quebec use of this mechanism, and could be

avoided by simply referencing the notion of servitudes in the legislation without mention of nearby lands. The tax treatment of conservation easements should also be considered in the context of the larger issue of enhancing cross-border land donations and appropriate recognition and incentives in both Canadian and United States domestic legislation and the *Canada-United States Tax Treaty*.

Many state property taxation statutes in the United States explicitly recognize the effects of conservation easements on property values (especially as an interest in gross, i.e. without benefitting nearby land), and some even provide particular direct incentives to encourage landowners to enter into easement agreements. The existence of these tax incentives may partly account for increased use of easements in these states in recent years.

Canada's legislation again is less clear, and in some cases the effect of the drafting of assessment directions for common law interests can preclude their use for conservation easements in gross. In all but a few cases, the property tax legislation does not provide a direct, positive incentive for entering easements. There is thus a strong need to review property taxation statutes' provisions for assessing easements (especially those in gross) to eliminate unclear, unintended and internally inconsistent results in some jurisdictions.

Besides the legal arena, there are other activities which could enhance the valuation and understanding of tax mechanisms for conservation easements. First, focused materials, training and possibly standards and certification for appraisers can enhance the quality and reliability and broaden the Canadian experience with valuing conservation easements. Second, exchanges with or reviews by experienced American appraisers may help bring this experience to bear on what is a relatively new technique in Canada. Third, among conservation organizations, the development of a common list of appraisers familiar with conservation easements can assist landowners and the development of appraisal practice.

The Vermont Land Trust and American Farmland Trust maintain registries of their own and other properties with conservation easements in place, and uses this registry to monitor the impact of easements on property values. This is useful for statistical data on factors affecting value, and can support development of formulae for appraising easements under current use, purchase of development rights or other programs.[170] This information is valuable for the land trust itself, but also ensures that municipal officials' fears of impacts on the property tax base can be assessed and addressed. A registry could also highlight where easements and easement-burdened land are purchased, sold or otherwise transferred, and thus document a market and comparable values for these interests.

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[170] Hancock, at p.7. Formulae developed under such programs need regular updating and market analysis to be accurate, but have the benefits of consistency and decreased time and cost for appraisals. Such programs often will allow a landowner to opt for conducting a full appraisal, rather than just using the formula.

The expanding ability to enter conservation easements in Canada has progressed much more quickly than has their recognition within Canadian tax legislation. The country is thus experiencing a lag period filled with many procedural, mathematical and legal uncertainties. Easement valuation questions will always continue to arise, since every property, every easement's terms and the availability of information are different. However, these questions require a more comprehensive and clear framework in which to assess the value of these interests, particularly within their unique role in land conservation efforts.

A few measures are beginning to emerge in Canada, and examples and experience are available in the United States. It is now the task of all interested participants in this field — taxpayers, conservation organizations, land professionals and appraisers and governments — to help examine, elaborate and revise this Canadian framework. Accordingly, this report has attempted to make a contribution towards this process. By addressing difficulties and uncertainties, the use of conservation easements will thus become more straightforward and widespread, leading to enhanced conservation of Canada's rich natural and cultural heritage.

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APPENDIX A

Ducks Unlimited Canada
Impact Matrix

DUCKS UNLIMITED CANADA IMPACT MATRIX FACTORS

(For factor details see Table 1)

1. *Allow access to Ducks Unlimited with 24 hours notice:* Probably not a serious issue except where access may have to be gained by crossing other lands and the land may be occupied with cattle. The critical times would be: calving, weaning, and breeding. There are also periods when there are no problems such as: when cattle are not on the property.

2. *Allow Ducks Unlimited to monitor land and its use:* This is probably not a serious situation in most cases — but could be a problem when monitoring requires frequent visual inspections and access is via other properties with cattle, etc.

3. *Landowner receives lump sum payment — income tax considerations:* There is a cost the landowner will have to cover to deal with accountants, lawyers, etc. These issues will have to be addressed and could, for example, complicate planning already underway. The positive side is that the agreement might provide for a mechanism to carry out estate planning with different possibilities.

4. *Landowner stewardship over remaining rights:* The landowner is left with a "shell of a property," and the need to look after the remaining rights, even though there is no income being received on an ongoing basis. There is very little that will create work or interfere with their remaining rights, other than issues over land use, etc.

5. *Wetlands remain unimproved:* For farmers this could be negative because it removes their option to carry out drainage, to straighten fields, etc. Also, farmers do not typically like duck ponds in fields because of ducks eating crops, etc. For acreage owners, this could be a benefit as the land could be viewed as a buffer zone, wildlife habitat, etc.

6. *Landowner continues to pay property taxes and other levies:* The income valuation excludes a provision for the capitalization of property taxes. This is because it is unknown what future taxes will be, and whether the current calculation is sufficient for five to ten years into the future. There would only be neutral (0) or negative ratings for this factor.

7. *Landowner will not, without Ducks Unlimited approval:*

   (a) *grant an easement or right-of-way:* Ducks Unlimited, with either a Conservation Easement or a Profit à Prendre could not "stop" an easement or right-of-way for a pipeline, power line, well site, etc., because of legal statute. This factor, therefore, relates more to the landowner wishing to lease the land or to provide an easement or right-of-way to a neighbour, etc.

   (b) *sever or subdivide the property:* This factor would appear to be only neutral (0) negative, because it is infringing on the rights and freedom of the landowner. They have less control over their property than they had before.

Both 7(a) and 7(b) are probably neutral (0) or negative. It does not seem, from the landowners' point-of-view, that these could be positive factors, although they might easily be viewed that way by adjacent landowners.

(c) *erect or remove building, signs, fences, and other structures:* From the landowners' viewpoint, this can only be considered neutral (0) or negative. Adjacent landowners could view this as positive.

(d) *construct, improve road, parking lot, dock, landing strip, etc.:* This factor would be the same as for (c), except for landowners with a true desire to see the land remain "untouched," but then these individuals do not need to have an agreement not to do this, they do it by their own desire.

(e) *allow operation of snowmobiles, ATVs, etc., on the property:* As with the other provisions under #7, this is an infringement on the landowners' rights, and can only be viewed as neutral (0) (no effect) or a negative effect on the value of the property.

(f) *allow drainage of permanent or seasonal wetlands:* This factor could impact adjacent land owned by the individual with the agreement, as well as the subject property. It could also affect adjacent landowners. This factor could be a fairly major issue for most landowners, especially farmers, who would view it as neutral (0) at best. Other types of landowners might not view it as negatively as farmers would.

(g) *allow dumping soil, rubbish, ashes, garbage, etc.:* This factor, for the subject property owners, can only be viewed as neutral (0) no effect, or negative, again because it is a restriction on their natural rights as owners. Often, landowners will move soil in to fill in wetlands.

(h) *allow use of pesticides, insecticides, chemicals, etc.:* Landowners generally like to be able to use weed control (herbicides), pesticides, and insecticides for control of weeds and insects. Those who do not want to use these or other chemicals are not impacted by this provision, so a neutral (0) impact, or negative for those who do wish to use them.

(i) *allow any changes to appearance, topography, etc., including tilling, grazing livestock, ditches, dams, etc.:* Again for many landowners who farm, this would be, at best, neutral (0) or negative. For acreage owners or others who want to retain the original character of the property, it would be probably neutral (0).

(j) *allow or cause adverse effects on water conservation, erosion, soil conservation, preservation of native plant and animal species:* This factor is really just protecting the concept of good husbandry, and for the majority of landowners this should be neutral (0), or no effect. The only impact might be the preservation of native plants, in other words, no land clearing would be possible which would then be a negative impact.

(k) *allow the introduction of non-native plants or animals:* For many landowners this could be a non-issue, but for acreage owners wanting to utilize their entire area, the control over non-native plants might be viewed as fairly negative. Often new trees can be added which enhance the use and enjoyment of a property. This factor may not allow for this to occur, therefore, it would be probably a negative impact for acreage owners and neutral (0) to negative for farmers.

(l) *impact negatively on surrounding lands:* This again is just called land stewardship, and should really be just typical restrictions already in place for owners.

(m) *allow anything to detract from aesthetic, scenic, and natural character of the property:* This could be very broad in definition, and in the minds of many landowners could have a negative impact as they would be restricted with regard to the removal of trees or drainage of low areas in fields.

8. *Owner reserves the right to use the property for all purposes not inconsistent with this Agreement:* The landowners do retain some of the Bundle of Rights inherent in ownership, and they can utilize/enjoy these remaining rights only as long as they do not infringe on the Agreement. This could be viewed as neutral (0), no effect, or a positive impact for most landowners. Some (very few) might consider the remaining rights a burden, therefore, a negative.

9. *Ducks Unlimited shall be permitted to erect a plaque on the property:* The agreement goes on to say "in a tasteful manner and at Ducks Unlimited's expense." Some landowners might view a sign negatively because of the reaction to Ducks Unlimited and to birds (waterfowl) by others in the area. For the majority, the erection of a "tasteful sign" at "no expense" would be a neutral (0) impact.

10. The owner allows Ducks Unlimited to publicize the existence of the Agreement: Pride of ownership is a significant factor in ownership of real property. As such, the privacy of ownership and desire to have as few restrictions as possible on the use of the property, the publicizing of the existence of the Agreement could be negative, neutral or positive. In most cases it would be neutral (0) to slightly negative.

11. *Notice of the restriction has to be inserted on the title, lease, or other legal instrument:* Again, landowners have a desire to have as few restrictions as possible on their titles. Every "charge on the title" is viewed in a negative sense by purchasers, as the conditions have to be fully understood and interpreted in light of what they may want to do with the property. This factor is probably, in most cases, negative, but not significantly so.

12. *Owner notifies Ducks Unlimited of any changes of ownership immediately:* Again, this is an intrusion on the privacy of ownership, and an infringement on the normal rights enjoyed. There is little real impact, but a few landowners might consider it an inconvenience, and a nuisance, as prospective purchasers might discount the property value because of this factor.

13. *The restrictions shall remain with the property and be binding upon the parties:* This restriction has basically been considered under earlier factors, (i.e., charge on the title, infringement of rights, etc.). This factor would be viewed by most owners and prospective purchasers as a negative effect on value, as the restriction cannot be lifted without the consent of both parties. This is no different than most restrictions, i.e., easements, rights-of-way, etc. It will be a minor negative to neutral (0) factor for most landowners.

TABLE 1: IMPACT MATRIX

Factor	Rating								
	-4	-3	-2	-1	0	1	2	3	4
1. Allow access by Ducks Unlimited employees, agents, and others to the land and over the land with 24 hour notice to the landowner. 2. Allow Ducks Unlimited to monitor the use of the land. 3. Landowner has to consider tax consequences 4. Landowner responsible for stewardship over remaining rights. 5. Wetlands remain in unimproved state for wildlife 6. Landowner continues to pay for property taxes and levies. 7. Landowner will not, without Ducks Unlimited approval: a) grant any lease easement or right-of-way b) sever or subdivide the property c) erect or remove or permit the erction or removal of any buildings, signs, fences, or other structures of any type d) construct, improve or allow for the construction or improvement of any road, parking lot, dock, aircraft land strip, or other such facility except for the maintenance of existing foot trails, fire lanes, etc. e) allow the operation of any type of motorized vehicles on the property f) allow the drainage of any permanent or seasonal wetlands g) allow the dumping of soil, garbage, waste or unsightly, hazardous non-compostable or offensive materials h) allow the use of pesticides, insecticides, chemicals, or other toxic material of any type i) allow any changes in the general appearance or topography of the property, including tilling, grazing of livestock, ditches, retaining walls, dams									

TABLE 1: IMPACT MATRIX (Cont'd)

Factor	Rating								
	-4	-3	-2	-1	0	1	2	3	4
j) allow any activities, actions or uses detrimental or adverse to water conservation, erosion control, soil conservation, or preservation of native plant and animal species k) allow the planting or other introduction of non-native plant or animal species l) allow detrimental impact on surrounding lands m) allow anything to detract from the aesthetic scenic and natural character and condition of the property. 8. The owner reserves the right to continue to use the property for all purposes not inconsistent with this Agreement. 9. Ducks Unlimited shall be permitted at their expense to erect a plaque on the property in a tasteful manner. 10. The owner allows Ducks Unlimited to publicize the existence of the Agreement. 11. Restriction notice shall be inserted by the owner in any deed, lease or other legal instruments by which he transfers either the Fee Simple title or a possessory interest in the property. 12. The owner shall immediately notify Ducks Unlimited of any change of ownership or of its possessory interests. 13. The restrictions set out in the Agreement shall remain with the property and shall insure to the benefit of an be binding upon the parties hereto (a caveat on the title).									

Source: Serecon Valuation and Agricultural Consulting Inc. (Edmonton). 1995. *Appraising a Conservancy Easement and a Profit-à-Prendre.* Ducks Unlimited Canada. Stonewall, Manitoba.

APPENDIX B

Vermont Housing and Conservation Board
Specifications for Narrative Appraisal Reports
for Valuing Conservation Restrictions

VERMONT HOUSING AND CONSERVATION BOARD SPECIFICATIONS FOR NARRATIVE APPRAISAL REPORTS FOR VALUING CONSERVATION RESTRICTIONS

The Appraisal Process

Standard definitions should be used to explain the appraisal process. The methods that are utilized should be explained and a discussion of why they are being utilized should also be included.

I. Before Value Analysis

The Direct Sales Comparison Approach should be utilized as the primary method in valuing the unencumbered property. The Cost of Development Approach and Income Approach should only be used if they are applicable. A discussion of why they are being utilized should be included. If any secondary approach to value is used, the results should be compared against the Comparable Sales Approach. If values do not closely agree, the reason for the divergence should be explained fully.

Direct Sales Comparison Approach:

a. Comparable sales (lots and acreage) should be summarized including perimeter sketches (include an Addenda).
b. A comparable sales map should be included.
c. Sales should be presented in table or grid form, showing adjustment for times, size, location, appeal, soils, improvements (farm and residential) and circumstance of the transaction that may affect value.
d. Each sale must be discussed in detail in the narrative including such factors as: time, location (desirability, view, etc.), zoning, frontage, topography (including soil type, wetlands and floodplains), utilities, financing, etc.
e. Sales from neighbouring towns may be used if necessary, providing adjustments are made for market characteristics, etc.

II. After Value Analysis

The Highest and Best Use of the property subject to the proposed restrictions should be carefully considered. While agricultural use may often be the highest and best use of the encumbered land, the after value should not be assumed to be synonymous with "Farm Value." A careful discussion of the proposed restrictions should be included in the after value analysis. Make sure that the proposed restrictions including any reserved building rights or access easements are carefully considered as they may affect highest and best use. Again, the Direct Sales Comparable Approach is considered to be the best indicator of value. An Income Approach should be used only as a secondary approach.

Tasks

a. Description of land to be subject to Grant of Development Rights and Conservation Restrictions.
   1. A map showing the land to be encumbered and all lands to be excluded from the Grant of Development Rights and Conservation Restrictions must be included. Any reserved building rights allowed under the proposed Grant of Development Rights and Conservation Restrictions must also be indicated in the appraisal and shown on the map of encumbered land.

b. Direct Sales Comparison
   1. Sales should be legally encumbered with similar easements or adjusted to best reflect the easement to be imposed on the subject property.
   2. Physically restricted properties such as floodplain land should be adjusted including adjustments for soil productivity and any factors associated with the proposed easement on the property which affect value. For example, consider the diminution in value to the property by the 90 Day Right of First Refusal, review and approval of grantee requirements, loss of timber, sand and gravel rights and other mineral rights, etc. should be addressed. Also note any specific conservation practices which may be included in the easement that may affect value.
   3. Enhancement value of abutting land under related ownership and estate value of land to be encumbered shall be considered. Due to limited market transactions involving restricted land, greater adjustments for time and location may have to be made.
   4. Include a discussion of the comparable sales and point out any circumstances that could have an effect on value. All comparable sales should be carefully confirmed with knowledgeable parties. This is especially true of the transaction included the sale of conservation restrictions to the Board or an applicant of the Board.
   5. Consideration of enhancement of reserved lots or adjacent lands under related ownership.
   6. Discussion of "estate" value of farm in the foreseeable future.

c. Certificate of Valuation of Before and After Value and the resultant Value of the Conservation Restriction.

d. Agenda
   a. Comparable sales maps
   b. Photographs of subject and comparable sales
   c. Zoning By-Laws
   d. Wetlands or Flood Plain Map
   e. Site plan sketch if Development Approach is used
   f. Appraiser's qualifications
   g. Limiting conditions
   h. A copy of proposed conservation easement (note reserved building rights).

Source: Brighton, D. and D. J. Cable. 1992. "Taxation of Land Subject to Conservation Easements in Vermont: a Lister's Guide." Appendix B in Unpublished Report available through the Vermont Land Trust. Montpelier, Vermont.

APPENDIX C

Appraisal Examples

APPRAISAL EXAMPLES

The following are a series of examples taken from the law and literature that demonstrate some of the approaches to appraising conservation easements.

Example No. 1: Adjusted Cost Base and Enhancement

1. E owns 10 one-acre lots that are currently woods and parkland. The fair market value of each of E's lots is $15 000 and the basis [equivalent to "adjusted cost base" in Canada] of each lot is $3 000. E grants to the county a perpetual easement for conservation purposes to use and maintain eight of the acres as a public park and to restrict any future development on those eight acres. As a result of the restrictions, the value of the eight acres is reduced to $1 000 an acre. However, by perpetually restricting development on this portion of the land, E has ensured that the two remaining acres will always be bordered by parkland, thus increasing their fair market value to $22 500 each. If the eight acres represented all of E's land, the fair market value of the easement would be $112 000, an amount equal to the fair market value of the land before the granting of the easement (8 X $15 000 = $120 000) minus the fair market value of the encumbered land after the granting of the easement (8 X $1 000 = $8 000). However, because the easement only covered a portion of the taxpayer's contiguous land, the amount of the deduction under section 170 [of the U.S. *Internal Revenue Code*] is reduced to $97 000 ($150 000 minus $53 000), that is, the difference between the fair market value of the entire tract of land before ($150 000) and after ((8 X $1 000) + (2 X $22 500)) the granting of the easement. Since the easement covers a portion of E's land, only the basis of that portion is adjusted. Therefore, the amount of basis allocable to the easement is $22 400 ((8 X $3 000) X ($112 000/$120 000)). Accordingly, the basis of the eight acres encumbered by the easement is reduced to $1 600 ($24 000 - $22 400), or $200 for each acre. The basis of the two remaining acres is not affected by the donation.

From: *Treasury Regulation*, 26 CFR Ch.1, s.1.170A-14 (h)(4), examples 10 and 11 (United States, 1987).

Example No. 2: Before and After Method

2. A 200-acre dairy farm lies eight miles from the heart of an expanding city. Excellent access into the city is provided by an interstate highway that borders the property. The most profitable use (appraisers would define this as its highest and best use) is for sale to a developer for subdivision into small suburban homesites. Comparable homesites of similar land with subdivision potential are selling for $4 000 per acre. Thus the before value of the farm is $800 000 (200 acres X $4 000 per acre). The farmer, in conjunction with a local open space [land] trust, has agreed to convey all subdivision and residential, commercial, and industrial use property rights to the trust. After easement imposition, the land can be used only for farming. Valuation of the remainder property (200 acres with restricted use) is accomplished by comparison with farmland sales of similar agricultural productivity but

little or no subdivisions potential. The appraiser finds similar farm sales about 40 miles farther out from the city — beyond residential commute. These farmlands sell for $2 500 per acre. Thus the after value is $500 000 (200 acres X $2 500 per acre). The conservation easement value (primarily the value of the development rights) is $300 000 ($800 000 — before value, less $500 000 — after value). The apparent $300 000 loss in fair market value reflects a change in the property's highest and best use from subdivision-potential land to agricultural land.

From: Warren Illi, "Appraising Conservation Easements," in: Russell L. Brenneman and Sarah M. Bates, *Land Saving Action* (Covelo, California: Island Press, 1984), at p.206.

Examples No. 3 and 4: Comparison Sales Approach

3. A 10 000-acre Montana cattle ranch has six miles of a famous trout river flowing through it. There is a strong demand for recreational homesites to enjoy the fishing, hunting, and scenic resources of the area. The before value, considering the ranch's subdivision potential, is $500 per acre, or $5 000 000. The proposed conservation easement, covering the entire 10 000-acre ranch, will preclude all subdivision and development except for agricultural purposes. A 1 800-acre cattle ranch in Montana, with a similar easement already encumbering its title, sold in 1977 for $445 000, or $247 per acre. For various reasons, not important to this discussion, that ranch, which sold in 1974 for $525 000, cannot be compared *directly* to the subject. The restrictive conservation easement was placed on it in 1975. Market evidence shows that cattle ranches in that area appreciated at the rate of 15 percent per year between 1974 and 1977. The comparable sale, if unencumbered by an easement, should have appreciated to about $760 000 ($525 000 X 45 percent) by 1977. In addition, $40 000 of capital improvements were added to the property in 1975. Overall the 1 800-acre ranch should have sold for $800 000 in 1977. Instead, with the very restrictive easement on it, it sold for $445 000. That indicates an after value of 56 percent ($445 000 — actual sale price ÷ $800 000 — the projected sale price without easement). This after value indication is then applied to the subject before value.

Before value	$5 000 000
After value (56% X $5 000 000)	2 800 000
Easement value (44%)	$2 200 000

If the appraiser felt there were differences between the subject and sale easements that would influence the after value, the percentages could be adjusted.

From: Warren Illi, "Appraising Conservation Easements," in: Russell L. Brenneman and Sarah M. Bates, *Land Saving Action* (Covelo, California: Island Press, 1984), at p.208.

4. In Stotler, the taxpayers purchased a 1 584-acre property in California's Carmel Valley at a bargain price of $315 000 and, less than two years later, donated a conservation easement on the property. The easement proscribed virtually all commercial and residential development. ... [The appraiser and expert witness] determined that the best use for the

property would be subdivision and development of single-family residences. Applying the comparable sales method, the expert witness compared 22 properties to the taxpayers' property, making adjustments for various factors. One comparable, for example, consisted of 289 acres which was sold for $356 000, or a per acre price of $1 232. The property was subdivided into 23 sites of an average 10 acres which sold from $160 000 to $197 500 each. The appraiser estimated that property to be 25 percent superior to the taxpayers' property with respect to topography, 15 percent superior by frontage access, and five percent superior by development density. Those comparisons led to a "before" valuation of $1 166 000 and an "after" value of only $1 000 000, for an easement value of $1 065 000 — a 91 percent reduction in the property's value. The appraiser also used the cost approach to check the "before" figure by estimating the effect of implementing the development plan.

From: Lonnie Goldman, "Conservation Easement Appraisal Methodologies and Their Acceptance by the Courts," 6(1) *The Back Forty* 1, at p.8, referring to *Stotler v. Commissioner*, T.C. Memo 1987-275 (1987).

Example No. 5: Cost of Development Approach

5. For example, assume a parcel of 30 acres, the highest and best use of which is division into six residential lots of five acres, each potentially selling for a price of $20 000. The gross sale price is $120 000. Assuming subdivision and marketing costs of $20 000, the net income is $100 000, or $50 000 annually if a two-year marketing period is appropriate. Present worth of $50 000 annually for two years, discounted at 20 percent to allow for entrepreneurship profit, is $76 400. If the restriction allowed for subdividing into only two parcels, then it might be determined that both parcels could be sold within one year at $35 000, each with subdivision costs of only $8 000. The present worth of $62 000 discounted at 20 percent for one year is $52 700. The indicated value of the restriction would be the difference between the before and after values ($76 400 less $52 700), or $24 700.

From: Robert E. Suminsby, "Appraising Deductible Restrictions," in: Russell L. Brenneman and Sarah M. Bates, *Land Saving Action* (Covelo, California: Island Press, 1984), at p.199.