

## ***Form 990 Policy Series***

The attached Memorandum is a part of the *Form 990 Policy Series*, developed by a group of lawyers, all members of the California bar and practicing nonprofit law (the “Form 990 Policy Series Group”). The *Form 990 Policy Series* includes Memoranda containing rationales and procedures for legal counsel to use in advising their clients on drafting and adopting appropriate policies responding to the new Form 990 as well as form policies and/or questionnaires.

The members of the Form 990 Policy Series Group with respect to the attached Memorandum (posted July, 2011) were as follows: Joel S. Corwin, Co-Chair; Barbara Rosen, Co-Chair; Elizabeth Bluestein; Lani Meanley Collins; the late Gerald A. Laster; Henry Lesser; Nancy McGlamery; Louis Michelson; Joy P. Paeske; Alicia Plerhoples; Lisa A. Runquist; Robert Siemer; Myron Steeves; Patrick Sternal; and Martin J. Trupiano. The views expressed in the Memoranda do not necessarily reflect the views of the law firms or employers at which these lawyers practice or any individual member of the Group.

The date at the top of the attached Memorandum is the date that the Memorandum was finalized, and the Memorandum may not reflect changes in law or practice since that date.

**FORM 990 POLICY SERIES  
MEMORANDUM**

**Re: Conservation Easement Policy  
Form 990, Schedule D, Part II (Form 990 Policy Series Memo # 7)**

**Date: January 25, 2010**

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**NOTE ON THE SCOPE OF THIS MATERIAL**

This material is designed to provide general guidance about an aspect of nonprofit corporate governance in the specific and limited context of the governance questions contained in the new IRS Form 990 (published by the IRS in 2008 and applicable to 990 filers based on a 2009-2011 filing year phase-in period depending on the size of the nonprofit). It is intended to provide some general guidance on the establishment of processes and/or policies to address a specific governance question in the Form. The subject matter of that question implicates a broad array of legal and practical issues ranging far beyond the immediate subject matter of the question itself. This material may address some of those issues but does NOT attempt to review them comprehensively and is NOT intended to be relied on for guidance on how they should be addressed in any specific situation.

Whether or not a nonprofit organization adopts a specific governance process or policy (or modifies an existing one), either in response to the disclosure requirements of the new IRS Form 990 or to change its governance practices for other reasons is a matter to be carefully considered by that organization, with input from its board and advisors and evaluation of its specific circumstances. The IRS has explicitly stated that adoption of the policies and practices about which the new Form 990 asks is not mandatory, although the IRS has also indicated that it attaches significance to the manner in which all tax-exempt nonprofit organizations govern themselves. The inclusion of a sample policy in this material is not intended to suggest that the policy is appropriate for every nonprofit organization nor that, if a policy on that topic is determined to be appropriate, the formulation in the sample necessarily fits the needs of an individual nonprofit organization. A customized approach, with outside professional advice, is recommended. Accordingly, this material is intended as general information for legal practitioners advising nonprofit organizations as to their governance and does not constitute legal advice for any particular nonprofit organization.

Although the subject matter of this material may have relevance to nonprofit organizations that are not required to file informational tax returns with the IRS or are permitted to file on an IRS form other than Form 990, the focus of this material is 990 filers. While this material is meant to apply to Form 990 filers who are exempt under Section 501(c) of the Internal Revenue Code, certain portions of this material may be applicable only to Section 501(c)(3) organizations. In addition, although this material may be of assistance with respect to nonprofit organizations that are not subject to oversight under California law, there may be portions of this material that are relevant only to nonprofits organized under, or (by reason of their California-related activities) otherwise subject to, California law and, except as specifically discussed in this material, the laws of other States are not addressed.

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**1. Summary**

The new IRS Form 990 (published by the IRS in 2008 and applicable to 990 filers based on a 2009-2011 filing year phase-in period depending on the size of the nonprofit) substantially expands the information requested from organizations which receive or hold conservation easements, including easements to preserve open space, the environment, historic land areas, or historic structures. Schedule D, Part II seeks detailed information regarding the conservation easements held by the organization, including whether the organization has a written policy regarding the periodic monitoring, inspection,

violations, and enforcement of the conservation easements it holds. See Line 5, Part II, Schedule D. Schedule M, Part I, Lines 13 and 14 seek detailed information regarding the receipt by the organization of conservation easement contributions.

This Memorandum is intended to provide general guidance for the consideration and adoption of a conservation easement policy. It is more important than ever that conservation easement recipients adopt a conservation easement policy to assure compliance by the holder or recipients of conservation easements with the monitoring, inspection, violations and enforcement terms of the conservation easement.

## **2. Rationale for Adoption of the Policy**

For public charities and government entities which seek or are prepared to accept donations of conservation easements to preserve open space, the environment, historic land areas, or historic structures, compliance with the various laws including federal and state tax laws applicable to such transactions should be of paramount importance.

As a result of a large number of abusive transactions, the IRS began an initiative in 2004 to identify and disallow transactions which were abusive. From the beginning of this effort, the IRS has sought the cooperation of the organizations receiving donations of conservation easements and, with the overhaul of the Form 990 for tax year 2008 and later years, it greatly expanded the required amount of information reporting on conservation easements. Such heightened reporting requirements increase the risk that an organization's inadequate (let alone improper) receipt or oversight of a conservation easement may run afoul of tax law requirements. The adoption of a conservation easement policy will help to reduce or eliminate that risk.

## **3. Background of Requirements/Sources for the Policy**

Federal law governs the tax deductible contribution of a conservation easement. California law also provides for the conveyance of conservation easements.

### **A. Internal Revenue Code**

In brief, Section 170(h)(1) of the Internal Revenue Code (26 U.S.C. § 170(h)) requires that a *qualified conservation contribution* of a conservation easement must be of a *qualified real property interest, exclusively for conservation purposes* to a *qualified organization*.

Section 170(h)(2) defines a *qualified real property interest* as the contribution of any of the following interests in real property:

- (A) The entire interest of the donor;
- (B) A remainder interest; or

(C) A restriction [such as an easement], granted in perpetuity, on the use which may be made of the real property.

Section 170(h)(4)(A)-(C) defines *conservation purpose* as:

(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, plants, or similar ecosystems,

(iii) The preservation of open space (including farmland and forest land) where such preservation is for

(I) the scenic enjoyment of the general public, or

(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 a certified historic structure, or buildings in registered historic districts.

Section 170(h)(3) defines a *qualified organization* as a public charity, a supporting organization, or a governmental unit.

Of particular relevance to the subject of this Memorandum is Section 170(h)(5) which states that a contribution shall not be treated as *exclusively* for conservation purposes unless the conservation purpose is *protected in perpetuity*. As explained in the related regulations, any interest in the property retained by the donor must be subject to legally enforceable restrictions that will prevent uses of the retained interest inconsistent with the conservation purposes of the donation. See Reg. § 1.170A-14(g).

## **B. Form 990**

In an effort to increase compliance with the terms of the conservation easements which justify the charitable deduction, the new Form 990 includes Question 5 in Part II of Schedule D. It asks whether the organization has a written policy regarding the periodic monitoring, inspection, violations, and enforcement of the conservation easements it holds. If the response is “yes,” the related instructions for Schedule D request the organization to provide a brief summary of the policy and to indicate whether the policy is reflected in the organization’s easement documents by including that information in Part XIV, Supplemental Information of Schedule D.

The instructions for Schedule D also provide specific definitions for the terms *monitoring*, *inspection* and *enforcement*. *Monitoring* means the organization investigates the use or condition of the real property restricted by the easement to

determine if the property owner is adhering to the restrictions imposed by the terms of the easement to ensure the conservation purpose of the easement is being achieved. **Inspection** means an onsite visit to observe the property to carry out a monitoring purpose. **Enforcement** of an easement means action taken by the organization after it discovers a violation to compel a property owner to adhere to the terms of the conservation easement. Such activities may include communications with the property owner explaining his or her obligations with respect to the easement, arbitration, or litigation.

### **C. California Law**

Under California Civil Code §§ 815-816, California provides for the conveyance of conservation easements.

Section 815.1 defines a “conservation easement” as follows:

For the purposes of this chapter, "conservation easement" means any limitation in a deed, will, or other instrument in the form of an easement, restriction, covenant, or condition, which is or has been executed by or on behalf of the owner of the land subject to such easement and is binding upon successive owners of such land, and the purpose of which is to retain land predominantly in its natural, scenic, historical, agricultural, forested, or open-space condition.

Civil Code § 815.3 defines the organizations that may acquire and hold conservation easements, as follows:

(a) A tax-exempt nonprofit organization qualified under Section 501(c)(3) of the Internal Revenue Code and qualified to do business in this state which has as its primary purpose the preservation, protection, or enhancement of land in its natural, scenic, historical, agricultural, forested, or open-space condition or use.

(b) The state or any city, county, city and county, district, or other state or local governmental entity, if otherwise authorized to acquire and hold title to real property and if the conservation easement is voluntarily conveyed. No local governmental entity may condition the issuance of an entitlement for use on the applicant's granting of a conservation easement pursuant to this chapter.

(c) A federally recognized California Native American tribe or a nonfederally recognized California Native American tribe that is on the contact list maintained by the Native American Heritage Commission to protect a California Native American prehistoric, archaeological, cultural, spiritual, or ceremonial place, if the conservation easement is voluntarily conveyed.

Like the federal statute, California law requires the easement to be “perpetual in duration.” Civil Code § 815.2(b).

The provisions of the Internal Revenue Code cited in subsection A., above, are incorporated by reference in Section 17201(a), California Revenue and Taxation Code. Thus, the provisions quoted in subsection A., above, from the Internal Revenue Code also apply under California law.

#### **4. Considerations and Procedures for Implementation of the Policy**

**A.** Because of the past abuses of conservation easements to create unjustified charitable deductions, both the IRS and the Franchise Tax Board scrutinize conservation easement transactions, examining tax law compliance by both the donor and the donee. Given this heightened state of scrutiny, a conservation easement policy should assure that any prospective contribution of a conservation easement be reviewed by experienced counsel to assure its compliance with applicable federal and California tax laws, as well as applicable real estate, environmental, and other laws and regulations.

**B.** As a threshold issue, a determination should be made whether the organization may accept a conservation easement under federal tax law. Section 170(h) identifies four specific types of organizations which are deemed “qualified organizations” and able to accept contributions of conservation easements. They are governmental units described in section 170(b)(1)(A)(v) and organizations described in section 170(b)(1)(A)(vi); organizations described in section 501(c)(3) that meet the public support test of section 509(a)(2); and charitable organizations described in section 501(c)(3) that meet the requirements of section 509(a)(3) and are controlled by an organization described in section 509(c)(1)(i), (ii) or (iii). If the organization is a “qualified organization,” a suitable conservation easement policy may then be prepared; if not, it may be prudent for the organization to adopt or amend its gift acceptance policy to state that it is not qualified to accept the federal tax deductible contribution of conservation easements.

Similarly, a determination should be made whether the organization may accept a conservation easement under California law. Such organizations are limited to the following: a tax-exempt nonprofit organization qualified under Section 501(c)(3) of the Internal Revenue Code and qualified to do business in California which has as its primary purpose the preservation, protection, or enhancement of land in its natural, scenic, historical, agricultural, forested, or open-space condition or use; a state or any city, county, city and county, district, or other state or local governmental entity, if otherwise authorized to acquire and hold title to real property and if the conservation easement is voluntarily conveyed; or a federally recognized California Native American tribe or a nonfederally recognized California Native American tribe that is on the contact list maintained by the Native American Heritage Commission to protect a California Native American prehistoric, archaeological, cultural, spiritual, or ceremonial place, if the conservation easement is voluntarily conveyed.

C. A conservation easement policy should recognize the substantive differences between federal and California law in this area so that, if the property is located in California, the donor and donee are fully apprised of the impact such differences may have upon them at an early stage in the donation process.

D. Given the federal and California requirement that the donation be “perpetual,” donee organizations should develop a policy and maintain suitable budgets to monitor, inspect and enforce the terms of the conservation easement.

E. A conservation easement policy should be carefully explained to and adopted by the Board of Directors or other governing body (recommended), by the members of a membership organization, or both. Prior to adoption, it should be determined where the policy should be placed in the organization’s documentation. Locations may include, for example, in the bylaws, in a board policies and procedures manual or as a stand-alone item. In every case, the policy must be disseminated to all affected constituencies such as, for example, employees, directors, members and volunteers. Finally, the client should be cautioned that the organization should only adopt policies which it is confident it can follow. It may be worse to adopt a policy which is not followed than to have no policy at all.

## 5. Sample Policy

### CONSERVATION EASEMENT POLICY

#### I. Purpose of the Policy

To assure compliance with federal tax laws that govern the contribution of conservation easements, the [name of organization] adopts this policy to govern its acceptance, monitoring, inspection, violations, and enforcement of conservation easements.

#### II. Acceptance of a Conservation Easement

Prior to the acceptance of the contribution of a conservation easement to [name of organization], the proposed contribution shall be reviewed with attorneys experienced in such matters to confirm that it satisfies the requirements for a tax-deductible conservation contribution, including:

A. The conservation purpose of the contribution is consistent with the purposes of [name of organization] and the organization is committed to protecting the conservation purposes.

B. The [name of organization] has sufficient resources to enforce the restrictions on the property for conservation purposes.

C. The real property interest being contributed is the entire interest of the donor, a remainder interest, or a restriction, such as an easement, granted in perpetuity, on the use which may be made of the real property.

D. The contribution is for conservation purposes including [the organization may include only those conservation purposes for which it is prepared to accept a contribution] (1) the preservation of land areas for outdoor recreation by, or the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, plants, or similar ecosystems; (3) the preservation of open space (including farmland and forest land) where such preservation is for the scenic enjoyment of the general public, or pursuant to a clearly delineated Federal, State, or local governmental conservation policy and will yield a significant public benefit; or (4) the preservation of an historically important land area, or a certified historic structure, or buildings in registered historic districts.

E. The terms of the conservation easement shall include the provisions of this policy regarding monitoring, inspecting, and enforcing the conservation easement.

F. The contribution for conservation purposes is protected in perpetuity.

### **III. Monitoring and Enforcement of the Conservation Easement**

The [name of organization] shall take reasonable steps to monitor compliance with the restrictions placed on the property by the conservation easement.

A. It shall investigate the use or condition of the real property at appropriate intervals to determine if the property owner is adhering to the restrictions imposed by the terms of the easement to ensure the conservation purpose of the easement is being achieved. Such investigation shall include appropriate on-site visits to observe the property.

B. When a violation of the conservation easement is discovered, the organization shall take steps to enforce the terms of the conservation easement including but not limited to communications with the property owner explaining the obligation to comply with the terms of the easement and demanding compliance; mediation; arbitration or litigation.