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Conservation Easements:
A Closer Look at Federal Tax Policy

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To the Reader

Land trusts and conservation easements are major forces in today's environmental movement. Conservation easements are partial interests in land that prohibit intense development. They have helped conserve millions of acres of valuable open space, wildlife habitat, river corridors, and wetlands.

One factor behind easements has been federal tax policy, which allows landowners who donate easements to obtain tax benefits. This policy has led to criticisms of some trusts for their use of conservation easements. In this essay, "Conservation Easements: A Closer Look at Federal Tax Policy," Dominic P. Parker examines the impact of tax policy on the use of easements and recommends some new ways of thinking about conservation policies.

Dominic Parker is a doctoral student in environmental economics and science at the University of California at Santa Barbara and also serves as a PERC Senior Research Fellow. He has a master's degree in applied economics from Montana State University. In addition to studying conservation easements while at PERC, Parker researched wildlife management, water, and Indian reservation economies. He appreciates the collegial assistance of Walter N. Thurman, PERC senior fellow and professor of agricultural and resource economics at North Carolina State University.

This paper is part of the *PERC Policy Series*, which addresses timely topics involving markets and environmental issues. It is also part of the Dufresne Foundation series of essays, which seek to reconcile environmental and economic pressures, especially in the western United States. PERC, the Property and Environment Research Center, is a nonprofit institute dedicated to improving environmental quality through property rights and markets. Jane S. Shaw edits both series, and Mandy-Scott Bachelier is in charge of design and production. They were assisted by Dianna Rienhart.

"Bipartisan support for conservation easements exists because politicians know that this program works and brings important benefits to communities throughout the country."

—Land Trust Alliance (2005b)

Conservation Easements:
A Closer Look at Federal Tax Policy

Dominic P. Parker

Introduction

In recent years, Americans have addressed issues of sprawl, development, open space, and wildlife conservation through land trusts—nonprofit organizations that conserve open space amenities on private land. From 1984 to 2003, the number of land trusts in the U.S. grew from 535 to 1,537. Over that period, trusts acquired approximately 9.5 million acres in outright ownership or in conservation easements, which are partial interests in land that prohibit dense development.

Land trusts have expanded rather quietly, going about their business of conserving land while enjoying robust support from both the political right and left.[1] Most political conservatives prefer land trusts to traditional government ways of providing open space such as land-use regulations or government land acquisition. And political liberals tend to view land trusts as an effective complement to the more traditional government approaches.

Because of this broad support, federal and state politicians have in recent years extended or added tax benefits to those who donate conservation easements to land trusts.

The widespread support for land trusts may be eroding, however. In 2003, a series of articles in the *Washington Post* took aim at land trusts, focusing especially on the Nature Conservancy, the largest and best-known land trust (Stephens and Ottaway 2003b).[2] But reporters Joe Stephens and David Ottaway also identified conservation easements held by smaller trusts that are being used for tax reduction goals rather than for public benefit. They alleged that some land trusts are serving the interests of land developers who are obtaining "wildly exaggerated" easement appraisals (Stephens and Ottaway 2003a).

In response, Congress is now considering reducing or even eliminating the tax deductibility of conservation easements, without providing trusts with alternative ways to obtain federal funding. This move would be a drastic response to the questionable actions of a small group of rogue land trusts. The vast majority of land trusts are engaged in legitimate conservation, and federal tax benefits have helped them conserve valuable open space amenities for the public. Nevertheless, tax funding under current law does have drawbacks.

This essay accepts as given the public's willingness to assist in funding conservation easement acquisitions, but it takes a closer look at federal tax policy and identifies the shortcomings of this conservation easement funding vehicle. Current tax law allows tax abuse by land developers, and there are more subtle problems as well. Tax laws do not help legitimate land trusts protect contiguous tracts of land nor do the laws help these trusts respond to changing conditions in the future. Tax code funding also puts donating landowners in the driver's seat and weakens the ability (and incentives) of trusts to use taxpayer dollars in ways that best serve the public's interest.

The essay will present two ideas for long-range reform that could help land trusts use taxpayer dollars more effectively. Analysts should begin looking at ways to increase the accountability of land trusts, while also affording them more flexibility to act on behalf of the public beneficiaries of open space.

About Land Trusts

Land trusts are nonprofit organizations that conserve open space amenities on private land, primarily by owning land outright or holding conservation easements. The nation's largest and best known land trust is the Nature Conservancy, but 1,537 smaller trusts operate in state or local regions across the United States (Table 1).

Table 1: Growth of State and Local Land Trusts

Geographic Region	Number of Land Trusts		Acres in Conservation Easements & Fee-Simple	
	1984	2003	1984	2003
Northeast	297	647	178,116	2,505,073
Mid Atlantic	30	120	44,320	746,287
Southeast	29	153	29,971	461,166
Midwest	96	236	60,467	267,977
South Central	9	39	1,253	170,128
Northwest	31	83	59,287	773,336
Southwest	12	71	54,196	995,631
Pacific	31	188	14,013	592,993
United States	**535**	**1,537**	**441,623**	**6,512,597**

Sources: Parker and Thurman (2004a) for 1984 data. Land Trust Alliance (2005a) for 2003 data. These data exclude the Nature Conservancy.

Goals and Financial Resources

The Nature Conservancy has an ambitious goal of preserving the biodiversity of plant and animal communities, but smaller trusts typically have more modest objectives. About one-third of land trusts responding to a recent Land Trust Alliance (2005a) survey said they seek to protect open spaces. This is a broad and somewhat vague term, but an earlier Land Trust Alliance survey identified a number of more specific goals (see Table 2). For example, 55 percent of the surveyed land trusts reported that they conserved wetlands; 38 percent said they conserved rare species habitat; and 33 percent said they provided trails for recreation.

How do land trusts finance their efforts? A few large trusts are able to

Table 2: Amenities Conserved or Provided

Amenity	Percentage of Land Trusts Conserving Amenity
Wetlands	55
Rare Species Habitat	38
River Corridors	45
Scenic Views	42
Trails	33
Greenways	31
Parklands	17
Community Gardens	4

Source: Parker (2005).

raise revenues from land they own.[3] Most land trusts, however, pursue their goals with a mix of private donations and public monies. Land trusts solicit donations of cash, land, and conservation easements. Some gifts come from corporations and individuals who can claim the value of the gifts against their tax burden (as long as the land trust recipient is a qualified public-charity organization). Public monies are also channeled more directly to land trusts through ballot initiatives that authorize levying bonds or increasing property taxes for open space conservation. From 1998 to 2003, nearly 700 referenda were on ballots in the United States and more than 80 percent were approved (Kotchen and Powers 2004).[4]

A set of laws is in place to encourage the fiduciary responsibility of public-charity land trusts. These trusts are governed by an unpaid board of trustees whose members are legally forbidden from enriching themselves with trust lands and easements, which are public assets. Charitable land trusts are legally obligated to provide open space amenities that yield public benefits (see Fairfax and Guenzler 2001).

History and Growth

The first land trust was probably the Massachusetts Trustees of Reservations, formed in 1891. The motivation for the trust was to "establish an organization with a board of trustees that would have 'power to hold lands

free of taxes . . . for the use and the enjoyment of the public'" (Abbott 1982, 150). Organizations with similar purposes, such as the Block Island Land Trust in Rhode Island, created in 1896, and the Society for the Protection of New Hampshire Forests, created in 1901, emerged shortly after. Major growth in the number of land trusts, however, began in the second half of the twentieth century. There were 53 trusts in 1950, 308 in 1975, 887 in 1990, and 1,537 in 2003 (Parker 2004, 489).

Table 1 illustrates the tremendous growth in the acreage held by state and local land trusts from 1984 to 2003. Their holdings in conservation easements and fee simple increased from almost 442,000 acres to 6.5 million acres. These impressive numbers do not include the Nature Conservancy, whose holdings in these categories grew from 792,000 acres in 1984 to approximately 4.3 million acres in 2003.[5]

This growth reflects, at least in part, the increasing affluence of Americans and their growing interest in protecting open spaces from development pressures near urban centers. As our income grows, we are more able and typically more willing to spend money on the preservation of environmental amenities (Yandle, Bhattari, and Vijayagharavan 2004). Increases in our income also increase our demand for houses, restaurants, and shopping malls—land uses that compete with open spaces. Thus, land trusts appear to be emerging to broker deals with landowners and developers on behalf of those willing and able to pay for open space amenities.

This implies that land trusts should be more prevalent in wealthier regions of the country, but other factors drive land trust growth as well. County-level data of land trust acquisitions from 1990 to 2000 show the strongest land trust growth in counties endowed with significant natural amenities, with rapid income growth, and without large-scale federal government land acquisitions in recent years (Parker and Thurman 2004a).

Conservation Easements

Conservation easements are legally binding agreements between landowners and land trusts or government agencies. Typically, they prohibit subdivision and commercial development but permit agriculture

and residential development. Depending on the agreements, conservation easements can prevent landowners from actions such as commercial timber harvest, farming, spraying pesticides, altering water courses, building new fences, and harvesting native plants (see Parker 2003).

The restrictions in conservation easements "run with the land." That is, successor landowners are bound to the terms agreed upon by the original parties. Furthermore, the Internal Revenue Service requires that donated easements for which federal charitable claims are made be held in perpetuity (Mahoney 2002). Perpetual easements cannot easily be extinguished, as discussed later.

Land trusts are acquiring conservation easements at a much faster rate than they are acquiring fee-simple land. In 1984, 22 percent of the Nature Conservancy's acres were held in easements compared with approximately 42 percent in 2003. The change is even more dramatic for the Land Trust Alliance trusts. In 1984, 33 percent of their acres were held in easements compared with 78 percent in 2003 (Parker 2005, tbl. 1).[6]

Whether easements are purchased by land trusts or donated to them, their value is appraised as the difference between the value of the land with the easement (the encumbered value) and without the easement (the full-market value) (Boykin 2000). Consider a tract of farm land that could be sold for $2 million to a developer who intends to build a residential subdivision. If a conservation easement is placed on the land, keeping the land from being developed, and the value of the land in agriculture is estimated at $1.5 million, then the value of the conservation easement is $500,000. While this appraisal methodology is conceptually simple, it can be difficult for appraisers to calculate easement values with a high degree of accuracy.

A conservation easement is an important legal innovation that has helped serve the needs of landowners and of those wanting open space amenities. Easements provide a way for landowners to be compensated for keeping their property but leaving it undeveloped. To land trusts, easements can be more attractive than fee simple ownership because they cost less to acquire and because they provide a way to negotiate with landowners who are unwilling to wholly give up their land. Easements also save trusts the management costs they might incur if they owned land outright.

What accounts for the increasing popularity over time of conservation easements compared with land trust ownership? One contributing factor is the emergence of state laws that explicitly accept or acknowledge easements as legally binding agreements. Another factor is that over time lawyers have developed greater technical expertise in drafting clear easements that are defensible in court (see Parker 2004). Thus, land trusts can now more confidently provide open space amenities for their beneficiaries via easements, and landowners can be more assured of which land uses easements allow and do not allow.

The Issue of Tax Incentives

Tax incentives also contribute to the popularity of conservation easements. Federal income tax deductions for donors of conservation easements received explicit statutory authorization in 1976, and estate tax benefits for easements were expanded in 1997. Many states have begun to offer tax benefits in recent years as well.

Tax Benefits for Landowners

To be eligible for federal income tax benefits, the Internal Revenue Service requires that a donated easement preserve land for one of the following general purposes: outdoor recreation, wildlife habitat, scenic enjoyment, agricultural use, or historical importance.

The extent to which a landowner can obtain tax benefit from an easement depends on income, primarily because the law caps the deduction amount a landowner can claim at 30 percent of his or her adjusted gross income each year for six years. Table 3 uses information provided by McLaughlin (2004) to show the effect of income on the benefits to donors of conservation easements. The table assumes that three landowners of differing incomes donate easements appraised at $500,000. The high-income landowner can deduct $450,000 of the $500,000 value over six years. In contrast, the middle-income landowner can deduct $135,000 of the value,

and the low-income landowner can only deduct $63,000. In the end, the high-income landowner accrues a tax savings of $157,500 (unadjusted for inflation) compared to $36,450 for the middle-income landowner and $9,450 for the low-income landowner.[7]

Whatever their tax bracket, landowners may be able to increase their tax benefits through a phase-in plan. Donating smaller, separate easements over time may allow the donor to increase the number of years in which a charitable deduction can be claimed. McLaughlin (2004) estimates that this strategy could increase the high-income landowner's savings to $175,000, the middle-income landowner's savings to $135,000, and the low-income landowner's savings to $75,000.

An easement donor can also claim the appraised value of the donation against his or her federal tax burden, provided the donor meets the eligibility requirements for income tax deduction. This benefit is only relevant to landowners wanting to pass to heirs estates valued in excess of an exclusion amount (currently at $1.5 million), but it offers significant savings to these landowners' heirs. Donating the easement may allow them to avoid the tax altogether if the value of the land with the easement is less than the exclusion amount. (The tax had a top marginal rate of 48 percent in 2004.) It should be noted that estate tax rules are currently in a period of great flux, so the actual benefits from donating an easement are rapidly changing.

Many states provide additional tax benefits. A number of states offer

TABLE 3: FEDERAL INCOME TAX BENEFITS TO EASEMENT DONORS

	HIGH-INCOME DONOR	MIDDLE-INCOME DONOR	LOW-INCOME DONOR
Adjusted Gross Income	$ 250,000	$ 75,000	$ 35,000
Marginal Income Tax Rate	35%	27%	15%
Charitable Donation	$ 500,000	$ 500,000	$ 500,000
Annual Deduction	$ 75,000	$ 22,500	$10,500
Aggregate Deduction over 6 Years	$ 450,000	$ 135,000	$ 63,000
Aggregate Tax Savings	$ 157,500	$ 36,450	$ 9,450

Source: McLaughlin (2004, 32).

income tax credits. According to McLaughlin (2004, 39) these tend to be "relatively modest" when compared with federal tax benefits. Colorado and Virginia, however, recently enacted generous tax credits that allow donors of easements to sell easement tax credits to other taxpayers. These measures equalize the tax-credit incentive across owners of differing incomes.

A final tax incentive may come in the form of property tax relief. According to a study by Defenders of Wildlife (2002), about seventeen states have statutes requiring local assessors to reduce property value assessments so that they are based on the encumbered, not full market, value of land with a conservation easement.[8]

Under some circumstances, the combined tax benefits to a landowner can be large. This occurs when landowners have sufficient income to offset the entire deduction, hold land that is otherwise ineligible for an estate tax exemption, and live in a state offering attractive tax credit programs. In Colorado and Virginia, it may be possible for some landowners to recoup the entire value of an easement donation through tax breaks (see McLaughlin 2004). That is, their "donations" cost them nothing.

Even in states with less generous tax credits, landowners can come close to recouping the entire value of a donated easement. Parker and Thurman (2004b) show that this can be the case for a high-income landowner nearing retirement in North Carolina. Consider a farm parcel at the edge of a growing city in North Carolina. Assume it is worth $2 million if sold to developers but only $1.2 million if the future use is restricted to farming through a conservation easement. Assume further that the landowner is not eligible for estate tax exclusion, has sufficient income to claim the value of the entire deduction, and is eligible for the state income tax credit in North Carolina. If the landowner's marginal federal tax rate is 33 percent and his or her state income tax rate is 8.25 percent, the landowner can claim tax benefits of $506,000 while also giving an encumbered estate worth $1.2 million to his or her heirs. Alternatively (without donating the easement) the landowner can pass on the unencumbered farm, which will be worth $1.775 million after the heirs pay an estate tax of $225,000. The cost of donating the easement to the landowner is only $69,000 (the $575,000 loss in value minus the $506,000 tax savings). He recoups 88 percent of the value

of his donation through tax savings.

These examples show how inexpensive it can be to donate an easement even when it is accurately appraised. If appraisals are exaggerated, as the *Washington Post* alleges they often are (Stephens and Ottaway 2003a), then some high-income landowners may actually profit by "donating" easements.

The Cost to the Treasury

How many dollars have been forgone by the U.S. and state treasuries through donations of conservation easements? Unfortunately, aggregate estimates are unavailable—so the general public simply does not know how much tax revenue has been given up due to easements financed through the tax code.

An intensive audit conducted by the South Carolina Department of Revenue, however, provides some clues. At a June 8, 2005, hearing before the U.S. Senate Committee on Finance, the director of the Department of Revenue (Maybank 2005) testified that landowners in the state had claimed approximately $290 million in easement donations for the three-year period from 2001 to 2003. He testified that he expects the value of easements granted during the last two years to "easily surpass this amount."

Multiplying the amount claimed per easement acre in South Carolina by the number of easement acres acquired by land trusts nationwide provides a rough estimate of the value of easements claimed from 2001 to 2003. Doing so suggests that the charitable value of claimed donations nationwide was in the neighborhood of $20.7 billion from 2001 to 2003.[9]

It is important to emphasize that this estimate is only a rough approximation for several reasons. It is not clear how closely the amount of charitable donations claimed per acre in South Carolina compares with claims in other states. There may be differences across regions in the proportion of easements that are purchased by land trusts rather than donated, in the full market price of land, and in the prevalence of exaggerated appraisals.

But if we suppose that the $20.7 billion is a reasonable approximation for the 2001 to 2003 period, the next question is: How much of this amount

would have otherwise been paid in taxes? Parker and Thurman's (2004b) hypothetical landowner in North Carolina was able to recoup 88 percent of the value of his or her easement donation in tax savings. If the average landowner could also recoup 88 percent, then easement donations would have cost federal and state treasuries $18.2 billion from 2001 to 2003 (not including any loss of property taxes). This figure is an upper-bound estimate because it assumes that all donating landowners had high incomes and carried a federal estate tax burden.[10] A lower-bound estimate of $5.2 billion assumes that the average landowner could recoup 25 percent of the claimed value through federal and state tax benefits.

Problems with Tax Code Funding

The purpose of this essay is not to examine the extent to which taxpayers are willing to allow others to hold back on tax payments in return for conservation easements that yield public benefits. In order to determine whether the $5.2 billion to $18.2 billion estimate for 2001 to 2003 met this criterion, we would have to know how much people value amenities such as open space, scenery, and biodiversity—amenities that can be difficult to directly price in markets. (We would also need to subtract from this the amount that people were already paying for amenities they value through other markets).

Instead, the purpose is to describe why current tax policies may not provide the most effective means for funding conservation easements. The problems with tax policies range from allowing tax abuses by a small number of unethical land trusts to impeding the effectiveness of legitimate trusts in subtle ways.

"Rogue" Land Trusts

Some conservation easements are being accepted by a handful of "rogue" land trusts that simply provide tax shelters for land developers. These trusts take advantage of the subjective "public benefits" criteria and

the difficulties involved with appraising conservation easements. It can be argued that most land provides for wildlife habitat, scenic enjoyment, agricultural use, or historical importance. Moreover, the degree to which a conservation easement truly reduces the full market value of a parcel is also rather subjective and thus open to abuse.

Appraising easements can be more of an art than a science. When calculating the full market value of the land without the easement, appraisers should account for any preexisting zoning regulations, which might have already reduced the value of the land, and they should provide realistic estimates of the demand for intense development on the land. But these factors may be difficult to assess, and appraisers working on behalf of landowners wanting tax breaks have incentives to overestimate full market value. When calculating the encumbered value, appraisers should take into account the fact that buyers of land value scenery and wildlife and are often willing to pay extra for these amenities, so the value of the land may remain high even with the easement. But these factors are difficult to quantify, and here too appraisers working for landowners wanting tax breaks have incentives to underestimate the encumbered value.

The problem is exacerbated by the fact that land trusts are not held liable by the IRS for erroneous or fraudulent valuations under current law (McLaughlin 2004). Freedom from liability weakens trusts' incentives to encourage reasonable appraisals.

Given the ambiguities in the law and the appraisal process, it is easy to see how opportunistic land developers can profit by setting up rogue land trusts to hold conservation easements. According to expert testimony before the U.S. Senate Committee on Finance (Maybank 2005), some developers are encumbering the fairways of golf courses with conservation easements. Their tax benefits have been significant. The director of the South Carolina Department of Revenue reported that in South Carolina developers claimed at least $125 million in charitable contributions over golf courses between 2001 and 2003. These claims accounted for nearly 50 percent of the claimed value of all easement donations in the state, but are being accepted by only a small number of land trusts.

The golf course scheme seems to violate the spirit of the law, but such

tax abuses would be difficult to prosecute and may not even be illegal. Although golf courses surrounded by housing development do not offer physical or scenic access to the general public (except when they pay to play), it can be argued that they provide good habitat for birds and other animals. And, although this type of development scheme might maximize profits to developers because homes on golf courses demand premium prices (see Limehouse and McCormick 2005), it can be argued that the alternative use of the land is a dense development project that could generate more profits for the land developer.

Regardless of whether a golf course easement is ethical or even legal, it is likely that few taxpayers would choose to direct their money toward these deals. Rogue land trusts breach the public's trust, and the federal tax code gives them a way to do so.

Genuine Land Trusts

The Land Trust Alliance contends that the vast majority of trusts are engaged in legitimate conservation, and there is evidence supporting this contention. Data for all land trusts in the United States suggest that trusts, as a group, act in cost-effective ways (Parker 2005).

Land trusts consider the long-term costs of stewarding easements, and many do not acquire conservation easements when these costs are likely to be high. Parker and Thurman (2004a) show that land trusts are more active in areas of the country endowed with natural amenities. This finding suggests that land trusts generally focus on conserving land with high conservation values, a sign that most trusts are engaged in legitimate work.

Despite the legitimacy of their efforts, land trusts solicit donations of easements from landowners who want tax benefits. This is the institutional system within which they work.

Three factors stemming from this institutional system threaten to impede the cost-effectiveness of land trusts relying on donated easements. These are: the Internal Revenue Service's requirement of perpetuity; the "disconnect" between those who benefit from easements and those who

pay a portion of their cost (federal taxpayers); and tax code funding that does not aid the conservation of contiguous tracts of land.

Perpetuity

Internal Revenue Service rules require that donated conservation easements be held in perpetuity—forever. This requirement is lauded by most environmentalists and land trusts but is inconsistent with centuries of common law, which tends to discourage perpetual constraints on land use (Mahoney 2002). The reason is that restrictions that freeze land use to a landowner's present desires may become antiquated and inefficient over time (Meiners and Yandle 2001).

As economic and ecological conditions change over time, the benefits and costs of conserving different parcels will change. It is doubtful that every conservation easement currently held by land trusts will continue to yield conservation benefits in the face of population growth and migration, changing demands on agricultural land, climate change, and changes in preferences towards the preservation of different wildlife species.

Fortunately, obsolete conservation easements currently held by land trusts need not really last forever. IRS rules allow for extinguishment if a change in conditions makes it "impractical or impossible" for the easement to serve its intended purpose. If an easement is extinguished and sold for development, the proceeds from the sale are to be reinvested in a conservation purpose similar to the one initially intended by the easement. The IRS inserted this provision to safeguard the public's investment in conservation easements (McLaughlin 2005).

These IRS allowances make it less likely that isolated tracts of conservation easement land harboring no valuable amenities will remain enforced for hundreds of years. Even so, the difficulties of transferring land to more productive economic and ecological uses are substantial. Courts will have to determine whether a conservation easement can no longer "practically" or "possibly" fulfill its initial purpose. But courts will be obligated to consider the desires of the easement donor who presumably had strong personal connections to the land. Furthermore, neighboring landowners may lobby

to keep the easement as it is even if public benefits are few and the conservation value of the easement if reinvested elsewhere is substantial. While such neighbors probably do not have formal legal standing, they benefit from adjacent open space and may be able to forestall extinguishment through political means.[11]

In spite of the complex problems posed by perpetuity, most land trusts support it. Land trusts recognize that some landowners donate conservation easements because they want to protect their property forever. This is a key selling point in land trust marketing. "A conservation easement is an agreement that you can make with the Three Valley Conservation Trust to ensure that your land will be protected, according to your wishes, forever," says an Ohio trust on its Web site (Three Valley Conservation Trust 2005). Similar comments on other trust Web sites are easy to find.

Land trusts understand the appeal of perpetuity to potential donors and resist policies that reduce landowners' confidence that their choice of land use will endure. Yet this security—a decidedly private benefit—is paid for with taxpayer dollars, and land trusts accepting donated easements are legally obligated to act on behalf of public beneficiaries. Those beneficiaries could be better served if the trust thought of landowners as suppliers of inputs for environmental protection—a process that can change over time—rather than the primary customers of the trust, which is the role they sometimes must take with tax code funding.

Disconnect

Especially because conservation easements are difficult to extinguish, cost-effective conservation hinges critically on which donated parcels land trusts choose to accept. To be cost-effective conservationists, land trusts should protect only those donated parcels where the expected value of the conservation easement is equal to or greater than the full cost to all taxpayers. Otherwise, taxpayers are not getting their money's worth.

It is, of course, difficult to measure the full benefits and costs of protecting a specific piece of land. So it is unrealistic to expect that land trusts will make perfect economic decisions when choosing whether to accept

donated easements. However, both economic theory and empirical evidence indicate that individuals, businesses, and nonprofits make more prudent environmental decisions when they bear the full costs and can obtain the full benefits of their decisions (see Anderson and Leal 2001). The disconnect problem with respect to land trusts is that they have incentives to pay less attention to the costs to taxpayers generally than to the costs to local beneficiaries (see Parker 2005).

Local trusts want to obtain easements that preserve the scenic beauty or open space in their local areas. The problem is that tax financing gives the trusts incentives to accept conservation easements whenever the benefits to locals outweigh the costs to locals—even if the costs to distant and dispersed taxpayers are high and their benefits low.

Referring to the North Carolina landowner discussed on page 9 helps illustrate the issue. If the easement appraisal is calculated with perfect information, it will cost the landowner $69,000 to donate an easement, and it will cost U.S. and North Carolina taxpayers $506,000 in lost tax revenue. Suppose that the easement provides scenery and a few environmental services worth $200,000 to nearby residents and $100,000 to all other U.S. citizens. (To be sure, quantifying these values is difficult. Using numbers, however, helps to illustrate what can happen when those who benefit most are asked to pay the least). In this simple hypothetical case, a land trust with an effective marketing campaign might be able to collect from nearby residents the $69,000 needed to compensate the landowner. The land trust accepting this donation would be making local beneficiaries better off by $131,000 (their $200,000 valuation minus their $69,000 contribution). Yet the trust would be making society worse off by $275,000.[12] This figure is calculated by subtracting the benefits of the easement to society ($300,000) from the cost ($506,000 + $69,000).

At first glance, the root of the disconnect problem seems to be the vague language in the "public benefits" criteria under current tax law. A way to try to address the problem is to amend tax law to require that easements eligible for federal write-offs be over lands with important ecological and aesthetic features. In contrast to easements that merely provide scenic views for locals, these easements are more likely to provide significant benefits

to the whole of society and therefore to merit a contribution from national taxpayers. However, amending the eligibility criteria would probably do little to fix the disconnect problem in practice. It would be difficult for the IRS to audit a more stringent requirement because aesthetic and ecological qualities are fundamentally difficult to evaluate.

Furthermore, lands with these qualities attract easement donations from wealthy second-home buyers who would not actually develop the land into cookie-cutter homes or shopping malls if they didn't have the easement. Tax benefits for conservation easements provide them with a cheaper way of buying a second home for their personal enjoyment. Land trusts operating as a strategic broker on behalf of national taxpayers would probably not choose to target these lands because the cost to taxpayers would probably not justify the benefit. After all, the open space isn't really threatened. Yet tax code funding gives land trusts incentives to increase the acreage they hold even when the costs to distant and dispersed taxpayers are greater than the benefits.

Landscape Conservation

Land conservation for some purposes is more valuable when parcels of adjacent land can be combined than when land is conserved in isolated pieces. For example, 10,000 acres of contiguous easements typically do more to preserve critical wildlife habitat than 10 isolated easements over 1,000 acre parcels.[13] The case is similar for recreational trails. Trails over small, isolated parcels are virtually useless; connectivity of trails improves recreational experiences.

But if land trusts rely entirely on tax code funding to obtain easements, it may be difficult to provide trails or to conserve habitat for wildlife requiring large tracts of land. They must convince a group of adjacent landowners to donate land, but the motivation of relevant landowners will vary depending on their tax burden, how close they are to retirement, and their personal interest in perpetual conservation. Landowners who do not benefit from tax deductions have a strong incentive to say no.

Land trusts appear to understand these limitations. Data show that

trusts relying exclusively on easement donations are less likely to provide trails than trusts with a budget for purchasing land. Trusts with a purchasing budget can buy connector parcels where needed—they have the advantage of being able to offer landowners cash (see Parker 2005).

It is worth emphasizing that the IRS requirement of perpetuity is the main reason why it is hard for trusts to conserve contiguous parcels through donated easements. Because conservation easements are perpetually nontransferable, land trusts have fixed assets that cannot be easily extinguished and converted into cash to be reinvested in conservation elsewhere. For example, a land trust can rarely sell an existing conservation easement to buy a new easement to connect a gap between hiking trails. Thus, land trusts relying on easement donations are best suited to providing generic open space instead of recreational amenities and large tracts of wildlife habitat.

Promoting Better Land Conservation

The key to successful reform to promote better land conservation is to increase the accountability and transparency of land trusts, while also affording them more flexibility to act on the behalf of public beneficiaries of open space. The Land Trust Alliance has identified a number of reforms. In addition, this essay asks the reader to contemplate some more far-reaching ideas. They may not be feasible now but offer a longer-range view of how conservation might be made more effective.

Tax Code Changes and More Self-Regulation

Federal lawmakers are considering draconian steps—cutting tax benefits by two-thirds for easements that conserve open space amenities and completely eliminating deductions for historic facade easements. These reforms were proposed in a report by the Joint Committee on Taxation (2005). The Land Trust Alliance (LTA) is adamantly opposed. The LTA (2005b) argues that "drastically limiting the deduction for all easements would be like throwing out the baby with [the] bathwater." The alliance

instead proposes a two-pronged approach to reform. First, it endorses more standardization and greater transparency of easement appraisals. It also wants to certify easement appraisers and has requested that the IRS impose stricter penalties for overvalued easements. Second, it wants to use self-regulation tools to ensure that conservation easements are genuinely yielding public benefits; it is developing a new set of Standards and Practices guidelines to which members must adhere.

The reforms proposed by the alliance are a good starting point. There is evidence that self-regulation administered by the alliance is already helping trusts use public dollars more cost-effectively. Members of the LTA that are certified as having complied with its Standards and Practices are more likely to economize on long-run costs when choosing to own land or hold easements (Parker 2005). This is beneficial for the taxpayer, and it implies that requiring LTA accreditation would help discourage tax abuses (Anderson and Christensen 2005).

But these reforms would not ease the challenge that land trusts face in responding to changed conditions and in providing amenities over contiguous parcels. Both of these problems could be mitigated if lawmakers weakened restrictions on perpetuity so that LTA-accredited trusts could sell donated conservation easements back to landowners at the trusts' discretion.

Land trusts should be legally obligated to reinvest the proceeds in land conservation projects, and stiff penalties would have to be applied to land trusts that did not reinvest the money or that charged too little for conservation easement buybacks. Current IRS rules that specify how much money land trusts will receive if courts choose to extinguish an easement already provide a working model. These rules require that the proportional value of the easement to the full market value at the time of a donation serve as a basis for pricing extinguished easements in the future (see McLaughlin 2004).

The upside of relaxing perpetual restrictions on alienation is that it would let LTA-accredited trusts respond to changing conditions to ensure that conservation easements continue to yield conservation benefits over time. The modification would also let land trusts freely accept donations of

lesser conservation value. Because easements would be more liquid, the general public's financial contribution toward the easement could ultimately be reinvested in land that is more aesthetic or ecologically more important.

Allowing land trusts to sell back easements to landowners does not mean that land trusts will actually exercise this option, however. They may still want to attract easement donations from landowners who want to preserve their land in perpetuity. This will be a problem if extinguishing an easement would better serve the public's interest. As long as tax code funding for conservation easements is sustained, this kind of problem may continue. Tax code funding puts donating landowners in the driver's seat, and land trusts operating within this system are likely to continue to appease their donor base.

Competitive Matching Grants

A second solution would require a substantial overhaul of the public funding system, but might hold more promise for more effective land trust conservation. Federal tax code funding for conservation easements could be replaced with an equivalent level of funding through federal competitive grants requiring trusts to raise matching funds from private sources and local governments.

This may seem a radical step, but the potential benefits to the general taxpayer, who is already paying for conservation easements, should be considered. To put the idea into perspective, consider the rough estimate that donated easements reduced government treasuries by between $5.2 billion and $18.2 billion from 2001 through 2003. Could the federal government's share of the actual amount have been used more effectively by channeling the money to trusts through a competitive matching grant program?

To obtain federal funds, trusts would submit proposals to a board patterned after the National Science Foundation, composed of experts in the field of land conservation. The board could approve grants based on predetermined and discretionary criteria. The grant proposals could specify in detail the open space amenities to be conserved by the trust along with estimated acquisition costs. Eligible proposals should be for amenities with

national significance such as wildlife habitat and biodiversity.

These grants would be leveraged with a high percentage of private and local dollars. Ideally, 75 percent or more of the total cost of the conservation easement should be paid by the recipient organization. This would set up a sort of super-majority match rule.[14]

This approach could have several benefits compared to tax code funding. First, it would allocate federal dollars to areas about which there is some consensus that the value of conservation is particularly high. Supporters of the trust would pay the most and therefore guide the decision; proposals would also be evaluated by land conservation experts. This process is in contrast to the current situation where a local landowner who has an interest in donating an easement triggers the process.

Second, once trusts received grant monies, they would have a budget constraint that would encourage them to act as if they bore the full costs of acquiring different parcels. Currently, the source of forgone tax revenue is potentially limitless, as long as the trust can find willing landowners. In contrast, fixed allocations of grant dollars would force trusts to prioritize. The grant approach would encourage trusts to focus on using the funds effectively rather than finding new land donors, whose property might be of low priority.

A third and related advantage is that land trusts would have stronger incentives to oversee the appraisal of easements. Land trusts receiving federal grants would be using money from their own budget to buy easements, so they would be motivated to question appraisals that seem unreasonably high. Today trusts can benefit from high appraisals, which make landowners more willing to donate.

Fourth, trusts would not need to cater to potential donors of easements by offering them perpetual land protection. Grant proposals would be for conservation outcomes, and the most effective means for achieving those outcomes could change over time. Instead of seeking easement donors from a small pool of parties motivated by perpetuity and tax incentives, land trusts would have a public funding source that allowed them to negotiate with a larger pool of potential easement sellers.

To be sure, a competitive grant approach has potential drawbacks.

How could the granting agency ensure that trusts were indeed allocating their dollars toward the proposed plan? What measurable criteria could be established? A process that addresses these issues would be a critical prerequisite to a successful program. Yet the requirement that federal dollars be matched at a high rate by private and local dollars could provide self-enforcing incentives for sustainable, effective conservation. Federal taxpayers would be funding land conservation plans that had proved their merit in private and local markets. And federal taxpayers who currently do not know how much they have spent on conservation easements and what they have received in return could benefit from the monitoring efforts of private and local donors who will have more at stake in making sure that land trust objectives are met.

Conclusion

The land trust movement has expanded rapidly in recent years in part because of the tax benefits now available to conservation easement donors. These tax benefits have helped trusts provide valuable open space amenities for the general public, but they may also discourage more cost-effective conservation. The goal of this paper has been to suggest why changes in tax laws and public funding mechanisms could lead to more effective conservation by land trusts.

Alerted by a *Washington Post* series, federal lawmakers have delved into what are seen as questionable practices by land trusts. These include possible abuses such as placement of conservation easements over golf courses. But the congressional inquiry has gone further, to the point of questioning the entire tax-deductibility of conservation easements.

This is an extreme response. A more appropriate one would be to increase oversight of the easement appraisal process. This does not need to be led by the federal government, however. The Land Trust Alliance has proposed to help administer an accreditation system. It would certify land trusts that want to receive donated conservation easements, and certified land trusts would use accredited appraisers. The alliance would also continue

to train and educate member land trusts on cost-effective ways to steward and enforce conservation easements that it holds.

While these reforms are a good starting point, they fail to address the more subtle but more endemic potential problems related to tax code funding under current law. One source is the perpetual constraint on the transfer of conservation easements. This limits the ability of trusts to respond to dynamic economic and ecological conditions. In addition, it does not help trusts provide amenities such as hiking trails and wildlife habitat over contiguous parcels. Another source of problems is the "disconnect" between federal taxpayers, who pay for conservation easements, and local land trusts. Tax code funding can discourage local trusts from carefully considering whether the benefits of accepting donated easements justify the full costs to all taxpayers.

Reformers of the tax code should consider some more fundamental changes. One would be to relax perpetual requirements by giving land trusts the discretion to sell their easements back to landowners, provided that the trusts reinvest the money in land conservation. The drawback is that irresponsible land trusts could take advantage of this by converting donated easements into cash, but Land Trust Alliance accreditation and self-regulation combined with appropriate IRS rules could weed out imprudent or rogue land trusts.

A more radical alternative would be to replace federal tax code funding with a federal matching grant program. Total funding for the program could be the same as the aggregate decrease in taxes paid by landowners because of easement donations in recent years. Grant funds would be allocated to land trusts on a competitive basis, reflecting evaluations from experts in land conservation. These programs should require a high ratio of private and local dollars to each federal dollar granted.

This method would create an explicit financial budget constraint for land trusts' conservation projects. The current method tends to be largely dependent on the good will and tax liability of donating landowners. In contrast, a trust with a budget to allocate toward achieving a specific goal—a budget enlarged by federal funds if its goals meet the standards of experts and peers—is likely to be more focused and cost-effective.

Land trusts and conservation easements have enjoyed broad political support for good reason and should be applauded. Yet as the number of land trusts grows and as existing conservation easements age, we should carefully consider whether taxpayer dollars can be channeled to land trusts in ways that encourage more effective conservation. It is my view that public funding mechanisms that encourage full accountability and transparency while also providing trusts with flexibility to use their discretion have the best potential.

Notes

1. See Dana and Dana (2002) for a discussion of the bipartisan political support enjoyed by land trusts.

2. The investigation led to a series of reforms initiated by the Nature Conservancy. The reforms are explained by President Steve McCormick in his June 8, 2005, testimony before Congress. See www.nature.org/pressroom/press/press1949.html (visited on August 10, 2005).

3. The Nature Conservancy, for example, owns and operates several nature reserves with overnight lodging for guests. A vacation stay at the Conservancy's spectacular 18,000-acre Pine Butte Swamp Reserve in Northwest Montana offers mountain hiking, horseback riding, and the potential for viewing grizzly bears in their natural habitat. The Conservancy's Web site lists lodging rates at $1,400 per night for adults.

4. Federal and state monies are also channeled to land trusts for the purchase of conservation easements through various programs. Federal programs are relatively small in scale and include the Farm and Ranchland Protection Program and the Forest Legacy Program. State programs vary significantly in terms of funding and focus (see Defenders of Wildlife 2002, American Farmland Trust 2005).

5. These data come from e-mail communication with Christen McGinness, a database administrator at the Nature Conservancy (latest correspondence was on August 9, 2005).

6. These data may differ slightly from figures supplied by the Land Trust

Alliance because they do not include a handful of public agencies that the LTA considers land trusts.

7. This example assumes the landowner is claiming a deduction under the 30 percent limitation rule. Under this rule, landowners claiming an income tax benefit on an easement donation can deduct a maximum of 30 percent of their adjusted gross income in any given year. The donor can use the 30 percent deduction for up to six years or until the value of the charitable donation is used up. Alternatively, landowners have the option to use the property's basis (usually the original purchase price or its inherited value) instead of the appraised fair market value as the unencumbered land value. If the landowner chooses this option, he or she can claim an annual deduction of up to 50 percent of adjusted gross income for a period of six years or until the charitable contribution is used up.

8. Note that the property tax benefit will not provide additional tax relief to agricultural landowners whose land is already assessed below market value through an agricultural "current use" assessment program (see Parker 2005).

9. A more detailed explanation of the extrapolations is available from PERC upon request.

10. The estimates also assume that donating an easement does not change the landowner's interest or ability to take other federal income tax deductions, or to take advantage of federal subsidies and other privileges extended to farmers, which come at taxpayer's expense. If conservation easement tax incentives substitute for other tax-exempt charitable giving, then the calculations may overestimate the cost to taxpayers of easements. If conservation easement tax incentives cause more landowners to stay in farming then otherwise would—and therefore to take advantage of federal farm subsidies—then the calculations may underestimate the cost to taxpayers.

11. McLaughlin (2005) describes the process leading up to a potential extinguishment using the "Audry Farm Easement" example, which is loosely based on a real case reported in the media. In this example, an easement over a farm in a rural area in the Northeast was donated in 1976. By 2005, after the donor had died, the small, isolated parcel of land had been engulfed by

development and was generating few conservation values for the public. If the easement is extinguished and sold to a developer, the land trust holder could use the proceeds to protect tracts of land contiguous to other easements it holds. Although extinguishing the Audry Farm Easement seems appropriate to most, the family of the donor and neighboring homeowners dissent and can perhaps prevent extinguishment.

12. The assumption here is that government agencies would otherwise spend the $275,000 in ways valued by society.

13. In the language of environmental economists and conservation biologists, there are spatial economies of scale in the conservation of wildlife habitat (see Wu and Boggess 1999; Caughley and Gunn 2003).

14. These donations of dollars would themselves be tax-advantaged, but unlike conservation easements such donations of cash are not subject to appraisal abuses and the other problems discussed here.

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