

Golf, Real Estate & Club Tax Planning

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Conservation Easements for Golf Courses - Fact or Fantasy

As a presenter at several nationally sponsored golf related conferences and as a tax practitioner for over 30 years, I have recently become aware of a new phenomenon – promoters presenting fantastic tax benefits for golf course owners to place a “conservation easement” on the golf course. It’s a great story – presentations have indicated that it is “blessed and approved” by the IRS, “many golf courses may qualify”, and “we haven’t experienced a single adjustment by the IRS”. The presentations may include a “tax-exempt entity” that would be the recipient of the easement and all legal and appraisal documents prepared on a turnkey basis. Finally, values of the charitable contribution are presented in the millions of dollars. Sound too good to be true? Perhaps, in full or in the specific amount of the contribution deduction.

Let’s step back and look at the realities involved. A charitable contribution for a conservation easement is available if the easement meets the requirements of IRC Section 170(h). Second, the amount of the charitable deduction must be determined under “fair market value” principles. But first, what is a conservation easement in general? From Preserving Family Lands by Stephen J. Small, a conservation easement is “.....a restriction on the use of your property. It is a recorded deed restriction, and the right to enforce the restriction is given to a tax-exempt charitable organization (generally in the conservation field) or a governmental agency.” The event requires a legal, enforceable restriction that truly provides a “restriction” on its use or future development. The charitable contribution deduction under Section 170(h) was originally enacted in 1980 and has been utilized by many family land owners that want to protect their land from future development or want to preserve ownership of land in “the family” without a tremendous estate tax liability as a result of the future development value. The easement process allows the owner to specify and even design the limitations placed on the property without giving up legal title to the property. It is a common transaction that has been implemented and generally “accepted” by the IRS over the years, subject to the ever-challengeable fair market value issue.

Statutory Requirements

The easement must be a contribution of: (1) a qualified real property interest, (2) to a qualified organization, and (3) be exclusively for conservation purposes. Let’s walk through each of the rules. First, to meet the qualified real property interest, an easement must be a “perpetual conservation restriction”. Thus, it must be forever – a very significant factor to consider. Secondly, a “qualified organization” can generally be either a governmental unit or a charitable organization that *also* meets a public support test, a so-called “public charity”. This is important as I have become aware of certain entities accepting such easements that are clearly a “501(c)(3)” tax-exempt organization but may, or may not, meet the public support test. Generally you can rely upon published IRS lists, however a contribution of a significant value to an organization may require additional due diligence. In addition, the organization must have the commitment to protect the conservation purposes of the donation, and have the resources to enforce the restrictions.

Finally, “exclusively for conservation purposes” can be met by meeting any one (or preferably more) of the following purposes:

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- 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, or plants, or similar ecosystem,
- 3) The preservation of *open space* (including farmland or forest land), or
- 4) The preservation of a historically important land area or a certified historic structure.

This is an area that is not well settled with respect to the golf course industry. Let's first focus on items 1 and 3 of the above qualified conservation purposes. First, *outdoor recreation by, or the education of, the general public*. This has not been considered in any IRS pronouncement or court case to date for a golf course. A simplistic view could argue that a daily fee or "public" golf course could qualify *if* the easement required the property to be preserved as a daily fee golf course or otherwise revert to its natural habitat as open space – a very significant economic matter to consider by the owner. The Treasury Regulations provide that, for example, this could include the preservation of a water area for the use of the public for boating or fishing, or a nature or hiking trail for the use of the public. Query – does a daily fee golf course qualify under this criteria if it is a "high end" golf course, i.e. \$100-plus cost per round? This pricing may be hard to be presented as available to the "general public" using the regulations examples above. On the other hand, a daily fee golf course that is competitive to a municipal golf course pricing may meet this objective. The Treasury Regulations provide that access must be available for the substantial and regular use of the general public. It is a factual matter that must be addressed on a case-by-case basis.

The preservation of open space is the typical conservation purpose identified by promoters of the golf course conservation easement. It sounds very appropriate. A golf course is "open space" per se. However, the Treasury Regulations have several requirements. Preservation as open space must be (a) pursuant to a clearly delineated Federal, state, or local government conservation policy and will yield a significant public benefit, or (b) for the scenic enjoyment of the general public *and* will yield a significant public benefit. This sounds good, but the regulations go further. "Scenic enjoyment" will be evaluated by considering all pertinent facts and circumstances to the contribution. This is followed by eight (8) enumerated items including: compatibility with other land in the vicinity, the degree of contrast provided, openness of the land, relief from urban closeness, harmonious variety of shapes and textures, the degree to which the land use maintains the scale and character of the urban landscape to preserve open space, and consistency of the proposed scenic view with a regional or local landscape inventory. Finally, the regulations provide that access by the public is not required as visual (rather than physical) access to or across the property by the general public is sufficient, "*although the public benefit from the donation may be insufficient to qualify for a deduction if only a small portion of the property is visible to the public*".

The regulations provide additional factors to consider in determining whether a "significant public benefit" is present. Eleven (11) factors are enumerated. These include: the uniqueness of the property to the area; the intensity of land development in the area; the consistency of the proposed open space use with public programs; the consistency of the open space with existing private conservation programs; the likelihood that development of the property would lead to or

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contribute to degradation of the scenic, natural, or historical character of the area; *the opportunity for the general public to use the property or appreciate its scenic values*; the importance of the property in preserving a resource that attracts tourism or commerce to the area; the likelihood that the donee will acquire equally desirable substitute property or rights; the cost of enforcing the terms of the conservation restriction; and the consistency of the proposed open space with a legislatively mandated program identifying particular parcels of land for future protection.

Recently constructed, or to be constructed golf courses, may have one additional obstacle to overcome. Many federal and state conservation policies and regulations specifically provide that the development of existing “open space” to a golf course or purchase of a golf course is not a qualified use of conservation funds. It can be pointed out that farmland is likewise property that has been developed and altered from its original state. However, this was clearly intended to qualify as “open space” by its inclusion in the statutory language.

Golf Course Examples Reflecting the Application of Statutory Requirements

Examples of golf course easements are available. The Forest Preserve District of DuPage County wanted to buy Klein Creek Golf Course outside of Chicago to link two forest preserves next to the site with a bike trail. But the owner wanted to keep the land. So the district asked CorLands, an affiliate of Open Lands, one of the oldest conservation organizations in the country, to assist with the project. CorLands prepared and accepted a conservation easement that enabled the owner to keep the property. Meanwhile, the district gained the desired trail link and the assurance that the land would permanently remain open space. The conservation easement prohibits future development and retention as open space by reverting to its natural state if it is no longer operated as a golf course. This appears to clearly meet many of the open space requirement of the regulations, is viewable by the general public and was even supported by local government conservation policy. Conservation organizations likewise consider true conservation principles. As stated by Joe Roth, director of special programs at CorLands, in their newsletter “In considering easement donations, we assess both the property’s natural amenities and its proximity to other open spaces. With Klein Creek, we accepted the easement because of the golf course’s key location. Maintaining the golf course as open space provides an important buffer for the adjacent forest preserve and trail”.

Another example is The Merit Club in Libertyville, Ill. An easement was granted in 1993 to CorLands that covers the 319-acre golf course property, excluding the clubhouse and parking lot. Part of the 2,000-acre Liberty Prairie Reserve, The Merit Club’s rolling topography features 75 acres of restored prairie meadow, 30 acres of wetlands, 30 acres of oak and hickory savanna and a two-acre tree nursery. These natural features attract an abundance of wildlife and thousands of birds. Key factors conservation factors include the location as part of the Liberty Prairie Reserve, open space, and the unique ecological topography.

Existing, older golf courses may have specific factors that meet more than one requirement of the regulations. The Ponce deLeon Golf Course in St. Augustine, Florida may be another example of a golf course that may meet various conservation purposes including the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem and the preservation of a historically important land area. The Ponce is located on a strip of land between Route 1 and

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Reynolds' Creek, a part of the Intercoastal Canal. In 1915, the Florida East Coast Railway Company, the business of John D. Rockefeller's partner Henry Flagler, commissioned Donald J. Ross to design and build two golf courses in St. Augustine to be used by the members of the St. Augustine Links Club as well as the guests of the Ponce deLeon Hotel, which was owned by the railway. The St. Augustine Links South was designed but never built. The St. Augustine North course was built in 1915 and opened for business in 1916. It is the home of the oldest Golf Club in the State of Florida and is in fact the oldest or second oldest course in the State. Five of the holes on the front side of the course are snug to Reynolds' Creek, giving the players an unobstructed view of the Intercoastal and the marshes that surround it. As a matter of fact the view is open on eleven of the eighteen holes. The view of the Intercoastal is also available directly from Route 1 by the general public. From an ecological perspective, the property lies along the marsh and contains numerous tidal wetlands. It contains a coastal hammock of many thousands of trees including hundreds of mature majestic oak trees, red southern cedar, magnolia, pines, and palms. This hammock is habitat for hundreds of species of birds such as wood storks, eagles, blue herons, roseate spoonbills, ibis, egrets, and a variety of migratory ducks. Raccoons, foxes, deer, alligators are some of the animals seen. The estuaries are the home and breeding area for shrimp, mullet, and redfish, to mention a few. Manatees have also been found there. All of these ecological structures have become further established during the 90-year history of the golf course. A change in the use of this property, even a well-intentioned "ecological sensitive" real estate development, may bring risk to the existing ecological structure.

A developer has acquired the Ponce, along with hundreds of adjacent acres of undeveloped property, with plans in various stages of approval to develop all the acreage, including the golf course, into a residential development. Several public and private groups are trying to preserve The Ponce due to its place in history, Donald Ross heritage, potential ecological implications of a change in the use of the property, and the open space that it represents. A conservation easement could be a critical piece of this process and would appear to clearly meet several criteria of the regulations. The charitable contribution deduction for a conservation easement may provide the developer with a portion of monetary incentive to modify his plans

These good examples need to be contrasted with the many traditional golf course facts. Private golf courses in gated communities, for example, have several factors that may not be consistent with the statutory requirements. It is "developed" property and it is not specifically delineated by the statute as farmland is. The general public may have limited or no access to the property, physically or visually. Ecological factors such as habitats for birds, animals, etc. can be challenged under various conservation authorities compared with truly undeveloped land. Every situation is different but substantial due diligence must be made to determine and document the "exclusively for conservation purposes" requirement. A conservation easement on a typical golf course green space or open space may or may not meet the requirements, or perhaps, the intent of the code and regulations. Alternative facts may be present in or around a golf course. The ecological factors appear to present, for example, at The Merit Club. In existing urban areas, there may be significant public benefits to maintaining the open space if it operates as an effective water management feature for the surrounding real estate that, if developed, would have to be replaced in some manner. Land may be available that is truly undisturbed, ecologically important or pure open space within the traditional view. Conservation easements that include these areas or only include these areas may meet the statutory requirements. This simply points out the need for

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a thorough examination of all factors in determining whether a conservation easement can be structured with the parameters of the Internal Revenue Code requirements.

The Amount of the Charitable Deduction

Meeting the statutory and regulatory requirements is just the first step. The next step is to determine the fair market value of the easement, which represents the amount of the charitable deduction. *It is very possible to make a qualified conservation easement yet not derive a charitable contribution deduction as the restriction may have little or no reduction in value to the property and may, in fact, actually enhance the value of the property or other properties owned by the donor.* The regulations specify that the value be based on comparative record of sales of such easements. If a substantial record of comparable sales does not exist (and they generally do not) the value is equal to the difference between the fair market value of the property it encumbers *before* the granting of the restriction and the fair market value of the encumbered property *after* the granting of the restriction, *less* the increase in fair market value of other property owned by the donee even if not contiguous.

This fair market value determination, a “before” and “after” estimation, must follow traditional appraisal principles. It also may comparable to condemnation valuations. Keep the thoughts simple -- the documentation needs to clearly demonstrate that something of true value today has been relinquished. It must take into account not only the current use of the property but also an objective assessment of how immediate or remote the likelihood is that the property, absent restriction, would in fact be developed, as well as any effect from zoning, conservation, or other laws that already restrict the property’s highest and best use. Zoning, conservation, or other laws may present significant obstacles to this valuation. In the case of a golf course, absolute or practical hurdles may exist to develop the property for other uses with a higher market value – this needs to be documented in every case. The locality of each property will have different facts to consider. A simple discounted cash flow calculation of the potential proceeds from forgone hypothetical development of the property will not meet the valuation principles enumerated in the regulations. A conservation easement may also be part of the negotiations to obtain zoning or other entitlements to meet the developer’s needs. In this case a “quid pro quo” issue is present and the value may have been received in the zoning or entitlements obtained. Thus, the easement restriction may have little or no *net fair market* value at the time of contribution.

The regulations will also require filing a separate form with the donor’s tax return (and each partner’s if a partnership) that documents the value and requires a formal appraisal signed by the appraiser. Substantial penalties can be assessed if there is a significant overstatement of the value. A 20% penalty can be assessed if the underpayment of tax is more than \$5,000 and the deduction claimed was more than 200% of the allowed amount. The penalty increases to 40% if the value is over 400% of the allowed amount. This penalty is in addition to normal understatement penalties and interest assessment. Finally, the value ultimately determined is between the donor, its advisors and the appraiser, subject to challenge by the IRS. The qualified organization receiving the easement does not support or otherwise become responsible for the valuation.

Conclusion

The charitable conservation easement may bring significant income tax, and potential real estate tax, benefits to certain owners of golf courses and related properties; however,

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conservation easements on golf courses is a challengeable area. Each situation must be reviewed in detail with the enumerated conservation requirements and valuation principles. As a simple rule of thumb, a real estate person should truly believe conservation principles have been met, a significant public benefit is present *and* a future value measurable in today's dollar has been relinquished. A presentation that presents huge tax benefits without truly giving up something of value is likely to be too good to be true. It is highly advisable to use qualified professionals practicing in the traditional conservation easement arena. These legal and tax professionals, land trusts and conservation organizations truly understand the principles involved and can provide balanced advice.

Any and every conservation easement can be challenged by the IRS – both the qualification for and the amount of the contribution. The number of IRS audits and the issues raised ebb and flow based upon the focus of the IRS, examination resources and even the specific examiner involved. Conservation easements on golf courses could receive scrutiny given the present state of “tax shelter” focus and we are aware of some golf course easement related examinations in process. Each donation will have to be separately justified and representations that other contributions have not been challenged or have been accepted on audit will not provide any protection against the assessment of interest and penalties if your easement is challenged. Penalties can be onerous if a substantial overstatement of value is claimed. *A promoter who requests conditions of confidentiality should be immediately suspected.* First, the matter is not proprietary or secret, and perhaps more importantly, this will likely make any contribution a “tax shelter” requiring substantial disclosure, promoter maintenance of lists and exposure to additional significant penalties under the newly enacted tax shelter laws and regulations.

Just 4 years ago the IRS deemed the golf course owners industry to be “noncompliant” with many IRS pronouncements, most particularly their age-old position disallowing deductions for depreciation. The IRS was poised to push for industry-wide audits coordinated within IRS Districts. Through a carefully planned and executed plan, the industry responded with facts and reasoned positions that resulted in the IRS and Treasury agreeing with the industry's position that a substantial portion of modern golf course construction costs are eligible for depreciation. A new published revenue ruling has been issued, District-led audits of the golf industry have not materialized and the industry has made efforts to follow the new rules. Likewise, conservation easements should be based on a proper analysis of facts and reasoned positions. Positions that seem to be too good to be true usually are and the adverse consequences can be painful to the taxpayer and the industry.

Other Articles

The Washington Post, in an article dated December 21, 2003 “**Developers Find Payoff in Preservation** - Donors Reap Tax Incentive by Giving to Land Trusts, but Critics Fear Abuse of System” raises more questions than are answered. Clearly, if the valuation of what was transferred in a conservation easement is beyond the belief of the owner/taxpayer, something is wrong. Steve Small (www.stevesmall.com), a recognized

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authority on conservation easements, has responded to the article in a letter that is included in his web site.