Article Summary:

DCS guidance on drafting conservation restrictions; in particular subordinations and proportional value sections.

As Division of Conservation Services has been reviewing 2009 end-of-year Conservation Restrictions (IRS deduction CRs), we have noticed a couple of things that we want to share with interested parties.

1. Subordinations to CRs

All Conservation Restrictions (as with any lien or grant of a portion of the property) require a subordination from any lienholder, such as a bank mortgage, line of credit, etc. An assent is not sufficient; the lienholder must actually subordinate their interest in the property to the CR. This is also required by the Internal Revenue Service – a deduction for a CR will be disallowed if all liens are not subordinate to the CR. Without a subordination, a lienholder can foreclose on the property, which would not be subject to the CR because it would be wiped out by the foreclosure, if the lienholder did not subordinate their lien to the CR.

(Note: Subordination to a Conservation Restriction is a separate legal document which makes the Conservation Restriction superior to the claim of the lienholder, so that the Conservation Restriction will not be extinguished in the event of a foreclosure of the lien.)

2. Proportional Value

When drafting the proportional values section of a CR, particularly if the CR is for a tax deduction, using a provision that the proportional value as of the date of the CR will be used in the event of a future disposition or eminent domain taking is not sufficient. Who, in 100 years, would be able to reconstruct the 2009 property values to make that determination? Since the grantor is obtaining an appraisal establishing the relative values at the time of the gift, which is required by the IRS, that is what should be used, and the proportional values established by the appraisal should be inserted into the CR (based on the appraisal) at the time of the grant.

Some people use a provision that says the proportional value will be determined based on the deduction for the federal income tax. That is not acceptable. The IRS standard is the fair market value, as established by the appraisal. Should the

owner not have sufficient tax liability to take full advantage of the deduction (and how will anyone know what that figure was?), or if the IRS challenges the appraised value, how will anyone know in 100 years what the final value was? The value is established as of the date of the gift, based on the appraisal, which establishes the ratio of value of the CR to value of the property unencumbered, and that figure should go into the CR at the time of the gift.

If it is not a tax deduction CR, then there is probably not an appraisal, the figures aren't readily available, so the language should probably just say the proportional values, but not limited to the time of the gift - rather, at the time of the taking or disposition, when the values can be readily determined (or the parties can always agree upon the proportional values at the time of the gift and just put those percentages into the CR). Doing so now will save a lot of potential problems, litigation, and the costs of "dueling appraisals and dueling experts" later.

Sincerely,

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