

C08. Commercial Uses in Conservation Easements CLE

Friday, October 18 | 3:30 p.m. - 5 p.m.

Room 305 A/B

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Rally 2019: The National Land Conservation Conference
Raleigh, NC



COMMERCIAL USES IN CONSERVATION EASEMENTS

Land Trust Alliance Rally 2019
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I. History of Commercial Uses in Conservation Easements

- A. Blanket Prohibition on Commercial and Industrial Uses – Why?
- B. Existing Examples of Blanket Prohibitions (*not recommended*)
 - 1. “Agricultural, commercial and industrial uses of the Property are prohibited, except for grazing of livestock as permitted in Section.”
 - 2. “Any commercial or industrial use of, or activity on, the Property is prohibited [including, without limitation, any use of the Property for agricultural uses or commodities for sale or trade, the operation of a commercial winery, the breeding or raising of livestock for commercial purposes, or the operation of an inn, bed and breakfast or any similar lodging entity.”
- C. Limitations of Blanket Prohibitions
 - 1. Changing economic conditions and uses of large properties
 - 2. Inflexibility for stewardship purposes when impacts could be negligible on conservation values
 - 3. Impermissible private benefit or private inurement concerns with amending to permit commercial uses
- D. Existing Examples of Permissive Provisions (*not recommended*)
 - 1. “All public recreation activities as determined within the sole discretion of the City Council of the [City]” (together with a prohibition on “any commercial or industrial use of or activity on the Property.”)
 - 2. “Grantor reserves the right to all non-commercial and commercial recreational uses, including, but not limited to, hunting, skeet, trap, and target shooting, hang gliding, fishing, bird watching, horseback riding, swimming, photography, water recreation, camping, picnicking, education, wildlife viewing, hiking, cycling, rock climbing, and rock collecting. The following are prohibited on the Property: (A) commercial weddings that are attended by more than 500 persons at one time, (B) commercial concerts

that are attended by more than 500 persons at one time, (C) any other commercial activities that are attended by more than 500 persons at one time, and (D) off-road use of motorized vehicles for commercial purposes.”

- E. Limitations of Permissive Provisions or No Prohibition
 - 1. Need an overall qualifier that grantor cannot harm conservation values
 - 2. Limits on scope and intensity of uses may not be considered
 - 3. For-profit purpose of commercial uses threatens overuse and incompatibility with conservation values

II. **Federal Income Tax Charitable Deduction Perpetuity Requirement Overview**¹

- A. In general, a taxpayer may claim a federal income tax deduction for charitable contributions. See *I.R.C. § 170(a)(1)*. In order for a taxpayer to receive a charitable deduction for the contribution of a conservation easement, the donated interest must be a “qualified conservation contribution” and must meet all of the requirements of *I.R.C. § 170(h)*. Under *I.R.C. § 170(h)(1)*, a “qualified conservation contribution” is a:
 - 1. Qualified real property interest,
 - 2. Donated to a qualified organization,
 - 3. Exclusively for conservation purposes.
- B. For a conservation easement to be a qualified real property interest, it must place a restriction, in perpetuity, on the use of the property. See *I.R.C. § 170(h)(2)*. The requirements for a qualified organization are set forth in *I.R.C. § 170(h)(3)*.
- C. *I.R.C. § 170(h)(4)* defines the permitted conservation purposes, including: the preservation of land areas for outdoor recreation; the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; the preservation of open space where preservation is for the scenic enjoyment of the general public; or the preservation of an historically important land area or a certified historic structure. In order to be exclusively for conservation purposes, the conservation purposes of the easement must be protected in perpetuity. See *I.R.C. § 170(h)(5)*.
- D. A conservation easement should be carefully drafted to suit both the conservation purpose of the property and the desires of the donor. Although a conservation easement significantly limits the allowable use of the property, the donor may retain certain rights and allow certain uses on the property. However, any interest in the property retained by the donor must be subject to legally enforceable restrictions that will prevent use that is inconsistent with the purpose of the conservation easement. See *Treas. Reg. § 1.170A-14(g)(1)*.

¹ State Law may have different requirements, and therefore, it is important to address state law as well.

- E. Generally, a deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests. *Treas. Reg. § 1.170A-14(e)(2)*.

III. **I.R.C. § 2031(c)**

- A. Allows an exclusion of up to \$500,000 from the gross estate of a landowner under specific circumstances, when the land is subject to a conservation easement.
- B. Requires that the conservation easement include a restriction that commercial recreational activity be limited to no more than a de minimis use.

IV. **LTA Standards and Practices**

A. **Standard 9: Ensuring Sound Transactions**
Practice 9E: Conservation Easement Drafting

- 1. For every conservation easement,
 - a) Individually tailor it to the specific property;
 - b) Identify the conservation values being protected;
 - c) Allow only uses and permitted rights that are not inconsistent with the conservation purposes and that will not significantly impair the protected conservation values;
 - d) Avoid restrictions and permitted rights that the land trust cannot monitor and enforce; and
 - e) Include all necessary and appropriate provisions to ensure it is legally enforceable.
- 2. Review, on the land trust's own behalf, each potentially tax-deductible conservation easement for consistency with the Treasury Department regulations (U.S.C. § 1.170A-14), especially the conservation purposes test of I.R.C. § 170(h).

V. **Case Law Discussing Commercial Uses**

- A. *Wetlands America Trust, Inc. v. White Cloud Nine Ventures, L.P.*, 782 S.E.2d 131 (Va. 2016)

Conservation easement prohibited constructions of any buildings other than “farm buildings or structures.” The court held that the property owner’s construction of a building to operate a creamery, bakery, tasting room and retail store on the property did not violate the conservation easement. Finding the terms of the easement ambiguous, the court applied the common law rule of “strict construction” where restrictions limit free use of land. Relying on dictionary definitions of agriculture, the court determined that production, preparation and marketing are all components of agriculture and are all consistent with uses of farm buildings. Finally, in reliance on testimony of the landowner’s expert (and discounting the testimony of the holder’s expert), the court found that these uses would result in a de minimis effect on the property’s environment, and the commercial use did not significantly impair the easement’s conservation values.

The Virginia easement statute does not include a “pro-conservation” construction provision. Would result have differed had the easement itself provided for construction in favor of protection of conservation purpose? See also, *United States v. Park*, 536 F.3d 1059 (9th Cir 2008) where the court found that the operation of a dog training and kennel business was permissible as “livestock farming”. The easement permitted livestock farming but no other commercial activities except those that can be conducted from a dwelling.

B. *Windham Land Trust v. Jeffords, et. al.*, 967 A.2d 690 (ME 2009)

Landowners purchased land subject to a conservation easement and wanted to use the land for music festivals, hiking, hay rides, sleigh rides, etc. for paying guests. Whether the conservation easement prohibited money-earning activities was unclear. The easement purpose was protection of ecological features and values of the property, while not limiting the Grantor’s power to use the property for “residential recreational purposes.” The word “commercial” does not appear in the easement and the term “residential recreational purposes” is not defined in the easement. The Court held that the easement as a whole precludes the owners from using the property for the type of income generating purposes proposed.

C. *Merrill v. Saco Valley Land Trust*, ME Sup. Ct. Civil Action, Docket No. RE-16-44, April 29, 2017 (entered on the docket May 1, 2017)

Conservation easement prohibited commercial uses except for foresting or agriculture, including animal husbandry and on-site sale of produce. The purpose of the easement was preservation and protection of natural areas, farmland, open space and wildlife habitat. The landowner desired to sell the property to a non-profit entity for a proposed 120 student ecology and sustainable agriculture boarding school. The land trust determined that “whether the School is nonprofit or not, we believe that a large boarding school type institution is, for all intents and purposes, a commercial use.” The court interpreted “commercial uses” to be those where profit is the chief aim. Since the school would be conducted for education by a non-profit entity, and not with the chief aim of profit, the court determined the use of the property for a boarding school did not violate the conservation easement. This case demonstrates how a restriction on “commercial activity” can have no connection with protection of conservation values.

D. *In re: the Application of Living Word Bible Camp for a Conditional Use Permit and Planned Unit Development Permit in Re: The Final Planned Unit Development Application of Living Word Bible Camp*, MN Ct. App. A14-0464, A14-0481, A14-1224, A14-1225, Apr. 6, 2015

The court ruled that where the conservation easement prohibited commercial development of any kind, the conservation easement did not prohibit the commercial uses that were considered permitted recreational uses by the conservation easement, such as trails for firebreaks, walking, horseback riding and cross country skiing.

VI. **Private Letter Ruling**

A. *PLR 9632003 (1996)*

In this letter ruling, the donor reserved the rights to:

- a) use a “Ranch Area” for commercial uses and educational activities and to construct structures related to those activities without donee approval;
- b) a building envelope for one residence in “Area III” without donee approval; and
- c) relocate the building envelope, but only with donee approval.

This ruling states that the conservation easement provides an adequate means by which the conservation purposes will be protected. “The reserved rights...must have a low level of impact and intrusion on the property,” and the grantee has the right to inspect the property to ensure that the landowner’s use is not inconsistent with the conservation purposes. The ruling also mentions that the donee should consider effects to water quality, the need for additional road construction, and the extent to which the proposed activity would otherwise impair the conservation values. The IRS concluded that the easement is a qualified conservation contribution and is deductible.

VI. **Stewardship Problems for Land Trusts Related to Commercial Uses**

- A. Landowner intent on strict prohibitions for commercial activities
- B. Determining how many cuts is too many
- C. Considering enforceability and interpretation of easement provisions
- D. Considering the long-term obligation to defend easement provisions

VII. **Common Definitions and Ambiguities**

- A. Commercial
- B. Agricultural
- C. Recreational
- D. Bed and Breakfast
- E. Retreats
- F. Weddings
- G. Dude Ranch
- H. Eco lodge
- I. Short-term Rentals

VIII. Sample Provisions

- A. Commercial or Industrial Use. Any commercial or industrial use of, or activity on, the __Easement Area/Property__, except as expressly permitted herein, is generally prohibited. Among those uses and activities specifically prohibited are the construction or operation of a winery or any other processing facilities, the breeding or raising of livestock for commercial purposes, operation of a wedding facility, or the operation of an inn, hotel, bed and breakfast or any similar lodging entity. As used in this Easement, the term “**commercial**” shall mean any use or activity that involves the exchange of cash, goods or services, barter, forgiveness of indebtedness, or any other remuneration in exchange for goods, services, lodging, meals, entertainment in any form, or the right to occupy space over a period of time. Notwithstanding the foregoing, leasing or licensing the Agricultural Zone for commercial Agricultural use and rental of a permitted residence in accordance with applicable federal, state, and local laws, regulations and requirements shall be permitted. Owner shall be required to disclose this Conservation Easement in full in connection with any rental or lease of the Property.

Other commercial uses may be permitted only with prior written Trust permission as provided herein provided that the proposed commercial uses:

1. are compatible with the Purposes of this Easement,
2. are secondary or ancillary to other permitted uses of the Property, and
3. can be reasonably accommodated with only a de minimis adverse impact on conservation values.

Approval or disapproval of other commercial uses is within the discretion of the Trust, not to be unreasonably withheld, and approval may be granted upon conditions that tend to further the Purposes of this Easement.

Nothing in this paragraph shall prevent Owner from developing ecosystem functions on the Property including, but not limited to, carbon sinks, stream bank restoration, biodiversity mitigation, carbon sequestration and wetland and stream mitigation (other than creation of wetlands from historically upland property, such as hillsides or sites with no more than one of the following: current or historical evidence of hydric soils, hydrophytic vegetation, or wetland hydrology), provided that such developments are not in conflict or inconsistent with the conservation purpose of or the restrictions set forth in this Easement and that prior written approval for same shall have been obtained from Trust. The Trust is not responsible for monitoring any such activities for compliance with permit(s) therefore, and Trust has no obligation to enforce said permits. The Trust shall receive a portion of any proceeds from this type of mitigation. The Trusts share shall be determined by multiplying (1) the fair market value of the __Easement Area/Property__ unencumbered by the Easement (minus any increase in value after the date of this grant attributable to improvements) by (2) the ratio of the value of the Easement at the time of this grant to the fair market value of the __Easement Area/Property__, without deduction for the value of the Easement, at the time of this grant. The values at the time of this grant shall be those values used to

calculate the deduction for federal income tax purposes allowable by reason of this grant, pursuant to section 170(h) of the Internal Revenue Code of 1986, as amended.

- B. Commercial or Industrial Use. The establishment and conduct of commercial or industrial uses or the construction, placing, or erection of any signs or billboards is prohibited; provided, however, that ranching, agriculture, the production or processing of food and fiber products as contemplated by the provisions of Exhibit B (Permitted Uses and Practices) and the production of non-commercial solar or other renewable energy to the extent permitted by Exhibit B shall not be considered prohibited commercial or industrial uses. Further provided, however, that Holder shall have the right in its sole discretion to approve the establishment and conduct of non-agricultural commercial and industrial uses or activities that Holder determines in its sole discretion (a) are compatible with the Purposes of this Easement and (b) will not substantially diminish or impair the agricultural productivity of the Property. Notwithstanding the prohibition above on the placing or erecting of signs, Holder, in its sole discretion, may approve signs related to any such commercial or industrial uses approved by Holder provided that the signs, individually or collectively, are consistent with the Purposes of this Easement.
- C. Special Events. Grantor also reserves the right to conduct, or to permit others to conduct, special events on the Property, provided such special events: (i) originate off-site, are restricted to Trails on the Property or otherwise traverse through the Property without encouraging the congregation of participants on the Property; (ii) and provided such special events are specifically approved in the Management Plan or are otherwise approved by Grantee pursuant to Sections 17 (Grantor's Notice) and 18 (Grantee's Approval); and (iii) provided Grantor conducts such special events in a manner that minimizes damage to the Conservation Values and promptly and diligently re-vegetates any disturbed areas with native seed and/or vegetation. Upon approval of a special event, Grantor shall provide to Grantee copies of any permit or other approval issued with respect to the special event. Grantor shall compel any third parties conducting special events to carry commercial general liability insurance, to name Grantee as an additional insured on such insurance policy, and to provide proof of such insurance to Grantor and Grantee prior to the commencement of the special event.
- D. Other Relevant Provisions within the Conservation Easement.
1. General Prohibited Uses preamble 1: Any activity on or use of the Property that is inconsistent with the purpose of this Deed of Easement is prohibited. If Grantor is uncertain whether an activity or use may have an adverse impact upon the Conservation Values that this Deed of Easement is intended to protect, Grantor shall seek the prior written approval of the Trust as set forth in Paragraph.
 2. General Prohibitions, Restrictions and Reserved Rights preamble 2: The Property shall be used in a manner consistent with the terms and conditions of this Easement. Any activity on or use of the Property that is inconsistent with the Purposes of this Easement is prohibited. All uses are prohibited, except for those expressly allowed by this Easement. The Owner reserves

all rights accruing from ownership of the Property, including the right to engage in, or to permit or invite others to engage in, all uses of the Property that are permitted herein or are neither expressly prohibited herein nor inconsistent with the Purposes of this Easement. Without limiting the generality of the foregoing, the following activities and uses are expressly prohibited, expressly permitted, or qualifiedly permitted as set forth in this Easement. If an activity or use is neither expressly permitted nor expressly prohibited, or is not documented in the Baseline Documentation, and is inconsistent with the protection of the Conservation Values, Owner shall seek the prior approval of the Trust as set forth below. Nothing in this Easement relieves the Owner of any obligation or restriction on the use of the Property imposed by federal, state, and local laws, regulations and requirements.

3. Rental of Structures. Notwithstanding the foregoing, rental of a permitted residence in accordance with applicable federal, state, and local laws, regulations and requirements shall be permitted. Owners shall be required to disclose this Conservation Easement in full in connection with any rental or lease of the Property.
4. Home Occupations. So long as otherwise consistent with the conservation purposes and Conservation Values of this Easement, those persons lawfully residing on the Property may engage in “home occupations” conducted in accordance with applicable federal, state, and local laws, regulations and requirements.
5. Agricultural Use Permitted. Owners retain the right to use the Property for commercial agricultural purposes, including the Agricultural Uses described below, or to permit others to use the Property for commercial agricultural purposes, in accordance with applicable federal, state, and local laws, regulations and requirements as long as the agricultural productive capacity and open space character of the Property are not thereby significantly impaired. **“Agricultural Uses”** shall mean the commercial production, processing, storage or retail marketing of crops, livestock, and livestock products.
6. Extinguishment clause (relevant portion): Both Granting Owner and Trust intend that any changes, including but not limited to economics, climate change, or governmental zoning or policy, should not be assumed to be circumstances justifying the termination or extinguishment of this Easement. In addition, the inability to carry on any or all of the permitted uses, or the unprofitability of doing so, shall not impair the validity of this Easement or be considered grounds for its termination or extinguishment.

IX. **Operations Plans to Provide Limits for Permitted Commercial Uses**

A. Components of a Plan

1. Description of existing and proposed uses
2. Limitations on uses in number and scope
3. Reporting and monitoring requirements
4. Annual review

X. **Discussion or Questions?**