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## **An Agricultural Law Research Article**

# **Conservation Easements: Prospects for Sustainable Agriculture**

by

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# CONSERVATION EASEMENTS: PROSPECTS FOR SUSTAINABLE AGRICULTURE

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## I. INTRODUCTION

Easements — which involve the transfer of certain rights relating to the use of private property — are becoming central to a new wave in land conservation. Given current constraints on public budgets, easements provide the government with a thrifty method of land conservation and the private sector with an opportunity for increased involvement in land protection.

Key to the success of this new wave in land conservation is the “conservation easement,” which enables a private landowner to limit land uses to protect scenery, wildlife habitat or other amenities in return for a tax deduction equal to the value of the property rights surrendered. Conservation easements present an excellent opportunity to improve environmental quality in American agriculture while helping the United States farm economy. Unfortunately, recent legislative reforms may have weakened the incentives by eliminating full deductibility of donated conservation easements for certain taxpayers.

This article discusses the role of easements in land conservation, reviews the potential of easements to promote agricultural conservation, suggests ways to improve conservation easement tax benefits, and explores the need for complementary incentives to strengthen the role of conservation easements in land conservation.

## II. THE ROLE OF EASEMENTS IN LAND CONSERVATION

An easement is a legal agreement whereby a property owner, while retaining title, relinquishes certain specified rights to use of

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This article describes the tax rules governing easements in general terms only, and does not purport to render legal, financial, tax accounting or other professional advice. Qualified legal counsel should be sought in connection with any conservation easement donation.

the property.<sup>1</sup> Easements are a common device in real estate law, used routinely to secure rights-of-way for sidewalks, utility lines, alleys and driveways.<sup>2</sup> "Term" easements are of finite duration, as distinct from restrictions governing current and future owners of the affected property in perpetuity.<sup>3</sup>

The United States government has longstanding experience in easements for conserving land and natural resources. Some of the first long-term conservation easements were acquired by the National Park Service in the 1930s and 1940s to protect scenic views along the Blue Ridge Parkway in Virginia and North Carolina, as well as the Natchez Trace Parkway in Mississippi, Alabama and Tennessee.<sup>4</sup> Programs administered by the U.S. Fish and Wildlife Service have placed over one million acres of wetlands under permanent easement.<sup>5</sup>

The private sector also plays a major role in the conservation easement movement. For example, The Nature Conservancy, a national organization with nearly 400,000 members, uses easements as a part of its ambitious program to protect threatened plants, wildlife and ecosystems.<sup>6</sup> Another national organization, the American Farmland Trust, frequently uses easements to keep good agricultural land in farming.<sup>7</sup>

On the local level the conservation easement movement is led by private land trusts, "those non-profit conservation organizations that work within a local community, a state or, occasionally, a regional area in the direct protection of lands having open space, recreation or ecological importance."<sup>8</sup> As of 1985, a varied assortment of 152 trusts distributed throughout 34 states reported having conservation easement programs in place.<sup>9</sup>

Such extensive private sector involvement in land conservation is welcome, given current constraints on public budgets. For exam-

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<sup>1</sup> Black's Law Dictionary 457 (5th ed. 1979).

<sup>2</sup> 25 Am. Jur. 2d *Easements and Licenses* § 7 (1966).

<sup>3</sup> *Id.* § 99.

<sup>4</sup> See Coughlin & Plaut, *Less-than-fee Acquisition for the Preservation of Open Space: Does it Work?*, 44 J. Am. Inst. of Planners 457, 458 (Oct. 1978).

<sup>5</sup> T. Barrett & P. Livermore, *The Conservation Easement in California* 4 (1983).

<sup>6</sup> Hinchman, *The Fine Art of Infiltrage*, 20 High Country News 8-13 (1988).

<sup>7</sup> Am. Farmland Trust, *Annual Report: 1987* 10 (1987). In fact, AFT was responsible for the first private farmland conservation easements in Michigan, Wisconsin, and North Carolina.

<sup>8</sup> Emory, *Land Trusts: A Key Link in the Conservation Chain*, 20 Parks and Recreation 45, 45-46 (1985).

<sup>9</sup> *Id.* at 46.

ple, the 1987 appropriation for the Land and Water Conservation Fund, the principal instrument for federal land acquisition, was less than one-third the 1978 level.<sup>10</sup> Moreover, as one conservation writer has observed, “[t]he 1980s are a time when few local governments can brag of revenue surpluses or strong voter support for large bond packages for acquiring parkland.”<sup>11</sup>

There are many public advantages to conservation easements. They generally entail less expense and administrative complexity than outright public ownership. Properly constructed conservation easements “run with the land,” remaining in force upon sale, inheritance or other transfer of the protected property.<sup>12</sup> Less transitory than zoning ordinances and other forms of land use control, conservation easements thus help to guarantee a legacy for future generations. Furthermore, by retaining property in private ownership, conservation easements often have only modest impacts on state and local tax revenue.

For private landowners, easement donation is an increasingly common form of philanthropy. In a recent survey of some 500 governmental and private conservation organizations, donations accounted for one-fourth the land protected by easement (more than 460,000 acres).<sup>13</sup> Landowner concern for long-term environmental protection is the main motivating force; as the Maryland Environmental Trust puts it, “[m]ost landowners who are interested in land conservation have . . . a desire to see their property remain largely undeveloped—perhaps as a farm, woodland or natural area—even after their ownership comes to an end.”<sup>14</sup>

At present, tax policy is the federal government’s principal instrument for rewarding conservation easement donors. Congress first enacted tax benefits for gifts of “less than fee” interests in property in 1964.<sup>15</sup> The tax benefits were consistent with Congress’ longstanding policy of using the Internal Revenue Code to “further

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<sup>10</sup> K. Barton, *Federal Fish and Wildlife Agency Budgets*, Audubon Wildlife Report 349 (1987).

<sup>11</sup> Mertes, *Trends in Land Use*, 20 Parks and Recreation 46 (1985).

<sup>12</sup> See S. Small, *The Federal Tax Law of Conservation Easements*, 16-4 to 16-5 (1986) [*hereinafter* Tax Law of Conservation Easements].

<sup>13</sup> Land Trust Exchange, *Report on 1985 National Survey of Government and Non-Profit Easement Programs* 7 (1985) [*hereinafter* Non-profit Easement Report].

<sup>14</sup> Maryland Environmental Trust, *To Preserve a Heritage: Conservation Easements* 7 (1987).

<sup>15</sup> Hambrick, *Charitable Donations of Conservation Easements: Valuation, Enforcement and Public Benefit*, 59 Taxes 347 (1981).

nonrevenue national objectives."<sup>16</sup>

The key provision is Section 170(h) of the Internal Revenue Code, which enables taxpayers to claim charitable contribution deductions for conservation easement gifts.<sup>17</sup> To be deductible, easement restrictions must be enforceable in perpetuity and donated to a "qualified organization . . . exclusively for conservation purposes."<sup>18</sup> Qualified organizations basically are units of government or tax-exempt private entities such as land trusts. Within the law, "conservation purposes" comprise four categories:

- 1) the preservation of land areas for outdoor recreation by, or the education of, the general public;
- 2) the protection of relatively natural habitat . . . [for] fish, wildlife, or plants, or similar ecosystem;
- 3) the preservation of open space (including farmland and forest land) . . . 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 certified historic structure.<sup>19</sup>

The third, or "open space" category, is the most important for conservation easements relating to agriculture.

In January of 1986, the Treasury Department published a final regulation implementing Section 170(h).<sup>20</sup> This concluded a protracted rulemaking process that had been a major obstacle to fulfillment of the law's purposes. In particular, the absence of interpretative criteria had made it difficult for easement donors and their legal advisers to predict the IRS's case-by-case response to Section 170(h) deductions claimed on tax returns.<sup>21</sup>

Of special note, the regulation interprets the "open space" category at some length, setting explicit criteria for determinations of what constitutes "clearly delineated" government policy and "significant public benefit." With respect to the first issue, the regula-

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<sup>16</sup> Madden, *Tax Incentives for Land Conservation: The Charitable Contribution Deduction for Gifts of Conservation Easements*, 7 B.C. Envtl. Aff. L. Rev. 105, 122-123 (1983).

<sup>17</sup> 26 U.S.C. § 170(h) (1982). Section 170(h) departs from a general proscription against tax deductions for gifts of "partial interests" in real property.

<sup>18</sup> *Id.* § 170(h)(1).

<sup>19</sup> *Id.* § 170(h)(4)(A).

<sup>20</sup> Dept. of the Treasury, *Income Taxes, Qualified Conservation Contributions*, 26 C.F.R. §§ 1.167(a)-5, 1.170A-7, 1.170A-14, 20.2055-2, & 25.2522(c)-3 (1988), 51 Fed. Reg. 1496-1507 (1986).

<sup>21</sup> *Id.*

tion notes that “[a] general declaration of conservation goals by a single official or legislative body is not sufficient” to qualify as “clearly delineated.”<sup>22</sup> Treasury has mandated instead that the open spaces to be protected should “further a specific, identified conservation project.”<sup>23</sup> For example, the test is likely to be satisfied where the protected open space adjoins a national park or other lands in public ownership for conservation purposes.

The regulation lists eleven factors that may be considered in determinations of “significant public benefit.”<sup>24</sup> Notable examples include: “uniqueness of the property” within its geographic setting; levels of built development in the vicinity of the property; and the consistency between the easement and public conservation programs.<sup>25</sup> Making reference to the “clearly delineated policy” test, the regulation stipulates further that “[t]he more specific the governmental policy with respect to the particular site to be protected, the more likely the governmental decision, by itself, will tend to establish the significant public benefit associated with the donation.”<sup>26</sup>

### III. AGRICULTURAL APPLICATIONS

At present, most conservation easements are structured to preserve existing natural scenery, special physiographic features, ecosystem integrity, pastoral landscapes or historic artifacts. However, enormous untapped potential resides in conservation easements to adjust existing land uses for environmental protection. The Director of the Iowa Natural Heritage Foundation’s Resourceful Farming Project has recommended that conservation easements, heretofore the province of “wildlife managers, land preservationists, water control officers, and recreation planners,” be used specifically to promote sustainable and environmentally sound farming practices.<sup>27</sup>

In certain instances, the federal tax deduction should be available for such creative easement purposes. The following discussion outlines several promising applications, describing how some bene-

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<sup>22</sup> 26 C.F.R. § 1.170A-14(d)(4)(iii)(A) (1988).

<sup>23</sup> *Id.*

<sup>24</sup> *Id.* § 1.170A-14(d)(4)(iv).

<sup>25</sup> *Id.* §§ 1.170A-14(d)(4)(iv)(A)(1)-(3).

<sup>26</sup> *Id.* § 1.170A-14(d)(4)(vi)(A) (1988).

<sup>27</sup> Sand, *Conservation Easements and the Conservation Movement*, 40 *J. Soil and Water Cons.* 337 (1985).

ficial agricultural land uses may fall under the "open space" purpose specified by Section 170(h). In each case, the central question is whether the easement terms meet the two tests of (1) deriving from a "clearly delineated" government policy and (2) yielding a "significant public benefit."

#### A. *Protecting Productive Farmland from Built Development*

One of the most obvious applications is the preservation of farmland for farming. As noted, the Internal Revenue Code makes special reference to farmland as a category of open space appropriate for conservation easement restrictions. This is the most explicit expression of an agricultural purpose within Section 170(h).

However, the law stops far short of blanket authority for deductible easements on farmland. As one expert on the subject points out:

[t]his is not a farmland preservation statute; the inclusion of farmland and forestland in the statute means that an open space easement on farmland or forestland will be tested against the same standards (clearly delineated governmental policy, scenic enjoyment, and significant public benefit. . .) as will an easement on a vacant downtown lot, or on open land between the highway and the ocean, or on fifty undeveloped acres in the path of advancing urban sprawl.<sup>28</sup>

In other words, "farmland for farmland's sake, *without more*, is not enough to qualify for a deductible conservation easement."<sup>29</sup>

Nevertheless, significant amounts of important farmland should be eligible to meet the 170(h) criteria. For example, the Treasury Department regulation cites two examples of government policy relevant to farmland. One is "the preservation of farmland pursuant to a state program for flood prevention and control."<sup>30</sup> The other is "a government program according preferential tax assessment or preferential zoning for certain property deemed worthy of protection for conservation purposes."<sup>31</sup>

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<sup>28</sup> Tax Law of Conservation Easements, *supra* note 12, at 6-4.

<sup>29</sup> *Id.* at 10-4.

<sup>30</sup> 26 C.F.R. § 1.170A-14(d)(4)(iii)(A) (1988). In comments on the proposed Treasury rule, conservationists cautioned that this illustration could mislead easement donors and the IRS into an overly narrow view of allowable farmland conservation easements. The commenters urged, but did not obtain, addition of more generic language affirming the importance of conserving farmlands' food and fiber production capability. See Tax Law of Conservation Easements, *supra* note 12, at D-16 to D-17.

<sup>31</sup> 26 C.F.R. § 1.170A-14(d)(4)(iii)(A) (1988).

The second example theoretically represents a virtual "catch-all," as nearly every state offers preferential property tax assessment of farmland.<sup>32</sup> However, the regulation makes plain that the "significant public benefit" test may also be applied.<sup>33</sup> In practice, the IRS has ruled favorably on farmland easement donations where the delineated government policy has been accompanied by significant development pressure in the affected area.<sup>34</sup>

Apart from the taxpayer's having to document government policy and public benefit, some farmland — particularly if near popular travel routes or tourist areas — may qualify for open space easements by providing "for the scenic enjoyment of the general public."<sup>35</sup> In making determinations on this ground, the IRS weighs such factors as:

- (1) The compatibility of the land use with other land in the vicinity;
- (2) The degree of contrast and variety provided by the visual scene;
- (3) The openness of the land (which would be a more significant factor in an urban or densely populated setting or in a heavily wooded area);
- (4) Relief from urban closeness;
- (5) The harmonious variety of shapes and textures;
- (6) The degree to which the land use maintains the scale and character of the urban landscape to preserve open space, visual enjoyment, and sunlight for the surrounding area;
- (7) The consistency of the proposed scenic view with a methodical state scenic identification program, such as a state landscape inventory; and
- (8) The consistency of the proposed scenic view with a regional or local landscape inventory made pursuant to a sufficiently rigorous review process, especially if the donation is endorsed by an appropriate state or local governmental agency.<sup>36</sup>

As noted, all tax-deductible conservation easements must be made "exclusively for conservation purposes."<sup>37</sup> The Treasury rule states that charitable deductions may not be claimed where an easement serves one of the four specified conservation purposes (recreation/education, natural habitat, open space, historic preser-

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<sup>32</sup> See K. Grillo & D. Seid, *State Laws Relating to Preferential Assessment of Farmland 4* (USDA-Economic Research Service Staff Report No. AGES870326, 1987). Basically, preferential taxation involves assessing farmland property at its value for agricultural uses, rather than its market value inflated by development pressures.

<sup>33</sup> See 26 C.F.R. § 1.170A-14(d)(4)(vi) (1988).

<sup>34</sup> Tax Law of Conservation Easements, *supra* note 12, at 10-4.

<sup>35</sup> 26 U.S.C. § 170(h)(4)(A)(iii)(I) (1982).

<sup>36</sup> 26 C.F.R. § 1.170A-14(d)(4)(ii) (1988).

<sup>37</sup> 26 U.S.C. § 170(h)(1)(c) (1982).

vation), but contravenes another.<sup>38</sup> For example, the Department indicates that it might disallow a deduction on farmland whose protection is contemplated by delineated government policy, but where "a significant naturally occurring ecosystem could be injured or destroyed by the use of pesticides in the operation of the farm."<sup>39</sup>

Other forms of poor stewardship, including abusive cropping of highly erodible fields or natural wetland, should likewise disqualify conservation easement donations, even though such lands might fall under some indiscriminate government policy for farmland retention. Much of the obligation to prevent such inadvertent environmental damage must fall to prospective easement recipients who, to a greater degree than the IRS, have the expertise to recognize conflicts among conservation purposes.

### B. Retirement of Eroding Cropland

Conservation easements may also be useful in promoting the withdrawal of severely eroding farmland from crop production. Indeed, reverting to perennial grass, tree, or shrub cover may be the only effective conservation strategy on certain cropland where even heroic abatement measures or massive fertilizer applications cannot forestall lost productivity from soil erosion. Cropland retirement also can mitigate water pollution problems.<sup>40</sup>

Conceivably, a property owner who donates a conservation easement for erosion control could give up the right to raise annual crops but retain the right to conduct more sustainable pursuits. For example, a farmer might convert an eroding field with a history of soybean production to livestock grazing, tree farming, wildlife habitat, or recreation purposes. The farmer could deduct the difference between the field's market value as cropland and its value under its less intensive management regime.<sup>41</sup>

Such a transition could help lend economic stability to rural communities. A recent University of Missouri study concluded that an easement program structured for erosion control and commod-

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<sup>38</sup> 26 C.F.R. § 1.170A-14(e)(2) (1988).

<sup>39</sup> *Id.*

<sup>40</sup> Vegetative buffers have proved highly effective in keeping eroded sediments and farm chemicals from reaching streams and lakes adjoining cropland. *See, e.g.*, U.S. Environmental Protection Agency, *Setting Priorities: The Key to Nonpoint Source Control* 28 (1987).

<sup>41</sup> *See* National Trust for Historic Preservation and Land Trust Exchange, *Appraising Easements* 19-23 (1984) (discussing the general principles involved in easement valuation).

ity surplus reduction could have favorable results for the Midwest since:

. . .the output mix [of farms in the Midwest] would be more toward livestock and less [toward] grain sales than in the past. In the process, employment opportunities could be expected to be maintained and, in some areas and industries, even enhanced . . . . Also, this community stabilization . . . would strengthen the rural economy during a difficult transition period. Finally, allowing commercial use of [conservation easement program] land makes good economic sense if the enrolled land can profitably produce forage or timber rather than lie idle and generate little or no social product.<sup>42</sup>

In the right circumstances, conservation easements that shift eroding cropland to less intensive use should satisfy the revenue code's requirements. As to government policy, there are many statutory delineations of the public interest in erosion control.<sup>43</sup> In particular, the 1985 Food Security Act's erosion control language applies to a discrete category of "highly erodible" cropland identified by standard technical criteria based on soils' potential for degradation.<sup>44</sup>

Some state and local provisions may also be helpful in establishing government policy favoring retirement of eroding cropland. Some examples include strict soil conservation laws in Iowa and Colorado,<sup>45</sup> and Wisconsin's "T by 2000" program affirming a commitment to tolerable erosion rates by the turn of the century.<sup>46</sup>

In addition, the Treasury regulation's explicit reference to "consistency of the proposed open space use with public programs (whether federal, state, or local) for conservation in the region, including programs for . . . water quality maintenance or enhancement . . . [or] erosion control" is helpful in establishing a "signifi-

<sup>42</sup> Department of Agricultural Economics, University of Missouri-Columbia, *Conservation Easements: An Integrated Policy Approach to Soil Erosion Control and Agricultural Supply Management 150* (1987) [*hereinafter* Soil Erosion Policy].

<sup>43</sup> See 16 U.S.C. §§ 3801-3845 (Supp. IV 1986) (establishing an erodible land and wetland conservation and reserve program).

<sup>44</sup> See 7 C.F.R. § 12.21 (1988). Pursuant to USDA regulations, land is "highly erodible" if it meets or exceeds a value of eight on an erosion potential index that ranges from zero (low) to fifteen (high). This definition describes approximately 118 million acres (28 percent) of the nation's cropland base.

<sup>45</sup> See Iowa Code Ann. §§ 467A-467D (West 1971); Colo. Rev. Stat. §§ 35-70-101 to 35-70-121 (1984).

<sup>46</sup> See Wis. Stat. Ann. §§ 92.01-92.14 (West 1972).

cant public benefit" to favor retirement of eroding cropland.<sup>47</sup> Additional public benefits of cropland retirement through easements might include the creation of critical wildlife habitat and the reduction of crop surplus.

In some instances, conservation easements retiring cropland might be able to bypass these requirements altogether and qualify for a tax deduction under the separate allowance for "protection of a relatively natural habitat . . . [for] fish, wildlife, or plants, or similar ecosystem."<sup>48</sup> For example, the re-creation of native prairie on eroding Corn Belt cropland or reclamation of wetland environments should satisfy this test. Unlike "open space" easements, "natural habitat" easements presumably would have to proscribe or impose major restrictions on livestock grazing, timber production, or other commercial uses of the property.

In achieving erosion control, easements may provide a critical supplement to existing government programs. For example, under the 1985 Food Security Act's Conservation Reserve Program (CRP), the federal government is compensating farmers for maintaining grass or trees on excessively eroding cropland under ten-year contracts.<sup>49</sup> Unfortunately, the long-term success of this beneficial endeavor hinges precariously on a "sodbuster" provision in the 1985 law<sup>50</sup> denying farm subsidies to those producers who would resume abusive plowing after receiving ten years' "rental" payments for keeping their erosion prone land out of production. Economists at the University of Missouri note that "[g]iven the uncertainty of future government farm programs and the fact that not all producers will participate in those programs, there is reason to doubt the longevity of erosion control under the conservation reserve."<sup>51</sup>

Conservation easements would ensure that the CRP's erosion control gains are not lost in the event that the farm economy recovers to the point that the denial of government subsidies becomes only a weak deterrent to destructive plowing. In addition, easements would guarantee enduring protection for any CRP land

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<sup>47</sup> 26 C.F.R. § 1.170A-14(d)(4)(iv)(3) (1988).

<sup>48</sup> 26 U.S.C. § 170(h)(4)(A)(ii) (1982).

<sup>49</sup> Food Security Act of 1985, Pub. L. No. 99-198, §§ 1231-1245, 99 Stat. 1354, 1509-1516, 16 U.S.C. §§ 3831-3845 (Supp. IV 1986).

<sup>50</sup> *Id.* Pub. L. No. 99-198, §§ 1211-1213, 99 Stat. 1354, 1506-1507, 16 U.S.C. §§ 3811-3813 (Supp. IV 1986).

<sup>51</sup> Ervin & Blase, *The Conservation Reserve: Potential Impacts and Problems*, 41 J. Soil and Water Cons. 77, 79 (1986).

not affected by the sodbuster provision upon termination of the ten-year reserve contracts. The concept should appeal particularly to farmers with CRP land so fragile that resumed crop production is economically marginal.

Thus, Section 170(h) of the Internal Revenue Code should be seen as a complement to the conservation reserve. Used in tandem with the Food Security Act of 1985, persons enrolling eroding cropland in the CRP might obtain a charitable tax deduction provided they donate a permanent conservation easement on eroded farmland. Such easements could be enforced by the USDA in a manner similar to the Department's current administration of the 10-year reserve program. This would likely be cheaper than paying federal funds indefinitely to renew the ten year CRP contracts.<sup>52</sup>

### C. Groundwater Protection

Conservation easements could also be used to protect rural groundwater. The Iowa Natural Heritage Foundation has embarked on a pilot project for this promising application.<sup>53</sup> While site conditions in each instance would dictate the needed adjustments to agricultural practices, easements could, for example, specify the sealing of contaminated agricultural drainage wells such as those installed in the Midwest to enable intensive corn and soybean production on fertile, wet soils. On many farm fields in Iowa, water flowing through these wells contaminates groundwater with sediment, bacteria, fertilizer nitrates and chemical pesticides.<sup>54</sup>

Changes in tillage or irrigation practices, or reduced fertilizer and pesticide use, might be necessary where the contamination is not caused by constructed drainage wells but by natural topographic sinkholes, in parts of the country featuring porous limestone geology. In these "karst" regions, cropland runoff from rainfall and irrigation water tends to enter crevices and flow directly into underground aquifers.<sup>55</sup>

As noted, the Treasury rule cites consistency with public programs to maintain or enhance water quality as an indication of

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<sup>52</sup> Soil Erosion Policy, *supra* note 42, at 148.

<sup>53</sup> See L. Kemp, Farm Chemicals in Groundwater: Strategies for Nonprofits, 71-72 (The Minnesota Project, 1988) [*hereinafter* Chemicals in Groundwater].

<sup>54</sup> See Cramer, *Iowa Taxes Chemicals to Protect Groundwater*, 10 The New Farm 22, 22-23 (1988).

<sup>55</sup> See Moore, *The Penguin Dictionary of Geography* 121 (1974).

“significant public benefit.”<sup>56</sup> This language might be helpful to prospective donors, as might evidence of state and local laws concerned with water quality. Some conservation easements protecting groundwater might even qualify as preserving “natural habitats” where they enable the land to revert to its native vegetation and environments.

Conservation easements could work to conserve the supply as well as the quality of groundwater. For example, farmers might receive tax deductions for easements restricting cropland irrigation where pumping from agricultural wells is causing irreversible aquifer depletion or serious intermittent harm to local water tables. Where “dryland” farming is feasible, an easement might be worth the value of lost yield potential associated with the shift to unirrigated production.

#### IV. IMPROVING EASEMENT TAX BENEFITS

As beneficial as the provision has been, and as promising as it appears for agriculture, it is imperative that section 170(h) be kept on the books. However, rigorous monitoring and enforcement of conservation easements is essential to assure that the provision is used properly. In addition, Congress should remedy the weakening of incentives for easement donation and end confusion over how to treat conservation easements for estate and income tax purposes.

##### A. Preserving “Section 170(h)” Deductions

Section 170(h) of the Internal Revenue Code was enacted in 1980,<sup>57</sup> modifying authority that had been in place since the mid-1970s.<sup>58</sup>

The relevant Congressional panels offered a straightforward rationale for the 1980 easement provision. The Senate Finance Committee stated “that the preservation of our country’s natural resources and cultural heritage is important, and . . . that conservation easements now play an important role in preservation

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<sup>56</sup> See 26 C.F.R. § 1.170A-14(d)(4)(iv)(3) (1988).

<sup>57</sup> Tax Treatment Extension Act of 1980, P.L. 96-541, § 6, 94 Stat. 3204, 3206-3208 (1980).

<sup>58</sup> Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1520 (1976), as amended by the Tax Reduction and Simplification Act of 1977, Pub. L. No. 95-30, 91 Stat. 126 (1977). See also R. Dunford, *An Overview of Federal Tax Policies Encouraging Donations of Conservation Easements to Preserve Natural Areas*, 9-15 (Congressional Research Service Report No. 84-48 ENR, 1984).

efforts."<sup>59</sup> Similar language appeared in the committee print from the House Committee on Ways and Means.<sup>60</sup>

Under Section 170(h), qualifying taxpayers may deduct from taxable income the value of the easements, calculated as the difference in property value before and after imposition of easement restrictions.<sup>61</sup> Resulting reductions in tax liability, or tax "benefits," are functions of taxpayers financial situations. For example, an individual in today's 28 percent bracket who donates an easement worth \$50,000 could realize a \$14,000 benefit ( $\$50,000 \times 28\%$ ). In this case, the federal government would get a bargain, having acquired a conservation easement worth \$50,000 for just over one-fourth that amount in forgone revenue.

Last December, the Treasury Department, in fulfillment of a statutory instruction, issued an evaluation of Section 170(h).<sup>62</sup> This report affirmed that the rationale for Section 170(h) is similar to that for other charitable contributions in that an easement donation "may provide public benefits above and beyond any potential gain to the owner."<sup>63</sup> However, the Treasury Department gave the section less than a ringing endorsement. The report contended that the current system presented thorny administrative problems for the Internal Revenue Service, particularly with regard to valuation of matters beyond the Service's expertise.<sup>64</sup> The Department concluded that "some combination of direct government purchases of easements and government grants to nonprofit organizations for the purpose of purchasing easements may provide a more efficient means of land preservation and allow greater public benefit than the current policy of deductibility."<sup>65</sup>

Although problems of valuation pose a legitimate concern, the challenge of accurate assessment is common not only to Section 170(h) deductions, but also to other non-cash charitable contributions.<sup>66</sup> In fact, the Treasury Department acknowledged the absence of any reliable data confirming that excessive valuation has

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<sup>59</sup> S. Rep. No. 1007, 96th Cong., 2d Sess. 9 (1980).

<sup>60</sup> Staff of House Comm. on Ways and Means, 96th Cong., 2d Sess., Summary of Miscellaneous Tax Bills Passed by the Congress in the Post-election Session 16 (1980).

<sup>61</sup> For an excellent summary of the "before and after" method of easement valuation, see *Appraising Easements*, *supra* note 41, at 19-23.

<sup>62</sup> U.S. Department of the Treasury, A Report to Congress on the Use of Tax Deductions of Conservation Easements (1987) [*hereinafter* Use of Conservation Easement Deduction].

<sup>63</sup> *Id.* at 8.

<sup>64</sup> *Id.* at 10-12.

<sup>65</sup> *Id.* at 2.

<sup>66</sup> *Id.* at 2.

been a serious problem since the tax code has allowed easement deductibility.<sup>67</sup> Major abuses should be deterred not by abandoning Section 170(h), but by closer Internal Revenue Service scrutiny of large non-cash donations in general, including those for conservation easements.<sup>68</sup> In the absence of a strong, direct spending substitute for Section 170(h), elimination of the tax deduction would be a tragic mistake.

The Treasury Department report also argues persuasively for rigorous long-term monitoring and enforcement of conservation easement restrictions.<sup>69</sup> This recognizes that easement violations undercut the public's tax-supported investment in conservation. It is also consistent with recommendations issued from the Land Trust Exchange (LTE), a national clearinghouse for land trust organizations, in connection with that organization's 1985 national survey.<sup>70</sup>

So far, violations appear to be rare. Of the sample that responded to the LTE survey, just 13 percent of government programs and 5 percent of private-sector programs reported violations of easement terms.<sup>71</sup> There is, nevertheless, a strong need for vigilance as the conservation easement movement grows and matures. One helpful check is that donors must now furnish documentation to the Internal Revenue Service of recordation of easements on the deeds to their property.<sup>72</sup> As the Treasury Department points out, "[t]his will ensure that future owners are bound by the restrictions and that donors do not receive deductions based on a gift in perpetuity for donations that are, in fact, of short duration."<sup>73</sup>

### B. Reinstating Appreciated Value Deductibility

Although the rationale for Section 170(h) is roughly akin to that for charitable contributions in general, the easement deduction carries particular advantages for the donor. In cases where the donated easement has appreciated in value over time, the taxpayer benefits both from the deduction itself and from escaping taxation on a portion of the capital gain that would be realized if the prop-

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<sup>67</sup> *Id.* at 11.

<sup>68</sup> *Id.* at 12.

<sup>69</sup> *Id.* at 13.

<sup>70</sup> See Non-profit Easement Report, *supra* note 13, at 20.

<sup>71</sup> *Id.* at 13.

<sup>72</sup> Use of Conservation Easement Deduction, *supra* note 62, at 13.

<sup>73</sup> *Id.*

erty were sold. This is true not only for easements, but for all contributions of appreciated property.

Pursuant to the 1986 Tax Reform Act (TRA), this "double advantage" is no longer available to those taxpayers subject to the Alternative Minimum Tax (AMT).<sup>74</sup> The AMT is designed to ensure that persons with high incomes pay their fair share of taxes notwithstanding allowable deductions and credits.<sup>75</sup> It is calculated at a lower rate (currently 21 percent) than that normally applicable to upper income taxpayers, but with many deductions, the so-called "preference items," disallowed.<sup>76</sup> Any easement donation made by an AMT taxpayer is now limited to the person's adjusted "basis" (usually the original purchase price) in the donated property rights; the appreciated portion is a preference item that is taxable even though the taxpayer realizes no actual profit from the transaction.<sup>77</sup>

Although it is too early to assess fully the 1986 provision's impact on charitable giving, the reform may unfortunately deter some donors from constructing and making gifts of conservation easements.<sup>78</sup> The greatest reduction in tax benefits will probably be felt by prospective easement donors subject to the AMT who have held their purchased property through long inflationary periods.

The AMT's taxation of appreciated value at the time of donation cuts against the general rule that federal income tax is imposed "only on transactions. . . not on the mere enrichment of a property owner" through holding an appreciating asset without "realizing" gain.<sup>79</sup> Under current law, gains are generally not considered realized (and hence escape taxation) upon a gift and are never subject to income taxation upon the death of the property

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<sup>74</sup> Tax Reform Act of 1986, Pub. L. No. 99-514, § 701(a), 100 Stat. 2085, 2335 (amending 26 U.S.C. § 57 (1982)).

<sup>75</sup> See generally Dept. of the Treasury, Internal Revenue Service, Alternative Minimum Tax 1 (I.R.S. Publication 909, 1986).

<sup>76</sup> *Id.* at 5.

<sup>77</sup> *Id.* at 6.

<sup>78</sup> Another way in which the TRA reduced the value of charitable contribution deductions was through a general lowering of regular tax rates, particularly the drop in the top bracket from 50 percent to 28 percent. This appears to have had a chilling effect on donations of land, and presumably easements, to non-profit organizations. See Tax Changes Hit Groups in Land Conservation, Wall Street Journal, Jan. 26, 1988, § 2, p. 39, col. 2.

<sup>79</sup> R. Rice & L. Solomon, Federal Income Taxation 90 (1979). ("The realization requirement constitutes a deferral of taxation . . . . Even if the gain is ultimately taxed to the original owner at ordinary income rates, the taxpayer receives something of value as a result of the deferral of tax.")

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owner.<sup>80</sup> Requiring the gain to be taxed merely because the easement is donated to charity perversely penalizes the donation vis-a-vis the taxpayer's simply keeping full ownership of the affected property. To remove this disincentive to charitable giving, Congress should reinstate appreciated value deductibility for AMT taxpayers.<sup>81</sup>

### C. "Uncoupling" Estate and Income Taxation

Apart from income tax (including the AMT) considerations, conservation easement donations can also reduce estate tax liabilities.<sup>82</sup> This is because taxpayers may lower the appraisal of their estates by the value of donated easements. The basic mechanism is illustrated by the following example, developed recently by one expert in the taxation of conservation easements:

Broadly stated, decedents dying after 1988 with taxable estates greater than \$2,500,000 will be taxed at the maximum estate tax rate of 50 percent. Thus, a decedent with an estate valued at \$10,000,000 can expect to pay a significant portion of that amount in Federal estate taxes. If the bulk of the decedent's estate is held in a single large landholding, it will be necessary to sell some or all of the land to satisfy anticipated \$4,000,000 to \$5,000,000 in Federal estate taxes.

The gift of an easement valued at \$4,000,000 would reduce the value of the decedent's estate from \$10,000,000 to \$6,000,000, thereby reducing the estate tax burden from almost \$5,000,000 to around \$2,000,000. Although an easement gift, by itself, would not protect the land against forced sale, it does reduce the estate tax burden by approximately 60 percent and increases the chance that the family can continue to retain ownership of the property. If the family does not want to retain continued ownership, the easement insures that the land will be protected in perpetuity.<sup>83</sup>

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<sup>80</sup> See 26 U.S.C. § 102 (1982).

<sup>81</sup> This would not violate the basic purpose of the alternative minimum tax. Because the revenue code imposes a charitable deduction ceiling of 30 percent of an individual's gross income (see 26 U.S.C. § 170(b)(1)(B) (Supp. IV 1986)), there is no way AMT taxpayers can "zero out" their tax liabilities by donating an appreciated easement.

<sup>82</sup> Iowa state law permits payment of inheritance taxes with full title to property or a conservation easement. *Chemicals in Groundwater*, *supra* note 53, at 72.

<sup>83</sup> J. Coughlin, *Tax Consequences of Charitable Contributions of Easements in Income, Estate and Gift Tax Planning After Tax Reform Act of 1986* 5 (1987). Pursuant to the Revenue Act of 1987 (Pub. L. No. 100-203, § 10,401(a), 101 Stat. 1330-382, 1330-430 (1987)) the maximum estate tax rate will be 55 percent through 1993.

This scenario can carry a risk, however, in the form of a sizable unanticipated estate or gift tax burden in the event that the IRS rules against a claimed Section 170(h) income tax deduction after an estate has passed to an heir or donee. This is significant since even a remote threat of transfer tax has a chilling effect on the land conservation efforts of governmental agencies and private non-profit organizations.

In Section 1422 of the Tax Reform Act,<sup>84</sup> Congress wisely sought to "uncouple" estate and income taxation. The provision deleted, for estate and gift tax purposes, the form specific criteria under which an easement may qualify for a "conservation purpose" deduction. Apparently, the intent was to assure that rigid requirements would not be applied after donations had been made in anticipation of deductibility; House and Senate conferees stated the changes should allow "gift or estate tax deductions to be claimed for qualified conservation contributions without regard to whether the contribution satisfies the income tax conservation purpose requirement."<sup>85</sup>

Whether this result was accomplished is unclear, since Section 1422 did not repeal the more general language requiring that the easement be "exclusively for conservation purposes."<sup>86</sup> Presumably, the IRS and the courts could continue to apply some criteria and, if appropriate, disqualify some donations to assure that the basic intent of the law was met. This uncertainty needs to be clarified.<sup>87</sup>

## V. THE NEED FOR COMPLEMENTARY INCENTIVES

The Internal Revenue Code is not universally effective in inducing conservation easement donations. Some owners are not in a financial position to take advantage of an income tax deduction. Moreover, tax benefits will rarely come close to offsetting fully the value of forfeited property rights. As a result, there is a strong need for complementary incentives.

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<sup>84</sup> Pub. L. 99-514, § 1422, 100 Stat. 2085, 2716 (1986) (removing the requirements of 26 U.S.C. § 170(h)(4)(A) (1982)).

<sup>85</sup> H.R. Rep. No. 841, 99th Cong., 2d Sess., vol. 2, 772 (1986).

<sup>86</sup> 26 U.S.C. § 170(h)(1)(C).

<sup>87</sup> The problem may be ameliorated somewhat if the IRS successfully implements and extends Rev. Proc. 88-50, 1988-42 I.R.B. 81, which was adopted for a one-year test period in late 1988. Under this new procedure, the agency apparently intends to consider requests from living taxpayers for a ruling on all estate tax issues except tax computation, actuarial factors and factual issues such as fair market value.

### A. Easements for Farm Credit Relief

The farmers least likely to benefit from tax deductions are those suffering from chronic financial shortfalls as well as extraordinarily high ratios of debts to assets.<sup>88</sup> Many are unable to repay money borrowed from the Farmers Home Administration (FmHA), a "lender of last resort" within the United States Department of Agriculture (USDA) that provides funds to farmers unable to obtain credit from banks or other commercial sources.<sup>89</sup>

Section 1318 of the 1985 Food Security Act provides unprecedented authority for delinquent FmHA borrowers to grant conservation easements in exchange for partial debt forgiveness.<sup>90</sup> Under the law, FmHA may acquire easements for conservation, wildlife or recreation purposes on environmentally sensitive lands used as collateral to secure farmers' loans.<sup>91</sup> The easement must have a minimum term of fifty years.<sup>92</sup>

Farmers exercising this option may reduce their debts by a ratio equivalent to the fraction of the collateral land placed under easement restrictions.<sup>93</sup> For example, someone who commits 100 acres of a 300 acre farm to wildlife habitat may cancel the amount owed

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<sup>88</sup> As of 1985, approximately 11 percent of the nation's farmers fit in this category. D. Harrington & T. Carlin, *The U.S. Farm Sector: How Is It Weathering the 1980's?* 12 (USDA-ERS Agriculture Information Bulletin No. 506, 1987).

<sup>89</sup> Over 118,000 FmHA borrowers were in some type of default in early 1988. *See* 53 Fed. Reg. 18,392 (1988).

<sup>90</sup> Food Security Act of 1985, Pub. L. No. 99-198, § 1318, 99 Stat. 1354, 1530, 7 U.S.C. § 1997 (Supp. IV 1986). The Act also gave FmHA discretion to grant or sell conservation easements on "inventory" land the agency has obtained as a result of loan foreclosure. *Id.* § 1314, 99 Stat. 1354, 1526-1528, 7 U.S.C. § 1985 (Supp. IV 1986). A complementary provision in the Agricultural Credit Act of 1987 (Pub. L. No. 100-233, § 616, 101 Stat. 1568, 1682) enables FmHA to convey conservation easements without reimbursement "to any Federal or State Agency" on certain inventory land that "has marginal value for agricultural production; is environmentally sensitive; or has special management importance." *See* H. Rep. No. 490, 100th Cong., 1st Sess., 120 (1987) (Conference Report on H.R. 3030, The Agricultural Credit Act of 1987).

<sup>91</sup> Pursuant to the "sodbuster" (Pub. L. No. 99-198, § 1211(1)(E), 99 Stat. 1354, 1506, 16 U.S.C. § 3811(1)(E) (Supp. IV 1986)) and "swampbuster" (Pub. L.No. 99-198, § 1221(1)(E), 99 Stat. 1354, 1508, 16 U.S.C. § 3821(1)(E) (Supp. IV 1986)) provisions of the 1985 Food Security Act, no FmHA loan proceeds may go toward destructive plowing of highly erodible fields and natural wetlands. Enacting a multi-billion dollar "bailout" package, Congress last year rejected a conservationist proposal to apply this FmHA model to the Farm Credit System (FCS), a network of lending institutions that holds one-third of the nation's farm debt. Soil and wetland stewardship conditions — conservation "collateral" of a sort — should be attached to FCS lending policies the next time Congress revisits farm credit legislation.

<sup>92</sup> Food Security Act of 1985, Pub. L. No. 99-198, § 1318, 99 Stat. 1354, 1530, 7 U.S.C. § 1997(b) (Supp. IV 1986).

<sup>93</sup> *Id.* § 1318, 99 Stat. 1354, 1531, 7 U.S.C. § 1997(e) (Supp. IV 1986).

to FmHA by one-third. Pursuant to a 1987 amendment, the amount of the debt reduction may exceed the current value of the land securing the loan in some cases where land values have fallen.<sup>94</sup>

Enacting Section 1318, Congress seized upon a rare opportunity to address multiple farm problems simultaneously. The House Committee on Agriculture sounded a hopeful theme of "revitalized, productive farm unit[s]" operating under manageable debt loads while benefiting natural resource values.<sup>95</sup> The Senate Committee on Agriculture, Nutrition and Forestry dubbed the easement provision a useful complement to the conservation reserve program.<sup>96</sup>

Unfortunately, the Food Security Act's easement authority has thus far been little more than a paper exercise. More than two years have passed since the provision was signed into law, and, as of this writing, the FmHA has yet to take a conservation easement to restructure a delinquent debt.

Hopefully, this situation will change in the wake of a regulation promulgated in 1988 implementing Section 1318.<sup>97</sup> The rule laudably elevates conservation easements to a "primary loan service program" designed to restructure bad debts and keep farmers from facing foreclosure.<sup>98</sup> Based on the recommendations of inter-agency review teams, the FmHA would accept easements on wetlands, highly erodible land, and certain "upland" with environmental significance, provided the land was cropped in each of the three years prior to the 1985 enactment of the Food Security Act.<sup>99</sup>

### B. Direct Purchase of Easements

Governments have also achieved significant conservation results by direct purchase of easements from land owners. One example is the landmark Reinvest in Minnesota (RIM) program, created by the Minnesota state legislature in 1986.<sup>100</sup> Similar in concept to the federal conservation reserve program, RIM seeks long term retire-

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<sup>94</sup> H. Rep. No. 490, 100th Cong., 1st Sess., *supra* note 90, at 111 (Conference Report on H.R. 3030, The Agricultural Credit Act of 1987).

<sup>95</sup> H. Rep. No. 271, 99th Cong., 1st Sess., pt. 1, at 103 (1985).

<sup>96</sup> S. Rep. No. 145, 99th Cong., 1st Sess. 308 (1985).

<sup>97</sup> 53 Fed. Reg. 35,750-35,753 (1988) (Exhibit H — Primary Loan Service Programs; Farm Debt Restructure and Conservation Easements).

<sup>98</sup> *Id.*

<sup>99</sup> *Id.*

<sup>100</sup> Korczak & Gran, *RIM—Reinvest in Minnesota*, 41 J. Soil & Water Cons. 314 (1986).

ment of marginal and ecologically sensitive cropland.<sup>101</sup> The benefits of the program are manifest, as noted by staff for the Minnesota Soil and Water Conservation Board:

To conservationists, the program is a chance to slow pollution of Minnesota streams and lakes caused by cropland runoff. To environmentalists, it is a chance to regain for wildlife the environmental values of wetlands, fencerows, and woodlots lost to tillage during agriculture's boom years. To outdoor enthusiasts, RIM means better recreation. To resort owners and other tourist-oriented businesses, it means improved trade. To farmers it is both a source of income at a time when many of them desperately need it and a source of support for conservation practices.<sup>102</sup>

Within RIM, qualifying farmers may obtain direct payments in exchange for either a twenty year or permanent easement term, with significantly greater payments made for a permanent easement.<sup>103</sup>

In 1986, roughly 21,000 acres were enrolled in RIM through 900 easements, with approximately ten percent of the easements committed permanently; another estimated 10,000 acres entered the program in 1987, with some 60 percent of these lands retired permanently from crop production.<sup>104</sup> A small but significant portion — approximately 1,200 acres — of the 1987 total involves the restoration of agriculturally converted wetlands.<sup>105</sup> In addition, "purchase of development rights" (PDR) programs are currently administered by six states and eight local jurisdictions in the Eastern United States.<sup>106</sup> Under these programs, state and local govern-

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<sup>101</sup> *Id.* at 314-315.

<sup>102</sup> *Id.* at 316.

<sup>103</sup> RIM payments for permanent easements are the lesser of projected cash rent for farming the land in perpetuity or 90 percent of local prevailing farmland prices. Korczak & Gran, *supra* note 100 at 314-315. Payments for twenty year easements are always 65 percent of the calculated permanent easement values. In either case, the farmers may elect to receive the money as a lump sum or in equal installments spread over several years. To date, the cost to the Minnesota Treasury has been approximately \$13.9 million.

Background for this discussion was furnished by Wayne Edgerton, R.I.M. Reserve Coordinator for the Minnesota Department of Agriculture's Soil and Water Conservation Board.

<sup>104</sup> Minnesota Department of Agriculture, Reinvest in Minnesota (RIM) Legislative Report 5 (Jan. 1988).

<sup>105</sup> *Id.*

<sup>106</sup> Buckland, *The History and Use of Purchase of Development Rights in the United States*, 14 *Landscape and Urban Planning* 237, 246-247 (1987). The local jurisdictions with PDR programs include Suffolk County, New York; Burlington County, New Jersey; Howard County, Maryland; King County, Washington; Easthampton Township, New York; Southhampton Township, New York; Hunterdon County, New Jersey; and Forsyth County, North Carolina. The states with PDR programs include Connecticut; Maryland; Massachusetts; New Hampshire; New Jersey; and Rhode Island.

ments buy easements proscribing the permanent retention of farmland in agriculture.<sup>107</sup>

Massachusetts has reported particularly strong success with its Agricultural Preservation Restriction (APR) program.<sup>108</sup> From 1978 through 1986, APR obtained deed restrictions on more than 16,000 acres proscribing all uses that ruin the lands' farming capabilities.<sup>109</sup> By the end of 1987, the figure had risen to nearly 20,000 protected farmland acres.<sup>110</sup>

Other state and local governments should imitate these models. For example, land retirement programs patterned after RIM might benefit the Chesapeake Bay region, where the federal conservation reserve has failed to attract much participation. To stem the loss of prime farmland on urban fringes, states and local communities in the Midwest and other major agricultural regions should consider PDR programs similar to those at work in the East.

The federal government should also develop easement purchase programs along these lines. As noted, the U.S. Fish and Wildlife Service has already established an impressive track record for protecting natural wetland habitat.<sup>111</sup> The Service's easement program might serve as a model for other federal endeavors such as purchased cropping rights on erosion-prone farm fields.

Purchase programs administered by federal agencies could even operate in tandem with the Section 170(h) deduction by authorizing direct payment for a portion of the fair market value of any easement, with the balance remaining tax deductible. In such cases, no questions as to whether the claimed easement deduction satisfied the government policy test under Section 170(h) should arise.

## VI. CONCLUSION

Conservation easements can contribute enormously to a sustainable, environmentally sound agriculture. With the right combination of policies, the possibilities are virtually unlimited for conserving natural resources and protecting public health and welfare.

The task that remains is one of building upon past experience to

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<sup>107</sup> *Id.* at 244-245.

<sup>108</sup> Massachusetts Department of Agriculture, Annual Report: 1986 13-15 (1986).

<sup>109</sup> *Id.* at 13.

<sup>110</sup> *Highlights of 1987 State Activities in Farmland Protection*, 7 *Farmland Notes* 3 (1988).

<sup>111</sup> See text accompanying note 5, *supra*.

put an enlightened system of stewardship into practice. All parties with a stake in the issue, including government agencies, local land trusts, and individual farmers, would benefit by working together to develop and promote creative new applications and incentives for conservation easements. For the nation's farmers and rural environment, the tool is too good to waste.