

# **Appraising Easements, Covenants and Servitudes**

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We are indebted to and inspired by the many landowners in Canada who have granted conservation easements, covenants and servitudes to protect ecologically important spaces as well as the many conservation organizations that hold those interests. We hope that this publication will assist in meeting the challenges that landowners and conservation organizations have encountered in the valuation of conservation easements, covenants and servitudes.

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## Part 1: Introduction

Conservation easements, covenants and servitudes have become increasingly important land stewardship tools in Canada.<sup>1</sup> These partial interests in land are frequently used to protect ecologically significant spaces and habitat with high biodiversity value. As a result, landowners as well as the government agencies, conservation organizations and land trusts that hold these interests have a keen interest in the proper valuation of conservation easements.

*Appraising Easements, Covenants and Servitudes* attempts to bring together in one place the appraisal principles and practices that are used in the valuation of conservation easements. It is intended for use in appraising conservation easements where the interests are transferred either as donations or as sales. *Appraising Easements, Covenants and Servitudes* also highlights the specific requirements related to appraising conservation easements that qualify for income tax benefits as ecological gifts.

Since 1995, the federal government has been improving tax benefits associated with gifts of ecologically sensitive land or partial interests in ecologically sensitive land. The ecological gift provisions of the federal *Income Tax Act* enable landowners to claim a tax credit (in the case of individuals) or a deduction (in the case of corporations) if they donate an easement, covenant or servitude on ecologically sensitive land, or the land itself, to a qualified recipient. If the land is capital property, donors receive additional tax benefits. The tax implications of these gifts will be discussed in greater detail in Part 6.

The amount of the tax credit or deduction arising from a donation of land or an interest in land is based on the fair market value of the land or interest in land donated. To take advantage of tax benefits associated with gifts of interests in land, the value of the interest generally must be determined by an appraisal.

Appraising conservation easements poses a number of challenges:<sup>2</sup>

- Conservation easements are fairly new in Canada, and there are relatively few examples of sales of conservation easements or land subject to conservation easements to use as comparisons.
- Because the specific provisions of conservation easements can vary considerably, the easements that do exist may not always be comparable to the interest being appraised.
- Other, more commonly used kinds of easements and covenants that have different purposes, such as providing access, protecting views or providing rights-of-way for utilities and other services, may not always be useful in providing comparable values.

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<sup>1</sup> Unless the context requires otherwise, the term “conservation easement” or “easement” will be used throughout this publication to refer to an easement, covenant or servitude granted for conservation purposes.

<sup>2</sup> See, for example, the discussions in Ian C. Attridge, *Conservation Easement Valuation and Taxation in Canada*, Report No. 97-1, Ottawa, ON: North American Wetlands Conservation Council (Canada), 1997, at pp. 13–14, and in *Appraising Easements: Guidelines for Valuation of Land Conservation and Historic Preservation Easements*, 3rd ed., Washington, DC: Land Trust Alliance, National Trust for Historic Preservation, 1999.

- The market for conservation easements is still small in Canada. They are usually donated to governments or non-profit organizations. It is therefore difficult to establish a market value based on market transactions between buyers and sellers.
- There is virtually no subsequent arm's length market because conservation easements are generally intended to be held in perpetuity.

In the past, these challenges have contributed to unfortunate consequences that have had the effect of diminishing or eliminating tax benefits for the donor and discouraging donations of important ecologically sensitive land. However, changes to the *Income Tax Act*, among other things, have helped turn this around.

Increased understanding by donors and recipients of valuation approaches and principles will also help avoid a similar result in the future. This publication is aimed at increasing that understanding. It provides an overview of the process for appraising conservation easements. It begins with a brief explanation of the nature of partial interests in land and easements, covenants and servitudes in particular. It explains appraisal reports and appraisal concepts and principles relevant to the valuation of conservation easements. It discusses the role of easement holders in the appraisal process. Finally, it provides an overview of the relevant income tax provisions.

Although there are a number of kinds of interests in land that are less than the full ownership interest, this publication is confined to an explanation of the valuation of easements, covenants and servitudes used for conservation purposes. These are the partial interests in land referred to in the ecological gift provisions of the *Income Tax Act* and the partial interests most commonly donated in Canada today for conservation purposes.

## Part 2: Partial interests in land—what they are and how they work

A brief explanation of the law relating to land or real property will help in understanding the nature of partial interests in land and the valuation of partial interests.

Real property includes both land and, generally, whatever is erected or growing on land. Real property includes:

- the surface area of a piece of land;
- the undersurface and the air over the land—to the middle of the earth and to the heavens;
- things such as trees that are growing on the land;
- things attached to the land, such as houses and other buildings; and
- the rights a person has over land—for example, a right-of-way, easement or lease.

Under common law, a private landowner does not own the land itself but instead owns an estate, or interest, in the land. The Crown owns the land itself.<sup>3</sup> Land ownership is divided into a bundle of separate ownership rights. In its everyday usage, ownership of private land means ownership of an estate or interest in land known as a fee simple estate. The fee simple estate includes the following rights:

- the right to exclusive use and occupation of the land;
- the right to dispose of the land by sale, gift or will; and
- the right to divide up the bundle of rights and confer them on other people—for example, by granting a covenant, an easement or a lease.

Different people may have rights in relation to the same piece of real property at the same time. For example, two of the main features of ownership of land in fee simple are the unfettered right to dispose of the land and the right to occupy and use the land. However, the right to occupy the land can be divided from the fee simple estate by lease and by life estate. The landowner gives away the right to occupy the land but retains the right to dispose of it.

In addition, the common law allows some rights to use land to be shared or to be separated from other rights to use land. For example, a landowner can grant to another a restrictive covenant, easement or *profit à prendre* (the right to come onto the landowner's property and take some of what is growing or located there, such as timber or gravel). An owner of the fee simple does not cease to be the owner by granting a covenant, easement or *profit à prendre* over the owner's land. By doing so, however, the owner has given away, or sold, a part of the bundle of ownership rights to another party.

Subject to any conflicts between these various interests, an owner of the fee simple estate or interest in land can do one or more of the following:

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<sup>3</sup> Subject to unextinguished Aboriginal rights and title.

- grant a restrictive covenant on the property to benefit another landowner's property;
- grant an easement over the land to a neighbouring landowner;
- give someone the right to remove timber from the land;
- lease the land to yet another person; and then
- sell the land.

## ***Easements, covenants and servitudes***

Because of the tax provisions referred to briefly in Part 1 and explained in greater detail in Part 6, the three partial interests in land of particular interest for conservation are easements, covenants and servitudes. Easements and covenants can be created either under the common law or under legislation in most provinces in Canada. As explained below, servitudes are used in the civil law system in Quebec and are created under the *Civil Code of Québec*.

### **Common law easements and covenants**

Under common law, an easement is a right of one landowner to use another's land in a particular way, most commonly to cross the neighbour's land to reach his or her own land. A common law easement is attached to the land that benefits from the easement, so it belongs to whoever owns that land, not just the landowner who received the easement in the first instance.

A common law easement will only be enforceable by future owners of the land that benefits from the easement if it meets the following requirements:

- There must be two neighbouring or nearby pieces of land.
- The easement must benefit one piece of land and burden the other. The land burdened by the common law easement is called the servient tenement. The land that gets the benefit of the easement is called the dominant tenement. Therefore, if one landowner has the right to cross another landowner's property to reach his or her land, the first landowner's property is the dominant tenement and the second landowner's property (which the first landowner is entitled to cross) is the servient tenement.
- Each piece of land must be owned by a different person.<sup>4</sup>

A covenant affecting land is a promise made by one landowner to a neighbouring landowner not to do certain things on his or her land—for example, not to build on a certain part of the land. If a common law covenant meets certain requirements, it is enforceable by future owners of the land benefited by the covenant against future owners of the land burdened by the covenant. These requirements are as follows:

- The covenant must be restrictive or negative in nature. It can require a landowner to refrain from some activity concerning the land, but it cannot require the owner of the land burdened

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<sup>4</sup> The rule that the owners of the dominant and servient tenements must be different persons generally has been abrogated by statute.

by the covenant to do something, such as pay money, build on the land or restore the land to its natural state.

- As with easements, there must be two pieces of neighbouring property owned by different owners, one benefited by the covenant and one burdened by it.
- The covenant must touch and concern the land that receives the benefit of the covenant. Essentially, this means that the covenant must benefit the land, not just the owner of the land.
- The covenant must reflect an intention to annex the covenant to the land benefited by the covenant. This can be accomplished by language to that effect in the covenant document itself.
- A purchaser of the property burdened by the covenant must have notice of the covenant in order to be bound by it. In many provinces, the land registry system provides a mechanism to give prospective purchasers notice of a covenant.

Non-statutory easements and covenants that meet the above requirements:

- are interests in land and constitute real property;
- bind subsequent owners of the land burdened by the easement or covenant; and
- may be enforced by subsequent owners of the land benefited by the easement or covenant.

In most Canadian jurisdictions, some of the restrictions related to common law instruments have been removed by statute—for example, the requirement for two pieces of property, one benefited by the covenant or easement and one burdened by it, and the requirement that a covenant be restrictive or negative in nature. In many situations, statutory easements are preferable over common law instruments for conservation purposes. However, there may be cases where common law instruments continue to be useful conservation tools in spite of their limitations. Statutorily based easements and covenants are discussed below.

## **Servitudes in Quebec**

In the civil law of Quebec, a servitude is a charge or burden on one parcel of land for the benefit of another. It closely corresponds to an easement. The owner of the burdened land is required to tolerate certain acts of use by the owner of the land benefited by the servitude or abstain from exercising certain rights inherent in ownership.<sup>5</sup> A servitude may contain positive obligations, but positive obligations must relate to the service or use of the land. Servitudes meeting all the requirements of the *Civil Code of Québec*, including the requirements relating to registration of the interest in the appropriate land register, bind future owners of the burdened land and may be enforced by future owners of the land benefited by the servitude.<sup>6</sup>

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<sup>5</sup> *Civil Code of Québec*, s. 1177.

<sup>6</sup> *Civil Code of Québec*, s. 1182.

## **Statutory conservation easements**

Most jurisdictions in Canada have made legislative provision for the use of easements and covenants. Legislation creating statutory easements or covenants generally removes some of the restrictions associated with the common law instruments. Statutory easements have been used for some time in Canada by public utilities for rights-of-way and by local governments for various purposes associated with land development.

The common law rules governing restrictive covenants and easements have been changed by statute in many jurisdictions. For example, the holder of a statutory easement is generally not required to own property at all. Other restrictive rules governing what constitutes an easement or covenant have also been relaxed. Statutorily based covenants and easements generally can include restrictions on land use and impose positive obligations on landowners. Overall, this makes these tools more flexible and allows them to be used in a broader range of circumstances.

In addition, most Canadian jurisdictions have created specific statutory easements that can be used for conservation purposes.<sup>7</sup> A conservation easement is a particular kind of statutory instrument designed for conservation purposes and having legal authority to protect a range of ecological, cultural, heritage and other values, depending on the legislation. Generally, conservation easements can be granted in favour of a conservation organization as well as a government agency.

A conservation easement usually takes the form of a voluntary, written agreement between the landowner and an easement holder. It can cover all or part of a privately held parcel of property. In the agreement, the landowner promises to use the land in ways that are specified in the easement. For instance, the landowner might agree to provide specific protection for important habitat or agree not to subdivide the land. The easement holder holds the conservation easement and can enforce it if the owner does not abide by its terms. As with other easements, it is essential that a conservation easement be registered against title to the property. When registered, it binds future owners of the land.

### ***The role of easements in land conservation***

Conservation easements offer a cost-effective alternative to purchasing land for the purposes of protecting its important ecological features, because the owner of the land gives up some rights to the easement holder without the holder having to purchase the land from the owner. Like the land itself, conservation easements may be donated or sold.

The party that holds the conservation easement has the right to require the landowner to comply with the terms of the document. This provides the means to ensure that the protection described in the document is maintained permanently or for the duration of the conservation easement if it is not intended to last indefinitely.

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<sup>7</sup> For an overview of conservation easement legislation in Canada, see Judy Atkins, Ann Hillyer and Arlene Kwasniak, *Conservation Easements, Covenants and Servitudes in Canada: A Legal Review*, Report No. 04-1, Ottawa, ON: North American Wetlands Conservation Council (Canada), 2004.

Depending on the legislative regime, the agreement embodying the conservation easement can be designed to protect or preserve a broad range of values by restricting some uses or activities and requiring other things to be done. These can include some or many of the following:

- preservation of conservation values;
- protection of habitat for plant and animal species, including rare and endangered species;
- maintenance of areas that have been restored due to past destructive land practices;
- protection of historic structures;
- protection of scenic corridors;
- restrictions on types of industrial activities;
- restrictions on subdivision;
- permitting some uses and prohibiting or limiting other uses;
- management of forest land in accordance with specific forestry and conservation practices;
- restrictions on the use of pesticides;
- protection for areas adjacent to streams, lakes and other water bodies.

The specific terms and conditions in a conservation easement will depend on the relevant legislative provisions, the type of land, the values to be protected, the intentions of the parties and the outcome of the negotiations between the parties to the agreement.

Generally, conservation easements can be used in a wide range of circumstances. Since a conservation easement is a written agreement between the parties, there is considerable flexibility in how the terms and conditions in the agreement are written. The easement can contain provisions designed specifically to address the particular needs of the land and the parties involved.

## Part 3: Valuation of real property

### *Valuing property generally*

The process of valuing real property is one that is intended to result in a supportable conclusion of market value for the property being appraised. Generally, the appraisal process examines the marketplace for evidence of value relevant to real property and estimates the market value of real property based on its relationship to other properties that make up the potential market. This process, referred to as the direct comparison approach to value, often involves comparing the subject property with others in the marketplace. Other approaches are also used to estimate value. These are discussed below.

### **Market value**

The Canadian Uniform Standards of Professional Appraisal Practice (The Standards), issued by the Appraisal Institute of Canada, define “market value” as follows:

The most probable price which a property should bring in a competitive and open market as of the specified date under all conditions requisite to a fair sale, the buyer and seller each acting prudently and knowledgeably, and assuming the price is not affected by undue stimulus.

Implicit in this definition is the consummation of a sale as of the specified date and the passing of title from seller to buyer under conditions whereby:

1. buyer and seller are typically motivated;
2. both parties are well informed or well advised, and acting in what they consider their best interests;
3. a reasonable time is allowed for exposure in the open market;
4. payment is made in terms of cash in Canadian dollars or in terms of financial arrangements comparable thereto;
5. the price represents the normal consideration for the property sold unaffected by special or creative financing or sales concessions granted by anyone associated with the sale.<sup>8</sup>

The meaning of “fair market value” is discussed further in Part 6.

### **Highest and best use**

The principle of highest and best use is fundamental to the valuation of real property. “Highest and best use” is defined by the Appraisal Institute of Canada in The Standards as

that reasonably probable and legal use of vacant land or an improved property which is physically possible, appropriately supported, financially feasible, and that results in the highest value.<sup>9</sup>

Highest and best use is generally the most profitable and likely use that is legal.

Alternatively, highest and best use is that use which, at the time of the appraisal, is most likely to produce the greatest net return of money or amenities over a given period of time. The return

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<sup>8</sup> The Standards, 2006, at 6143.

<sup>9</sup> The Standards, 2006, at 6639.

may be monetary or may take the form of comfort or convenience or recognition of the contribution the particular use makes to the community or environment.

In determining highest and best use, factors such as zoning and other land use regulations (the legality of the use), the current development trends in the area and potential demand for the use must be taken into account. Other factors, such as the location, size and characteristics of the property, its productivity rating, existing improvements and available services, are also taken into account in forming an opinion as to highest and best use.

## **Methods of valuation**

The appraisal process involves a systematic analysis of the factors relevant to the value of real property. Three generally accepted approaches to estimating value are the most common in the valuation process—the direct comparison approach, the cost approach and the income approach. Another approach, the development approach, may also be used to estimate the value of land with development potential. However, the development approach is usually not helpful in appraising conservation easements.

If more than one method is used to estimate value, the values estimated are reconciled and any differences explained to reach one opinion of value.

### **The direct comparison approach**

The direct comparison approach is based on the principle that a prudent purchaser will not pay more for a property than the price of an equally desirable substitute property available under similar conditions. It estimates the value of property by comparing it with similarly improved properties that have sold or been listed recently in the same area. Adjustments are made to compensate for differences between the subject property and the comparable property.

This approach provides a reliable indication of value, particularly in an active market, given a reasonable availability of market data having a sufficient degree of comparability to the property being valued. It assumes that the price is not affected by unique circumstances, such as unusual financing terms or property conditions.

### **The cost approach**

The cost approach assumes that a prudent purchaser will not pay more for a property than the cost to recreate it in its present condition provided there are no costly delays or economic factors that might influence value. The cost approach involves a determination of the replacement cost of the improvements, less depreciation, plus the value of the land as if it were vacant.

This approach is especially appropriate when the property being appraised incorporates relatively new improvements representing the highest and best use of the land or when unique or specialized improvements are located on the land. Because it involves a determination of the cost of improvements, the cost approach is not appropriate for vacant land.

## **The income approach**

The income approach involves a conversion of anticipated future benefits to be derived from the ownership of property into a value that is estimated through a capitalization process. The capitalization process converts the anticipated future income to a present worth estimate. Market conditions, investment risk, costs for managing the investment and the liquidity of the investment are all factors that will affect the capitalization rate. The income approach is not appropriate if the real property is not generating income.

## **The development approach**

The development approach is used mainly for undeveloped land suitable for development. The undeveloped land is valued by assuming a hypothetical subdivision of the land. The total gross sales price of all the lots is estimated, and the estimated costs of development and financing are deducted from the gross sales price. The balance will represent the value of the property, including profit from selling the subdivided lots.

The usual profit required by developers on similar projects is then deducted and the resulting amount discounted for time to reflect the present value of the land. The final estimate is, in effect, the price a developer would pay for the land taking into account its development potential.

The development approach is rarely appropriate in appraising conservation easements.

## ***Valuing conservation easements***

This section brings together the appraisal principles and practices that are used in the valuation of conservation easements. These principles and practices apply to appraising conservation easements regardless of whether the interests are donated or sold. This section also highlights the specific requirements of appraising conservation easements donated as ecological gifts.

The value of a conservation easement may be significant—for example, in cases where it prohibits subdivision and development that would otherwise be permitted under land use legislation. On the other hand, the value of an easement may be negligible—for example, where it protects a wetland that would not or could not (because of land use or other legislation) otherwise be developed.

## **Methods of valuing conservation easements**

Valuing conservation easements is no different from valuing other kinds of real property. The approaches to valuation discussed above are used to the extent they are appropriate for the interest being valued.

However, because there is often no market for conservation easements, there may be little or no relevant evidence of value in the marketplace. The relatively few easement transactions that exist are often very different from the easement being valued, may be characterized by widely varying terms and conditions and often are too few in number to allow consistent patterns to be

identified. Where there are insufficient relevant comparable transactions, the valuation approach will be more deductive than evidentiary.

In these circumstances, the “before and after” valuation approach is central to the valuation of conservation easements.

### **Before and after method**

The before and after method is used to determine whether, and to what extent, granting a conservation easement changes the value of real property. Simply put, the before and after valuation method involves forming an opinion as to two separate values—the value of the real property immediately before the grant of the conservation easement and its value immediately after the grant of the easement. The value of the conservation easement will be the difference between the two values.

### **Determining before value**

The first step in the before and after valuation process is to determine the value of the real property immediately before the conservation easement is granted. This is no different from determining the fair market value of the fee simple interest in the entire property and is done without any regard for the conservation easement. It involves a determination of the property’s highest and best use in its condition at that time unrestricted by the easement. Highest and best use is explained above.

In this part of the appraisal process, the appraiser generally considers the suitability of the current use of the property in the context of existing land use and market conditions. The appraiser then considers the likelihood of a change in use as well as the costs associated with a change in use.

The appraiser must consider the property’s potential for the continuation of its existing use and for realistic alternative uses that might result in a higher value. Depending on the current use of the property, other uses might include subdivision, redevelopment, renovation or timber harvesting. The costs associated with each potential alternative use must be taken into account in determining the reasonableness of that use.

A determination of highest and best use also involves an evaluation of the likelihood that the use will be permitted under existing land use legislation or that land use legislation would be amended to allow the change of use. This evaluation must be based on evidence.

The second step is to apply, as appropriate, the approaches to valuation described above—the direct comparison approach, the cost approach and the income approach—to determine the value of the property. The appraiser must consider all relevant factors, such as trends in the market, zoning and potential for rezoning, trends in granting subdivision or other development approvals, and so on.

## Determining after value

As with determining the before value, the first step in determining the value of property after a conservation easement has been granted is to determine its highest and best use taking into account the restrictions imposed by the easement. This step involves a close review and analysis of the provisions of the easement, the nature and extent of the restrictions imposed and the rights retained by the landowner. Several types of easement provisions and their potential impact on value are discussed below.

The appraiser compares the restrictions imposed by the easement with existing and reasonable future zoning and land use legislation and controls to determine to what extent the easement affects possible existing and future uses.

Again, as with determining the before value, the appraiser applies the approaches to valuation described above to estimate the value of the property charged by the conservation easement.

A change in the highest and best use of real property brought about by granting a conservation easement is often a significant factor in the valuation of the easement. For example, if the highest and best use before the easement is one where subdivision of the property is permitted and the conservation easement prohibits subdivision, the easement changes the highest and best use and may have a significant impact on the value of the property.

Diminution in value of real property resulting from the grant of a conservation easement may also be reflected in the three main approaches to valuation discussed above, even if there is no change in the highest and best use of the property.

Under the [direct comparison] approach to value, for example, a well-informed purchaser would consider immediate and long-term costs of complying with the easement and pay less for a restricted property than for otherwise comparable unrestricted properties. Similarly, the replacement cost and income approaches may indicate immediate and long-term value impairment attributable to the easement because of increased costs of complying with the easement.<sup>10</sup>

It is important to remember that a conservation easement **may not reduce the value of property**. If the easement does not change the highest and best use—for example, where property could not profitably or legally be developed even without the existence of the easement—the easement value may be nominal.

It is also important to remember that any reduction in value will depend on the specific restrictions in the conservation easement and the specific rights retained by the landowner. It is not possible to generalize about a percentage reduction in value as a result of registering a conservation easement on a property. This must be determined on a case-by-case basis.

Where the direct comparison approach is used to value property after a conservation easement has been granted, the evidence of market sales may be very limited. Where an appraiser is using

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<sup>10</sup> *Appraising Easements: Guidelines for Valuation of Land Conservation and Historic Preservation Easements*, 3rd ed., Washington, DC: Land Trust Alliance, National Trust for Historic Preservation, 1999, at p. 21.

comparables with similar land use and other restrictions, it is essential to understand the circumstances in which the comparable transactions occurred. It may be necessary to conduct interviews with both the vendor and the purchaser of transactions used as comparables to ensure that the sales are real market transactions.

## **Particular requirements for ecological gifts**

The federal *Income Tax Act* addresses the valuation of real property that constitutes an ecological gift. To qualify for the tax benefits associated with ecological gifts, the fair market value of the land or interest in land must be certified by the Minister of the Environment. The Ecological Gifts Program requires an appraisal in support of the donor's estimate of value.

The only specific guidance as to value in the *Income Tax Act* relates to ecological gifts of servitudes, covenants and easements. The value of a servitude, covenant or easement is deemed to be the greater of its fair market value otherwise determined and the amount by which the fair market value of the land is reduced as a result of making the gift.<sup>11</sup> The latter method is the before and after method described above. The *Income Tax Act* provides no similar guidance for valuing charitable gifts of conservation easements that are not ecological gifts.

Although the *Income Tax Act* offers little guidance on how to value ecological gifts other than sanctioning the use of the before and after method, the Ecological Gifts Program has prepared *Guidelines for Appraisals* that are intended to assist appraisers in the preparation of appraisals of ecological gifts. The Guidelines include general recommendations for all ecological gifts, regardless of their fair market value. The current version of the Guidelines is available on the Ecological Gifts Program website at <http://www.cws-scf.ec.gc.ca/egp-pde/>.

## **Types of provisions in conservation easements**

Conservation easements are agreements between landowners and easement holders that contain a variety of kinds of provisions. Not all provisions in a conservation easement will affect the value of the land subject to the easement. Valuation of a conservation easement involves a close scrutiny of the conservation easement document itself to identify and understand the provisions in the document that have an impact on value. When valuing a conservation easement, it is essential to read the document carefully in its entirety, including all appendices and attachments, to ensure a proper understanding of the arrangements agreed to by the parties.

All conservation easements will contain provisions describing the restrictions on land use agreed to between the parties. All of the restrictions must be read in conjunction with the rights retained by the owner. In addition, the restrictions and other provisions should be read taking into account the stated purpose of the conservation easement, which assists in setting the context for the entire agreement.

Restrictions on land use may take one or more of the following forms:

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<sup>11</sup> *Income Tax Act*, ss. 118.1(12) and 110.1(5). This is applicable to gifts made after February 27, 1995.

- restrictions on subdivision;
- requirements relating to maintenance and protection of the land, including
  - maintenance of areas that have been restored due to past destructive land practices;
  - maintenance to protect historic structures;
  - protection of open space;
  - protection of scenic corridors;
  - protection of habitat;
  - protection of areas adjacent to streams, lakes and other water bodies;
- restrictions on types and extent of agricultural, timber harvesting, resource extraction, commercial and industrial activities;
- provisions permitting some uses and prohibiting or limiting other uses;
- restrictions on the use of pesticides and other chemicals.

In addition to provisions restricting land use, conservation easements may contain a variety of other terms governing:

- rights retained by the landowner;
- obligations of the parties;
- preparation of a plan for managing the land;
- monitoring the terms of the easement;
- enforcing the easement;
- permitting access for monitoring and enforcement purposes;
- liability of the parties.

Conservation easements will also contain general contractual terms, such as those relating to assignment, notice, amendments and so on.

Some conservation easements incorporate provisions governing management of the property. In these circumstances, management provisions should be taken into account in the valuation. However, if the management agreement is a separate agreement and is not part of the conservation easement, it should not be factored into the valuation.

### **Identifying provisions affecting value**

As explained above, many provisions of a conservation easement are unlikely to affect value. For example, provisions permitting the easement holder to monitor the land to ensure compliance with the easement terms generally will not affect value significantly. Similarly, provisions allowing the easement holder access to the land for monitoring or enforcement purposes are unlikely to affect value significantly. Generally, provisions included to give effect to the contractual arrangement between the parties will not affect value.

The provisions most likely to affect value are those restricting the use of the land and specifying the rights retained by the landowner on the granting of the easement. Examples of these kinds of provisions and their potential impact on value are identified in the next section.

## Sample provisions from conservation easement

Each conservation easement will contain provisions that reflect the purposes of the easement and the agreement between the parties to the easement. The sample provisions reproduced below include the intent section of a conservation easement, the restrictions on land use section and the rights reserved to the landowner section.

### Intent of Agreement

3.1 The parties each agree that the general intent of this Agreement is:

- (a) to protect and preserve the Land and the Amenities in a natural state; and
- (b) to prevent any occupation or use of the Land that will significantly impair or interfere with the natural state of the Land or the Amenities;

and the parties agree that this Agreement is to be interpreted, performed and applied accordingly.

3.2 This Agreement shall be perpetual to reflect the public interest in the protection and preservation of the natural state of the Land and the Amenities for ecological and environmental reasons.

### Restrictions on Use of the Land

4.1 Except as expressly permitted in this Agreement, the Owner must not do anything, omit to do anything, allow anything to be done, or allow the omission of anything that does or could reasonably be expected to destroy, impair, diminish, negatively affect, or alter the Land or the Amenities from the condition described in the Baseline Report.

4.2 Without restricting the generality of section 4.1, the Owner must not:

- (a) use or permit the use of the Land for an activity or use which:
  - (i) causes or allows silts, leachates, fills or other deleterious substances to be released into any watercourse on the Land;
  - (ii) causes the erosion of the Land to occur;
  - (iii) causes or facilitates the loss of soil on the Land;
  - (iv) alters or interferes with the hydrology of the Land, including by the diversion of natural drainage or flow of water in, on or through the Land in a manner which may have an impact on the Land;
  - (v) causes or allows fill, rubbish, ashes, garbage, waste or other material foreign to the Land to be deposited in or on the Land;
  - (vi) causes or allows any component of the Land, including soil, gravel or rock, to be disturbed, explored for, moved, removed from or deposited in or on the Land;
  - (vii) causes or allows pesticides, including but not limited to herbicides, insecticides or fungicides, to be applied to or introduced onto the Land; or
  - (viii) causes or allows any indigenous flora on the Land to be cut down, removed, defoliated or in any way tampered with;
- (b) use or permit the use of the Land for gathering or grazing of domestic animals;
- (c) construct, build, affix or place on the Land any buildings, structures, fixtures or improvements of any kind;
- (d) lay out or construct any new roads or paths on the Land;
- (e) lease or license the Land or any part thereof unless the lease or licence is expressly made subject to the provisions of this Agreement and expressly entitles the Owner to terminate the lease or licence if the tenant or licensee breaches any of the provisions of this Agreement;
- (f) after all financial encumbrances have been removed from the Land, place any new financial encumbrance on the Land;
- (g) subdivide the Land by any means.

### **Owner's reserved rights**

8.1 The Owner reserves all of its rights as owner of the Land, including the right to use, occupy and maintain the Land in any way that is not expressly restricted or prohibited by this Agreement, so long as the use, occupation or maintenance is consistent with the intent of this Agreement.

8.2 Without limiting the generality of section 8.1, the following rights are expressly reserved to the Owner:

- (a) to maintain, restore or replace existing buildings and other improvements on the Land, the location of which are indicated in the Baseline Report;
- (b) to maintain, replace or restore the existing waste disposal and water supply system, the location of which is indicated in the Baseline Report;
- (c) to maintain, replace or restore the utility lines running through the Land, the location of which is indicated in the Baseline Report;
- (d) to build, maintain, improve, replace or restore a driveway, the location of which is indicated in the Baseline Report.

As with all easements, these provisions must be read in the context of the entire document to fully understand their context and to accurately appraise the fair market value of the conservation easement.

### **Examples of how provisions affect value**

As explained above, each conservation easement needs to be carefully examined in its entirety to understand the restrictions on the use of the land. To understand how the conservation easement will affect the value, the restrictions, as well as the rights retained by the owner, need to be examined in the context of what is legally permitted under zoning and other land use legislation and other limitations on land use.

The following examples illustrate, in a simplified manner, possible approaches to assessing the impact on value of various types of provisions in a conservation easement.

#### **Eliminating subdivision potential where subdivision may be imminent**

A conservation easement is registered on a 15-hectare property located within the municipal boundary of a community that has experienced significant urban growth in the past decade. During that time, many similar parcels in the area have been subdivided, serviced and sold as suburban residential building lots. There are no zoning or regulatory measures in place restricting subdivision of the subject parcel into residential building lots.

The conservation easement contains the following provision:

The Owner must not subdivide the Land by any means.

In establishing the value per hectare of the land before the registration of the conservation easement, the appraiser first determines the highest and best use of the property. In doing so, the appraiser considers factors such as the land use controls in place, the current real estate market conditions, the time it would take to market the lots, overall market uptake for residential building lots, the availability of servicing and the neighbourhood's development potential.

Taking all of these factors into account, the appraiser is of the opinion that the highest and best use of the property is as a speculative suburban holding property with potential for subdivision.

The appraiser decides that the direct comparison approach to value is the most appropriate. The appraiser looks for comparable sales of properties with development potential equivalent to the subject property. Adjustments to the sales price are made to take into account factors such as location of the comparable sales, proximity to amenities, overall size of the comparable parcels and passage of time since the sales.

In establishing the value per hectare of the land after the registration of the conservation easement, the appraiser considers the highest and best use of the property now that the subdivision potential is removed. The appraiser is of the opinion that the highest and best use of the property with the conservation easement registered is as greenbelt and wildlife habitat with no speculative potential. Any agricultural potential for the land is limited by residential development that is occurring in close proximity to the subject property.

The appraiser decides that the direct comparison approach to value is the most appropriate for valuing the land after the registration of the conservation easement. In selecting suitable sales to consider, the appraiser looks for properties with comparable restrictions. These may be the result of similar conservation easements, zoning regulations restricting subdivision or environmental constraints that would eliminate development. Again, appropriate adjustments to the sales price are made.

### **Eliminating subdivision potential where subdivision not currently permitted**

In another situation, a conservation easement is registered on a 20-hectare parcel of land in a rural community about a one-hour commute to a major urban centre. Although it is in a predominantly agricultural area, this parcel is not being farmed and is not especially suited to agricultural use. A large portion of the parcel is marshy terrain that provides habitat and ecological services to a diversity of species. There is a modest home on the property.

While some areas between this rural community and the urban centre have experienced suburban development, this particular property is subject to zoning that would not currently allow for subdivision, since the minimum parcel size in this zone is 20 hectares. In addition, the planning documents for this community focus on maintaining the rural characteristics of the region, encouraging agricultural uses of the land and placing strict limits on development.

In spite of the current zoning, the owners want to prohibit subdivision of their land permanently. They anticipate changes to the zoning in future, since there is already significant pressure to accommodate smaller parcels for hobby farms and country estates. The owners do not want the land, with its important ecological features, subdivided in the future should the zoning of the area change to permit smaller parcels.

The conservation easement contains the following provision:

The Owner must not subdivide the Land by any means.

In establishing the value per hectare of the land before the registration of the conservation easement, the appraiser first determines the highest and best use of the property. In doing so, the appraiser considers factors such as the land use controls in place, including zoning and minimum parcel size, the permitted uses for the property, soil quality and productivity, the improvements on the property and the current real estate market conditions. After considering these and other relevant factors, the appraiser concludes that the highest and best use of the property prior to the conservation easement is as rural acreage with little agricultural potential. The appraiser identifies sales of parcels of similar size with similar physical characteristics to arrive at the price per hectare of the property prior to the registration of the conservation easement.

To establish the value per hectare of the land after the registration of the conservation easement, the appraiser determines that the highest and best use of the property continues to be rural acreage with little agricultural potential. While the appraiser concludes that smaller rural acreages would be physically possible and highly marketable if the property were subdivided, he determines that the possibility of subdivision in the near future is very remote. He concludes that the restriction against subdivision has little impact on the fair market value of the property and accordingly is of the opinion that the fair market value of the conservation easement is nominal.

### **Restrictions to protect habitat**

A conservation easement is registered on a 100-hectare parcel of agricultural land. The land is made up of several areas cultivated with grain, making up about half of the property, with the rest a combination of bush and marsh areas scattered throughout the entire parcel.

The conservation easement applies to the entire parcel and contains the following provisions:

- a) no activities that would harm the riparian habitat, natural water courses, wetlands or bodies of water;
- b) no cultivation or disturbance of the remaining permanent grass and natural cover;
- c) no use of industrial farm machinery in marsh areas; and
- d) no use of chemical herbicides, pesticides or fertilizers.

The appraiser concludes that these restrictions have an impact on the fair market value, for the following reasons:

- Because of the nature of the land and the potential agricultural uses, the restrictions on chemical herbicide, pesticide and fertilizer use would limit the ability to grow the highest-value crops from a production standpoint and, in general, would reduce the potential agricultural uses. The property would no longer be able to take advantage of the full range of agricultural options and would not be able to produce crops with the highest economic return.
- Because the restrictions apply to the entire parcel, rather than one specific part of the parcel, the easement has a greater impact on the permitted uses of the entire parcel and would more significantly restrict the way agriculture was carried on throughout the parcel.

- Prior to registration of the easement, the farmer ran machinery throughout the property during the summer as part of normal farm operations. Since the marsh areas are scattered throughout the property, a different method of farming would be required to eliminate the use of industrial farm machinery in the marsh areas. This may result in an increase in the cost of farming the property.

The appraiser concludes that the highest and best use of the property is as agricultural land, both before and after the easement is registered. The restrictions placed on the land as a result of the conservation easement would reduce the productivity of the land and its ability to generate income. To establish the fair market value of the land per hectare before the registration of the easement, the appraiser identifies comparables for land with a similar level of productivity. To establish the value per hectare after the registration of the easement, the appraiser identifies different comparables for land with a significantly lower level of productivity, equivalent to the reductions in productivity that result from the restrictions in the conservation easement. Appropriate adjustments are made in each case.

### **Restrictions to protect habitat on rear portion of land**

A 65-hectare parcel of land contains an area of approximately 20 hectares that is critical habitat for a threatened plant species. The area of critical habitat is located at the rear of the 65-hectare parcel and abuts other protected areas. There is no access to this rear area except through the front portion of the 65-hectare parcel.

A conservation easement is registered on the rear 25 hectares of the parcel rather than on the entire parcel. The conservation easement is intended to protect the critical habitat and provide a buffer from the remaining portion of the land. The front 40-hectare portion of the parcel, currently used for greenhouse operations, is not subject to the conservation easement and can continue to be used without restrictions.

Since the preservation of this particular plant species requires the easement area to remain undisturbed, the restrictions in the conservation easement are very stringent and eliminate the human use of the rear area altogether. There is to be no access to the easement area, except in the case of an emergency. Monitoring by the easement holder is to be conducted only by air and along the boundary of the easement area.

The appraiser determines that the highest and best use of the entire 65-hectare parcel, prior to the registration of the conservation easement, is agricultural. The land is located in a predominantly agricultural area with other greenhouse operations, large nurseries, produce farms and some dairy farms nearby. There is a realistic possibility of expanding the greenhouse operations to the rear of the parcel given the type of land, the permitted land uses and the market demand for greenhouse products.

The appraiser uses two methods to determine the fair market value of the easement. First, the appraiser uses the before and after method and determines the value of the parcel both before and after the registration of the conservation easement. To establish the before value, the appraiser identifies sales of land similar in size to the subject property that are used for greenhouse

operations. The appraiser makes adjustments for the value of the greenhouse improvements to take into account that the subject property currently has greenhouse operations on about two-thirds of the entire area. To establish the after value, the appraiser identifies sales of land similar in size to the subject property where only a portion of the land is suitable for greenhouse operations and the physical limits of the land prevent any expansion of those operations. Adjustments are made to all sales to take into account location and other relevant factors. The appraiser concludes that the difference between the before and after values is the value of the conservation easement.

In the second method, the appraiser again identifies sales of land similar in size to the subject property that is used or available in its entirety for greenhouse operations. The appraiser then identifies other parcels of land similar in size to the front portion of the parcel that remains available for greenhouse operations after the registration of the conservation easement. The appraiser notes that, where parcels of land over 20 hectares are used for greenhouse operations, the value of the land per hectare is similar, regardless of the size of the parcel. The appraiser establishes the value of the front portion of the subject property by multiplying the value per hectare by the size of the front portion of the subject property and making an upward adjustment to take into account the aesthetic benefits associated with the protected rear area. The appraiser uses this second method to confirm the value established by the first method.

### **Restricting forestry to sustainable practices**

A property is zoned for forestry, with specific permitted uses restricted to forestry, silviculture and agriculture. No subdivision is allowed under the current regulations affecting the land.

A conservation easement is registered on the property placing limitations on the use of the property, restricting subdivision and substantially reducing timber harvesting activities from what is currently permitted. Any timber harvesting must be done according to specific standards identified in the easement.

The appraiser concludes that the highest and best use, both before and after the registration of the conservation easement, is extraction of the forestry cover. However, after the registration of the conservation easement, the amount of timber available for extraction is substantially reduced and the actual costs of logging are higher.

The appraiser decides that the direct comparison approach to value is the most appropriate for the underlying land before the registration of the conservation easement. The market value of the timber is valued in consultation with a forestry expert. The combined value of the bare land and the merchantable timber is used to determine the market value of the property.

The appraiser decides that this method is also appropriate to value the property after the registration of the easement and makes appropriate adjustment for changes in the volume of timber available for extraction and the associated higher costs of cutting the timber. In the second valuation, the appraiser also carefully compares the results of valuing the bare land plus timber against the market evidence of sales of large acreage holdings that have no development potential.

## **Part 4: Guidelines for appraisal reports for gifts of conservation easements**

### ***Introduction***

When a donor makes a gift of a conservation easement, the donor and the recipient will need to know the value of the gift for tax planning and other purposes. This generally will involve working with a real estate appraiser.

This part outlines the information that should be provided to an appraiser to ensure that the appraiser is able to conduct a thorough appraisal and complete an accurate appraisal report. It describes the content of an appraisal report in general terms. It explains the principles and procedures used by appraisers in valuing charitable gifts of conservation easements. While much of this information may be relevant to obtaining an appraisal of a conservation easement in connection with the sale of a conservation easement, the focus of this part is on charitable gifts.

This part also describes the specific requirements that apply to valuing ecological gifts of partial interests in land. The Ecological Gifts Program requires donors wishing to make an ecological gift to provide appraisals as evidence of the value of the gift.

This part assumes that the donor will engage the appraiser. In practice, the recipient of a donation of a conservation easement is often involved in selecting and engaging the appraiser. The recipient may want to obtain independent advice about the value of a gift. In other cases, the recipient may be cooperating with the donor in obtaining an appraisal or may be obtaining an appraisal on behalf of a donor. In these cases, it is important for the recipient to keep the donor advised throughout the process.

### ***Engaging an appraiser***

The appraisal is central to obtaining tax benefits associated with the gift of a conservation easement. Selecting and engaging the appraiser are therefore important steps. Consider the following criteria when choosing an appraiser:

- **Qualifications**—What are the appraiser’s professional qualifications? Is the appraiser qualified to carry out the appraisal required?
- **Availability**—Is the appraiser available to do the work within the necessary timeframe?
- **Local knowledge**—Does the appraiser have experience with and knowledge of the local real estate market and conditions and, in particular, experience in valuing similar types of property?
- **Appraiser’s relationship to donor and recipient**—Does the appraiser have an arm’s length relationship to the donor and recipient? (For ecological gifts, all appraisals must be at arm’s length; appraisals done by the donor, by a close friend, family member or business associate

of the donor, by a corporation or partnership in which the donor holds a significant interest or by the recipient are not acceptable.)

- Experience and expertise in the kind of appraisal you want done—Does the appraiser have any experience appraising the kind of property you need appraised (for example, a conservation easement) and conducting the kind of appraisal you require (for example, for the Ecological Gifts Program)?
- Specific training—Does the appraiser have any training relevant to the assignment, and, if it is a proposed ecological gift, has the appraiser completed the Ecological Gifts Program Appraisal Training Course?

## Proposed ecological gifts

To qualify for the tax benefits associated with ecological gifts, donors of ecological gifts must submit an Application for Appraisal Review and Determination accompanied by an appraisal report to Environment Canada's Ecological Gifts Program. The Ecological Gifts Program's Appraisal Review Panel reviews each appraisal and makes a recommendation to the Minister of the Environment regarding the fair market value of the gift. It is essential that appraisers undertaking assignments to appraise ecological gifts familiarize themselves with and adhere to the requirements of the Ecological Gifts Program.

All appraisals of proposed ecological gifts must conform to the requirements of The Standards or, in Quebec, Les normes de pratique professionnelle des évaluateurs agréés (Les normes de pratique). All appraisers, whether or not they are members of the Appraisal Institute of Canada or l'Ordre des évaluateurs agréés du Québec (the organizations that prepare The Standards and Les normes de pratique), are expected to be familiar with The Standards or, in Quebec, with Les normes de pratique. When engaging an appraiser, the donor of a proposed ecological gift must ensure that the appraiser can meet this requirement.

In addition, appraisal reports relating to ecological gifts must be prepared in accordance with the Ecological Gifts Program's *Guidelines for Appraisals*. The current version of the *Guidelines for Appraisals* is available on the Ecological Gifts Program website at <http://www.cws-scf.ec.gc.ca/egp-pde/>.

The *Guidelines for Appraisals* have been prepared to assist appraisers in the preparation of appraisals of ecological gifts and include, among other things, the following:

- general requirements for valuation of all ecological gifts, regardless of their fair market value;
- a number of considerations that should be applied to different categories of gifts;
- mandatory format requirements for appraisals;
- information about the timing of appraisals;
- acceptable qualifications for appraisers of ecological gifts;
- details about certificates that must be completed for appraisals;
- contact information for Program coordinators across Canada.

All appraisers engaged in the valuation of ecological gifts should consult the *Guidelines for Appraisals* before undertaking an assignment. Donors who engage the services of an appraiser for the valuation of an ecological gift should provide the *Guidelines for Appraisals* to the appraiser at the earliest opportunity.

## **Letters of engagement**

When the donor and the appraiser have reached an agreement about completing the appraisal assignment, the donor should provide the appraiser with a letter of engagement. Appendix C contains a sample letter of engagement in which a donor, or a recipient, engages an appraiser to value a conservation easement that is a proposed ecological gift. The letter sets out the terms of the assignment. In the letter of engagement, the donor should tell the appraiser how many copies of the appraisal report are required from the appraiser and identify who will be provided with a copy of the report.

Before finalizing the engagement and to ensure that the donor and the appraiser understand all of the terms of the assignment, the donor should ask the appraiser to provide, in writing,

- an estimate of the total fees, disbursements and applicable taxes for completing the assignment; and
- the estimated date for delivery of the completed appraisal report.

If the appraisal is being prepared for a proposed ecological gift, questions may arise to which responses are necessary to clarify the appraiser's opinion of value during the Appraisal Review and Determination Process carried out by the Ecological Gifts Program's Appraisal Review Panel. The appraiser should include in the fee estimate an estimate of fees for time required to respond to such questions.

## ***Information to provide to the appraiser***

The type of information that a donor should provide to an appraiser will depend on the type of real property and the purpose of the conservation easement. The more complete the information, the more efficient and economical the appraisal process will be.

An appraiser will need a number of pieces of information. If the donor is able to provide the information, it will assist in ensuring a thorough and accurate appraisal and may save time and money. Some of this information may exist in publicly available records, but providing it to the appraiser can make the process more efficient.

After choosing an appraiser, the donor should provide the following information to the appraiser before the appraiser undertakes the assignment of valuing the conservation easement:

- full name and address of each registered owner of the property;
- contact information for each registered owner and each easement holder;
- contact names and phone numbers for arranging access to and an inspection of the property;

- civic description of the property with full street or mailing address;
- location of the property with directions on how to get to the property, if required;
- complete legal description of each parcel of the property;
- copy of the title for each parcel of the property showing all charges registered against the property;
- copies of charges registered against the property with plans attached where relevant;
- size of the property;
- brief physical description of the property and any improvements;
- map, plan, survey or boundary sketch of the property with improvements identified;
- graphics, photographs and, if available, air photographs of the property showing several aspects of the property and drawings of any important features;
- if a baseline report is available, information about how the appraiser can obtain access to the baseline report;
- a final copy of the conservation easement agreement or the most recent draft with the date of the document clearly identified; and
- any other information about the property or the market that the donor thinks is relevant to the appraiser's completion of the appraisal assignment.

If a final copy of the conservation easement is not available when the appraiser conducts the appraisal assignment, the donor must provide the appraiser with the final easement agreement when it is available so the appraiser can determine whether or not there has been a change in value as a result of the changes to the agreement.

Depending on the property being appraised, the following information should also be provided to the appraiser:

- income and expense data relating to the property for the past several years;
- summary of money spent on recent capital improvements;
- copies of leases or other agreements affecting the land or improvements;
- inventory of water rights associated with the property and a history of their use and yield;
- soil survey information;
- timber valuation information;
- other resources on the land, such as gravel or aggregate;
- any development plans;
- any subdivision applications or approvals.

### ***Contents of an appraisal report for real property***

This section describes the contents of an appraisal report supporting an opinion of the fair market value of a conservation easement. As one court explained:

The meaning of fair market value is too well known to require repetition but for an expert's opinion to carry any weight he or she must set out facts from which the opinion may be formed, the determination of

premises and assumptions and the articulation of conclusions flowing from the facts selected and from the premises or assumptions.<sup>12</sup>

These comments show the need for a comprehensive appraisal report explaining how the opinion as to value is formed.

The form, length and content of an appraisal report will vary depending on the nature of the property being appraised and the content of the conservation easement. This section describes the kind of information that can be expected to be included in an appraisal report.

The information in an appraisal of a conservation easement normally will be in the form of a narrative report supported by maps, photographs and copies of relevant documents. The Ecological Gifts Program provides that, in situations where certain criteria are met, appraisals of ecological gifts under a specified fair market value can be completed using the Ecological Gifts Program's Summary Report, available in a pre-printed form from the Program.<sup>13</sup>

Not all appraisal reports will contain all of the sections described below. Generally, however, reports will have the following types of sections: introduction; property description; analyses and conclusions; and appendices. Within these general sections there may be a variety of headings, not all of which will be included in every appraisal report.

## **Letter of transmittal**

The appraisal report will be delivered to the client with a letter of transmittal. Appendix D contains a sample letter of transmittal. In some circumstances, the letter of transmittal will be very brief. In other circumstances, it will be more detailed and will summarize the report's main conclusions as to value. In addition, the letter of transmittal will frequently include an identification and brief description of the property appraised and the effective date of the opinion as to value. In all circumstances, the letter of transmittal will contain the appraiser's opinion of value and be signed by the appraiser. It also may contain the certificate of the appraiser.

The information summarized in the letter of transmittal should be explained in greater detail in the full report.

## **Executive summary**

Some appraisals have a very brief letter of transmittal and are followed by an executive summary that provides a summary of important facts as well as the appraiser's major points and conclusions, including the conclusion of value.

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<sup>12</sup> *McCoy v. Canada*, 2003 D.T.C. 660, supplementary reasons at 2003 D.T.C. 1559.

<sup>13</sup> Check with the Ecological Gifts Program about the use of the Summary Report and the fair market value of gifts that can be appraised using the Ecological Gifts Program's Summary Report.

## **Introduction**

An appraisal report generally will begin with an introduction containing some or all of the following information:

- the terms of reference of the appraisal;
- the purpose of the appraisal;
- the scope of the appraisal;
- the intended use of the appraisal;
- any extraordinary assumptions;
- the format of the appraisal report and the process and approach used;
- the nature of the property interest being appraised (fee simple, easement);
- a definition of fair market value;
- the effective date of the appraisal.

If the appraisal does not have an executive summary, the introductory portion of an appraisal report may also include a summary of the full appraisal report.

## **Description of property**

Every appraisal report will include a description of the property being appraised. This description generally will include the following:

- the location of the property;
- information about property ownership;
- the legal description;
- a description of the site and of the improvements, if any;
- a description of charges, if any, against the property, and copies of the charges where relevant;
- in the case of appraisal of an easement, a dated copy of the easement document, the document that describes the nature of the interest being appraised.

## **Analyses and conclusions**

This section will form the bulk of the appraisal report. It will contain the facts relevant to value, an analysis of the facts and the conclusions based on the analysis of the facts. The information generally will be set out in a narrative fashion supported by photographs, maps, copies of documents such as charges against the property, land use legislation, and so on.

Every appraisal report will contain an explanation and analysis of the highest and best use of the property. In addition, depending on the circumstances and the nature of the interest being appraised, some or all of the following kinds of information will be included in this section of an appraisal report:

- facts relevant to valuation of the property, including

- local government zoning and land use information, particularly as it affects the subject property;
- local government assessments and property taxes;
- a description of the region in which the property is located, including geographical features and economic indicators (building and other economic activity, transportation, employment and so on);
- a description of the community in which the property is located, including geographical features and economic indicators;
- a description of available services;
- a site description including the date and results of a site inspection;
- general real estate market data;
- an explanation of different approaches to real estate valuation and a description of the approach or approaches used in the appraisal;
- an analysis of an estimate of value based on the facts outlined in the report using one or more of the approaches described;
- a description of sales of comparable properties to support the estimate of value;
- a recitation of assumptions made by the appraiser and conditions that limit the scope of the appraisal report.

In the case of an easement appraisal using the before and after approach, the appraiser will be required to give an opinion as to the value of the land before the easement is granted and after. In these circumstances, this section of the appraisal report will contain an analysis supporting each opinion of value.

## **Certificate**

Every appraisal report will include a certificate of the appraiser in which the appraiser certifies that:

- the appraiser inspected the property;
- the appraiser considered all factors relevant to the value of the property;
- the appraiser has no interest in the property and is not biased;
- the information in the report is true and factual;
- the report and opinions and conclusions in the report are limited only in the ways described in the report;
- the report complies with specified standards;
- the appraiser is qualified to complete the appraisal competently;
- the persons or organizations specified in the certificate may rely on the opinion in the report;
- the opinion as to value in the report is that of the appraiser.

The Ecological Gifts Program requires a specific certificate to be included in its entirety in every appraisal submitted to the Program. The form of certificate is set out in the *Guidelines for Appraisals*, located on the Program's website at <http://www.cws-scf.ec.gc.ca/egp-pde/>.

## Appendices

Generally, an appraisal report will have appendices that attach supporting information to the report. The supporting information will be specific to the property being appraised, but the following kinds of information are likely to be attached:

- qualifications of the appraiser;
- copy of the easement;
- copies of any other relevant charges;
- relevant sections from land use legislation and the official community plan;
- a copy of the title to the land appraised in the report.

## Sample outline of contents

The following is a sample Table of Contents of an appraisal report:

### Certification

Letter of Transmittal and Certificate of Appraiser

### Analysis and Conclusions

Photographs of property

Summary of facts and conclusions

Purpose of appraisal

Intended use of appraisal

Terms of reference and extraordinary conditions

Report format

Property rights appraised

Effective date of appraisal

Legal description of property

Ownership and recent history of property

Municipal assessment and taxes

Scope of the investigations undertaken

Regional description

Neighbourhood description

Site description

Land use controls

Description of improvements

Economic market overview

Real estate market overview

Highest and best use

Approaches to value in the appraisal process

Estimate of value using the [name of appraisal approach used]

Final estimate of value

Summary of results

Assumptions and limiting conditions

### Appendices

## **Part 5: Role of the easement holder in the appraisal process**

### ***Understanding the appraisal process***

It is essential that conservation organizations intending to hold conservation easements develop a basic understanding of the appraisal process and the valuation issues relevant to appraising partial interests in land. In the case of a charitable gift of a conservation easement to a conservation organization, it is the donor's responsibility to have the gift accurately valued. However, the recipient is also responsible for ensuring that the gift is accurately valued for the purpose of issuing an official donation receipt.

Having the gift accurately valued normally involves having an appraisal report completed. If the donation is a proposed ecological gift, the donor will have to meet the appraisal requirements of Environment Canada's Ecological Gifts Program, discussed in Parts 3 and 6.

In practice, the donor frequently looks to the recipient for advice about what is involved in the appraisal process, including advice about hiring a competent appraiser with experience in appraising conservation easements. The conservation organization needs to be familiar enough with the process to provide general guidance and identify issues or problems that must be addressed.

In addition, some conservation organizations are interested in purchasing conservation easements. In this case, the organization will likely want to retain an appraiser to ensure that the interest is accurately valued.

Easement holders with a sound understanding of the appraisal process will be better able to assist donors in ensuring that they claim tax credits or deductions based on competent, well-supported appraisals. They will also be in a better position to assist donors in compiling the information about the property and the conservation easement necessary for an appraiser to carry out the assignment in a timely and efficient manner.

### ***Understanding the appraisal report***

Conservation easement holders should become familiar with the contents of an easement appraisal report to learn what categories of information are included and how a competent appraiser makes a reasonable estimate of value. Familiarity with appraisal reports can also assist in identifying reports with inadequate support for the opinion of fair market value or reports where the opinion of value clearly is excessive or appears to be out of line with similar properties or easements.

No one benefits from appraisal reports that are not reasonable estimates of the fair market value of conservation easements. Although it may be attractive in the short term for a donor to receive a report with a very high value, if that value is not warranted and is not a reasonable estimate of the fair market value of the conservation easement, it places the donor at risk. If the gift is made

under the ordinary gift provisions of the *Income Tax Act*, the value may not be accepted by the Canada Revenue Agency. If the gift is a proposed ecological gift, the appraisal must be reviewed by the Ecological Gifts Program's Appraisal Review Panel, and the Panel may recommend a different fair market value to the Minister of the Environment. Both results will involve delays for the donor and may involve additional costs.

### ***Ensuring appraisers maintain independence***

To ensure that the valuation of a conservation easement is accepted by all parties, including those involved in reviewing its value, the valuation must be fair and objective. To assist in ensuring that all parties accept the value, the appraiser must not have a relationship with any party to the gift that could influence, or appear to influence, the valuation process.

Therefore, an appraisal should be conducted—and an appraisal report prepared—by an appraiser who is “at arm’s length” from the parties to the transaction. Among other things, this means that an appraiser who is employed by the recipient of a gift of an easement should not appraise the gift for tax purposes.

This is stated as follows in the Ecological Gifts Program's *Guidelines for Appraisals*:

All appraisals must be at arm’s length from the parties to the transaction. For example, appraisals done by the donor, by a close friend, family member or business associate of the donor, or by a corporation or partnership in which the donor holds a significant interest are not acceptable. Similarly, appraisals done by the recipient are not acceptable.

This approach is consistent with the approach taken in the United States. The U.S. Land Trust Alliance has addressed the issue of the relationship between donee (recipient) organizations and appraisers as follows:

Donee organizations should also be aware that employment of an appraiser on a retainer or on a frequent basis, even as an independent contractor, could jeopardize the appraiser's independence and could disqualify him under the qualification rules of Treas. Regs. 1.170A-13. The regulations make clear that those appraisers regularly retained by the donee will not be able to perform appraisals for easements donated to such charities.<sup>14</sup>

The U.S. regulations specifically do not permit an appraiser to be a person whose relationship to the taxpayer or the donee organization would cause a reasonable person to question the independence of the appraiser. As a result, in the United States, an appraiser who is regularly used by a donee organization and does not perform a substantial number of appraisals for other persons is not qualified to appraise property donated to that donee organization.<sup>15</sup>

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<sup>14</sup> *Appraising Easements: Guidelines for Valuation of Land Conservation and Historic Preservation*, 3rd ed., Washington, DC: Land Trust Alliance, National Trust for Historic Preservation, 1999, at p. 40.

<sup>15</sup> Small, Stephen J., *The Federal Tax Law of Conservation Easements*, Washington, DC: Land Trust Alliance, 1997.

## ***Providing information without giving advice to donor***

Donors often are not familiar with the appraisal process, particularly appraisals of conservation easements done in support of a proposed donation. Donors frequently look to recipient conservation organizations and land trusts for assistance through the process.

Recipients may be able to provide sound technical assistance to donors through all steps of a donation transaction, including the appraisal process. However, just as it is important for donors to obtain independent legal advice through the process and not rely on legal advice from recipients, donors must satisfy themselves that the appraisal of their conservation easement is prepared by a competent appraiser and that the opinion of value is a reasonable estimate.

A recipient may be able to provide information about the appraisal process, including where to obtain further information about any specific appraisal requirements, such as the appraisal requirements for the Ecological Gifts Program. A recipient also may be able to identify appraisers who have experience in appraising conservation easements and whose opinion of value generally is accepted by reviewing authorities.

However, providing information to donors is different from advising donors. Recipients should avoid advising landowners about what they should do or what actions are in their best interests. They should not assure donors of a particular outcome or advise donors about the specific tax implications of particular transactions.

If recipient organizations are involved in the appraisal process for appraisals that will be relied upon by donors, they should ensure that donors are well informed through all stages of the process. They should encourage donors to take whatever steps are necessary to fully understand the appraisal report and to obtain independent legal and tax advice that will allow the donors to fully understand the appraisal requirements and the implications of the completed appraisal report.

## Part 6: *Income Tax Act* provisions governing easements

### *Income tax*

Under Canadian income tax legislation, dispositions of easements may give rise to tax consequences.<sup>16</sup> A disposition of an easement may involve a sale for fair market value, a sale at less than fair market value or a gift. While some easements have little or no monetary value, many have a value that must be ascertained. Appraisals are used to determine the fair market value of property, including partial interests in land, for all tax purposes.

For tax purposes, land on which an easement is placed is classified as either capital property or inventory. The tax implications of a disposition of land will be different depending on whether the land is capital property or inventory. Inventory lands are lands acquired by a taxpayer for the purpose of subsequent sale in the course of a business rather than for the purpose of producing rental, agricultural or other income or for personal enjoyment. Inventory lands are lands acquired as inventory of a business—for example, lands held by a land developer that the developer intends to sell to others in the course of the developer's business. Generally, all other land is capital property.

Regardless of the nature of the property donated, an appraisal will determine its fair market value for tax purposes.

### **Charitable gifts of easements**

If a disposition of property is a gift within the meaning of the *Income Tax Act*, tax benefits may be available. A gift under the *Income Tax Act* is a voluntary transfer of property without valuable consideration.<sup>17</sup> To qualify as a gift, the transfer must be to a recipient qualified under the *Income Tax Act* to receive the particular kind of charitable gift and issue official donation receipts. These recipients include government agencies and registered charities.

Landowners who make a charitable gift of an easement are entitled to a non-refundable tax credit in the case of individuals and to a deduction of the amount shown on the official donation receipt in the case of corporations. Tax credits for individuals were previously calculated as 16% of the first \$200 of the eligible amount of the gift and 29% of the balance. For the year 2006, tax credits for individuals are calculated as 15.25% of the first \$200 of the eligible amount of the gift and 29% of the balance. The tax credit for 2007 will be calculated as 15.5% of the first \$200 of the eligible amount of the gift and 29% of the balance.

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<sup>16</sup> For more information about the tax implications of dispositions of real property, see the Ecological Gifts Program's *Donation and Income Tax Scenarios*; Ann Hillyer and Judy Atkins, *Giving It Away: Tax Implications of Gifts to Protect Private Land*, Vancouver, BC: West Coast Environmental Law Research Foundation, 2004; and Judy Atkins and Ann Hillyer, *Land Conservation Transactions: Tax Implications of Gifts of Land and Interests in Land*, Report No. 05-1, Ottawa, ON: North American Wetlands Conservation Council (Canada), 2004.

<sup>17</sup> Interpretation Bulletin IT-110R3, Part I, section 3. This is based on the common law interpretation of "gift." Sections 110.1 and 118.1 of the *Income Tax Act* deal with gifts. See the discussion about split-receipting below.

A corporate donor could deduct, in computing its taxable income for the year, the full eligible amount of the gift. For details on how to calculate the eligible amount of a gift for tax purposes, see the section below titled “Split-receipting.” The charitable gift tax credit is a federal tax credit and reduces the amount of federal tax payable. A provincial tax credit may also be available.<sup>18</sup> The impact of the tax benefits generally will be significantly greater when both federal and provincial tax benefits are taken into account.

In the case of charitable gifts of capital property such as land or interests in land, the amount against which a tax credit may be claimed is generally the total of

- 75% of the donor’s net income, plus
- 25% of taxable capital gains, plus
- 25% of recapture of any capital cost allowance arising as a result of the gift.<sup>19</sup>

Unused donations may be carried forward for up to five years and, in any of those years, deducted or a tax credit claimed to the extent that the donations were not used in a previous year. Tax credits are non-refundable and may only be used to offset tax liabilities. In other words, if a taxpayer cannot or does not use the full value of donations within the time allotted, the taxpayer loses any remaining benefit.

### **Gifts made in the year of death, including in a will**

In the year of death and the year preceding death, there is no income limitation on qualifying gifts (including gifts made in a will). This includes ecological gifts. Gifts made in a person’s will are deemed by the *Income Tax Act* to have been made immediately before the person died and not at the time the gifts are actually completed. Therefore, the relevant time as of which to value gifts made in a will is immediately before the testator’s death. Gifts by will are to be claimed in the taxation year in which the person died.<sup>20</sup>

Unclaimed gifts made in the year of death, including gifts by will, cannot be carried forward. Instead, unclaimed gifts made in the year of death may be carried back to the preceding taxation year, if the tax benefit could not be fully utilized in the year of death.<sup>21</sup>

### **Taxable capital gains**

As with a sale of capital property, if a donor makes a donation of capital property that has appreciated in value from the time the donor acquired the property, the donor will realize a capital gain. Unless the gift qualifies for special tax benefits (for example, as an ecological gift), 50% of the gain must be included in the donor’s income for the year. However, the tax credit or deduction that the donor will be able to claim generally will more than offset the additional tax resulting from the gain.

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<sup>18</sup> Donors should check with their tax advisers about the availability, nature and extent of provincial tax benefits.

<sup>19</sup> *Income Tax Act*, s. 118.1(1) (total gifts).

<sup>20</sup> *Income Tax Act*, s. 118.1(5).

<sup>21</sup> For further information, see Canada Revenue Agency’s pamphlet *Gifts and Income Tax*, available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/E/pub/tg/p113/>.

## Land that is not capital property

Gifts of land or interests in land that is not capital property—for example, inventory land—may qualify as gifts if they meet the criteria in the *Income Tax Act*. However, gifts of non-capital property will not attract the same tax benefits as gifts of capital property. In the case of charitable gifts of inventory land, the donor must include the fair market value of the land or the interest in the land donated in the donor's revenue for the year. In computing its profit, the donor may deduct the cost of the land or interest in land for tax purposes. Unlike gifts of capital property, the entire amount of the profit is included in the donor's income.

The result is that the tax implications of making a gift of land from inventory are essentially the same as those of making a cash donation. The *Income Tax Act* does not currently offer any tax incentives for businesses to donate inventory property rather than cash.

For more information about gifts for the purposes of the *Income Tax Act*, see *Gifts and Income Tax*, P113; *Gifts and Official Donation Receipts*, IT-110R3; *Gifts of Capital Properties to a Charity and Others*, IT-288R2; and *Gifts to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust*, IT-226R, available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/>.

## Split-receipting

A gift under the *Income Tax Act* is a voluntary transfer of property without valuable consideration. The transfer of the property must be made without the expectation of any benefit, advantage, right or privilege in return, unless the benefit or advantage is of nominal value. The benefit or advantage could be in the form of cash, other property or services.

On December 20, 2002, the Department of Finance introduced proposed amendments to the *Income Tax Act* that include provisions to facilitate split-receipting. On December 24, 2002, the Canada Revenue Agency issued interpretational guidelines on split-receipting that apply to gifts under the *Income Tax Act*.<sup>22</sup> Split-receipting can occur where a donor gives a gift to a qualified recipient, but the gift is only a portion of the entire transaction. Under split-receipting, the donor receives a receipt for income tax purposes for the value of the property transferred to the recipient, minus the value of the item or benefit that was given to the donor in return.

Before the introduction of these guidelines, the Canada Revenue Agency took the position that if the donor received something in return for making a donation, then the gift was not a gift under the *Income Tax Act* and the donor did not qualify for a tax receipt. A donor had to transfer the entire property comprising the gift and receive nothing<sup>23</sup> in return for it to be classified as a gift.

The proposed amendments change this interpretation and allow qualified recipients to do split-receipting where the donor has a clear intent to give a gift that will enrich the recipient. Under

<sup>22</sup> The proposed interpretational guidelines are contained in *Income Tax Technical News*, no. 26, at <http://www.cca-adrc.gc.ca/E/pub/tp/itnews-26/itnews-26-e.pdf>, and the legislative proposals and explanatory notes relating to the amendments to the *Income Tax Act* can be found at <http://www.fin.gc.ca/toce/2004/ita04-introe.html>.

<sup>23</sup> Tokens of appreciation for the donor's gift did not disqualify the gift.

the proposed legislation and policy, if the value of the advantage or benefit to the donor does not exceed 80% of the fair market value of the gift, the balance generally will be eligible for a tax credit or deduction. If the value of the advantage to the donor exceeds 80% of the fair market value of the transferred property, the gift may still qualify for a tax credit or deduction if the donor can establish to the satisfaction of the federal Minister of National Revenue that the transfer was made with the intention to make a gift. The eligible amount of the gift is the excess of the value of the property transferred to the recipient over the amount of the benefit or the advantage provided to the donor.

The proposed amendments to the *Income Tax Act* were not yet enacted at the time this publication was prepared. However, the Canada Revenue Agency has stated that the guidelines may be followed by donors and recipients for gifts made after December 20, 2002.

## Ecological gifts

To encourage the conservation of habitat and biodiversity in Canada, the Government of Canada provides tax incentives to those who donate ecologically sensitive land or an interest in ecologically sensitive land to qualified recipients.

An ecological gift is a particular kind of charitable gift under the *Income Tax Act*. A number of specific requirements are associated with ecological gifts, and donors of ecological gifts receive special tax benefits.

The *Income Tax Act* defines an ecological gift as

a gift ... of land (including a covenant or an easement to which land is subject or, in the case of land in the Province of Québec, a real servitude) if

- (a) the fair market value of the gift is certified by the Minister of the Environment,
- (b) the land is certified by that Minister, or a person designated by that Minister, to be ecologically sensitive land, the conservation and protection of which is, in the opinion of that Minister or that person, important to the preservation of Canada's environmental heritage, and
- (c) the gift was made by the individual in the year or in any of the five preceding taxation years to
  - (i) Her Majesty in right of Canada or of a province,
  - (ii) a municipality in Canada,
  - (iii) a municipal or public body performing a function of government in Canada, or
  - (iv) a registered charity one of the main purposes of which is, in the opinion of that Minister, the conservation and protection of Canada's environmental heritage, and that is approved by that Minister or that person in respect of that gift.<sup>24</sup>

The Ecological Gifts Program is administered by Environment Canada.

As with other charitable gifts under the *Income Tax Act*, ecological gifts entitle individual donors to a non-refundable tax credit and corporate donors to a deduction in computing taxable income.

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<sup>24</sup> *Income Tax Act*, ss. 110.1(1)(d) and 118.1(1), definition of "total ecological gifts" as amended by proposed amendments not yet enacted.

Ecological gifts differ from other charitable gifts, however, in that they are not subject to an “income limit” in computing the amount of the donor’s tax credit or deduction in respect of a gift.

In addition, ecological gifts benefit from a reduction in the normal taxable capital gain realized on the disposition of the property. Donors of ecological gifts of capital property receive a reduction in the taxable capital gain realized on the disposition of the property. In general, a taxpayer’s taxable capital gain is one-half the capital gain realized from the disposition of capital property. Until recently, where the disposition was an ecological gift, the amount of the taxable capital gain was generally only one-half of the gain that would otherwise be taxable. For example, for gifts made in 2005, the inclusion rate for capital gains realized on making an ecological gift was 25%. Under the 2006 federal budget, donations of ecological gifts are fully exempt from capital gains tax, effective May 2, 2006. For ecological gifts made after May 2, 2006, no portion of any capital gain deemed to arise on making the gift is taxable.

To qualify for the tax benefits associated with ecological gifts, the gift must satisfy all the criteria for an ecological gift—it must be a gift of land or an interest in land that is certified as ecologically sensitive by the Minister of the Environment; the recipient must be qualified to receive ecological gifts; and the fair market value of the land or interest in land must be certified by the Minister of the Environment.

As mentioned above, the certification process requires donors to have the value of the land or easement appraised and to submit an Application for Appraisal Review and Determination of fair market value together with the appraisal report to Environment Canada. The application is then reviewed by an Appraisal Review Panel, which will either recommend that the Minister determine the value of the gift to be that contained in the appraisal report or recommend another value.

If the Minister determines that the fair market value of the gift is a value other than that contained in the appraisal report, the donor may seek a redetermination by the Minister of the fair market value.

If the donor accepts the fair market value as determined or redetermined by the Minister, the Minister will issue a Statement of Fair Market Value of an Ecological Gift at the value as determined or redetermined by the Minister. The Minister will issue the Statement of Fair Market Value of an Ecological Gift only after receiving evidence, such as a registered transfer document, that the ecological gift has been made. The recipient of the gift will then issue an official donation receipt to the donor for the amount set out in the Statement of Fair Market Value of an Ecological Gift.

The value determined or redetermined by the Minister will apply to the land or easement, covenant or servitude for all income tax purposes related to charitable donations and gifts for a period of two years from the date of the determination or redetermination.<sup>25</sup>

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<sup>25</sup> *Income Tax Act*, s. 118.1(10.1).

A tax may be imposed on a municipality or registered charity that has received an ecological gift and then disposes of it or changes its use without the authorization of a designated certification authority.<sup>26</sup> The amount of the penalty tax is 50% of the fair market value of the property at the time of the unauthorized disposition or change in use.

### Calculating the original cost of an easement

To determine the amount of capital gain arising from a donation of capital property, the adjusted cost base of the property must be established. The adjusted cost base of land is the original cost adjusted as permitted by the *Income Tax Act*.<sup>27</sup> However, determining the original cost of an easement placed on land after the acquisition of the land can be difficult. While the original cost of the land itself is generally easily determined (the cost of purchasing the land), this is not true of an easement. Since there is usually no original purchase price for the easement itself, there is no amount that can be clearly allocated to it.

The *Income Tax Act* provides that where only part of a capital property is disposed of, the gain or loss on disposition is calculated by attributing as much of the adjusted cost base of the entire property to the part being disposed of as is reasonable.<sup>28</sup>

Despite the problems inherent in doing so, donors generally will have to take steps to determine the adjusted cost base of a donated easement. One method of doing so has been incorporated in the *Income Tax Act*<sup>29</sup> to provide a formula for determining the cost base of easements that qualify as ecological gifts. The formula, which applies to ecological gifts made after February 27, 1995, is:

<b>(A × B) divided by C</b>	where:	<b>A</b> is the original adjusted cost base of the land before the easement
		<b>B</b> is the value of the easement
		<b>C</b> is the fair market value of the land immediately before the easement was granted

This cost base would be used to determine whether granting the easement gives rise to a capital gain or loss. The *Income Tax Act* also provides that, for greater certainty, the donor's cost of the land itself is reduced at the time of the gift by the amount determined to be the cost base of the easement.

No such clarification has been proposed for easements that are not certified as ecological gifts. However, it is arguably reasonable to use the same formula to determine the adjusted cost base of all easements, covenants and servitudes, whether or not they are ecological gifts.

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<sup>26</sup> *Income Tax Act*, s. 207.31.

<sup>27</sup> *Income Tax Act*, s. 53. The adjustments may include additional costs of purchasing the property, such as legal fees.

<sup>28</sup> *Income Tax Act*, s. 43.

<sup>29</sup> *Income Tax Act*, s. 43(2).

## **Provincial income tax**

Each province has its own income tax legislation. Like the federal government, provinces impose income tax. Provincial rates, which vary from province to province, are calculated either at rates set out in the provincial legislation or as a percentage of the federal tax rate.

Provincial tax credits and deductions are also generally available. For example, provincial legislation may offer tax incentives for ecological gifts that augment the federal incentives. The impact of both tax liabilities and tax benefits generally will be greater when both federal and provincial tax implications are taken into account. In British Columbia, for example, the combined value of the federal and provincial tax credit in 2004 was 43.7% of the amount of a donation in excess of \$200. The federal tax credit is 29%.

Appraisal reports will provide evidence of the value of easements for the purposes of provincial as well as federal income tax.

## **Legal guidelines for easement appraisals**

As we have seen, the tax implications of transactions involving conservation easements are based on their fair market value. The objective of an easement appraisal is therefore to determine the easement's fair market value.

### **Fair market value**

“Fair market value” is not defined in the *Income Tax Act*. However, the courts have considered the meaning of “fair market value” and “market value” on many occasions. An appraisal report represents an opinion of value by an expert. In the case of disputes, expert valuation opinions are presented to the courts as evidence of value. In the absence of a statutory definition of value, the definition included in The Standards<sup>30</sup> or something similar to it has generally been accepted by the courts.

In *Carr v. Canada*,<sup>31</sup> for example, the Tax Court of Canada stated:

Fair market value is not defined in the [Income Tax] Act. However, the judicial definition accepted by the courts in Canada is that of Cattanach J. in *Henderson Estate and Bank of New York v. M.N.R.*, 73 D.T.C. 5471 (F.C.T.D.), at page 5476:

The statute does not define the expression “fair market value”, but the expression has been defined in many different ways depending generally on the subject matter which the person seeking to define it had in mind. I do not think it necessary to attempt an exact definition of the expression as used in the statute other than to say that the words must be construed in accordance with the common understanding of them. That common understanding I take to mean the highest price an asset might reasonably be expected to bring if sold by the owner in the normal method applicable to the asset in question in the ordinary course of business in a market not exposed to any undue stresses and composed of willing buyers and sellers dealing at arm's length and under no compulsion to buy or sell. I would add that the foregoing understanding as I have expressed it in a

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<sup>30</sup> Reproduced in Part 3.

<sup>31</sup> [2004] T.C.J. No. 319.

general way includes what I conceive to be the essential element which is an open and unrestricted market in which the price is hammered out between willing and informed buyers and sellers on the anvil of supply and demand. These definitions are equally applicable to “fair market value” and “market value” and it is doubtful if the use of the word “fair” adds anything to the words “market value”.

In *In Re Mann Estate*,<sup>32</sup> the Supreme Court of Canada stated:

The expression “fair market value” is well known in law and, indeed, there is little dispute before me as to the definition of the term. It has been the subject of much judicial discussion ...

I do not intend to quote at length from these authorities, but it is clear, from an examination of them, that the expression “fair market value” means the exchange value, the value an asset will bring in the market and, where no market exists, that value must be determined by other indicia of value. I refer to a passage in the judgment of Estey J. in *Attorney General of Alberta v. Royal Trust Co.*, (supra), at p. 288 [S.C.R.], which is representative of the views expressed in the other authorities referred to:

It is not suggested that the Commissioner has overlooked any factor that ought properly to have been taken into account in determining the value of the property. He had to determine the market value and when, as in this case, no market exists, it is the task of the Commissioner, so far as he can, to construct a normal market and to determine the value by taking into account all the factors which would exist in an actual normal market—a market which is not disturbed by factors similar to either boom or depression, and where vendors, ready but not too anxious to sell, meet with purchasers ready and able to purchase. Such a task is often very difficult, and this case is no exception.

The Saskatchewan Court of Appeal explained the following:

In James G. McLeod and Alfred A. Mamo’s *Matrimonial Property Law in Canada*, an article by Stephen R. Cole and Andrew J. Freedman appears at V-i. They provide this standard definition of fair market value (see V-2):

What is Fair Market Value?

The meaning of “fair market value” has been developed largely in the context of taxation law. It is submitted that, in Canada, the generally accepted definition of “fair market value” is: The highest price available in an open and unrestricted market between informed, prudent parties acting at arm’s length under no compulsion to act, expressed in terms of money or money’s worth.

Based on this definition, the main elements of the concept of “fair market value” are: there must be a willing buyer, there must be a willing seller, there must be an unrestricted market, the parties must be informed and knowledgeable, the parties must be acting at arm’s length, and the highest price or maximum value must be sought.<sup>33</sup>

In the absence of a statutory definition of “fair market value,” as is the case with the *Income Tax Act*, these are the kinds of definitions the courts will attribute to the term.

As discussed above, The Standards include a definition of market value that reflects these judicial comments. It is reproduced in Part 3.

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<sup>32</sup> [1972] 5 W.W.R. 23.

<sup>33</sup> *Russell v. Russell* (1999), 179 D.L.R. (4<sup>th</sup>) 723 (Sask. C.A.).

## Other legal guidelines

As discussed in Part 1, determining the fair market value of conservation easements presents a number of difficulties. In the past, there has been little legislative guidance for valuation professionals who were asked to value easements. In addition, reaching common ground as to principles and methods to apply to valuing easements has proved problematic.

The situation has now changed in relation to easements that qualify as ecological gifts. As explained in Part 3, the *Income Tax Act* authorizes the use of the before and after approach in valuing easements, covenants and servitudes. The Act specifically provides that the fair market value of an ecological gift of a covenant, easement or servitude to which ecologically sensitive land is subject is the greater of

- the fair market value otherwise determined of the gift; and
- the amount by which the fair market value of the land is reduced as a result of the making of the gift.<sup>34</sup>

The Canada Revenue Agency has provided no further interpretation of this provision of the *Income Tax Act*.

There are no similar provisions relating to gifts of easements that are not certified as ecological gifts. However, it could be argued in many circumstances that the before and after approach is the most reasonable approach to valuing easements whether or not they qualify as ecological gifts.

At the time of writing, the authors were not aware of any cases in Canada addressing the valuation of conservation easements and analyzing the appropriate valuation standards or methods.

In one Ontario case, the province's Court of Appeal was called on to consider the appropriate measure of damages after the Agricultural Research Institute of Ontario had breached a contract to buy from a landowner a restrictive covenant intended to protect tender fruit lands in the Niagara region.<sup>35</sup> The value of the covenant was calculated using the before and after method. However, the method of valuation was not in issue, and, for the purposes of its decision, the court accepted the valuation of the covenant.

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<sup>34</sup> *Income Tax Act*, ss. 118.1(12), 110.1(6).

<sup>35</sup> *Agricultural Research Institute of Ontario v. Campbell-High* (2002), 58 OR (3d) 321 (CA), application for leave to appeal to Supreme Court of Canada dismissed.

## **Appendix A: Provisions in the *Income Tax Act* related to ecological gifts**

The following provisions of the federal *Income Tax Act* set out the main requirements for ecological gifts. The full text of the provisions can be found on the Department of Justice of Canada website at <http://laws.justice.gc.ca/en/I-3.3/>.

### **Section 118.1**

- applies to individuals

### **Section 110.1**

- applies to corporations

## **Appendix B: Ecological Gifts Program *Guidelines for Appraisals***

Donors of ecological gifts must have the fair market value of the land, easement, covenant or servitude appraised according to the *Guidelines for Appraisals* and must submit the appraisal report with the Application for Appraisal Review and Determination. The *Guidelines for Appraisals* have been prepared to assist appraisers in the preparation of appraisals of ecological gifts and include, among other things, the following:

- general requirements for valuation of all ecological gifts, regardless of their fair market value;
- a number of considerations that should be applied to different categories of gifts;
- mandatory format requirements for appraisals;
- information about the timing of appraisals;
- acceptable qualifications for appraisers of ecological gifts;
- details about certificates that must be completed for appraisals; and
- contact information for Program coordinators across Canada.

See the Ecological Gifts Program website at <http://www.cws-scf.ec.gc.ca/egp-pde/> for the current version of the *Guidelines for Appraisals*.

## Appendix C: Sample letter of engagement for valuing a gift of a conservation easement

[If donor retains appraiser]

Jack and Sally Smith  
4414 Treebark Lane  
Fairgrove, Ontario

[OR]

[If recipient retains appraiser]

ABC Land Conservancy  
123 Wildwood Street  
Fairgrove, Ontario

July 10, 2005

Action Real Estate Appraisers Ltd.  
4456 Birch Avenue  
Fairgrove, Ontario

Attention: Mr. John Doe, AACI

Dear Mr. Doe:

**RE: Appraisal Conservation Easement on Smith Property – SW 34-28-13-W2**

We are writing to confirm our earlier correspondence and telephone conversations with you regarding our request for appraisal services from your firm, Action Real Estate Appraisers Ltd. The purpose of this appraisal is to establish the fair market value of a conservation easement on the property located on Treebark Lane, Fairgrove, Ontario. We intend to donate [or, have donated] the conservation easement to the ABC Land Conservancy. [Or, Jack and Sally Smith intend to donate [or, have donated] the conservation easement to our organization, the ABC Land Conservancy.] We require a full narrative appraisal [or, a pre-printed summary report] with respect to the current market value of the conservation easement that will be [has been] registered against title to the property.

The conservation easement on this property is to be [was] the subject of a gift under Environment Canada's Ecological Gifts Program. The Ecological Gifts Program promotes the donation of privately held land certified as ecologically sensitive as well as

donations of conservation easements, covenants or servitudes on ecologically sensitive land. The donations can be made to a variety of types of recipients, including registered charities approved by Environment Canada. The tax benefits associated with the Ecological Gifts Program are established under the federal *Income Tax Act*. The Program is administered by Environment Canada, and the Minister of the Environment determines the fair market value of the gifts for income tax purposes.

Donors wishing to make an ecological gift must provide an appraisal to the Ecological Gifts Program as evidence of the value of the gift. The Ecological Gifts Program's Appraisal Review Panel reviews each appraisal and makes a recommendation to the Minister regarding the fair market value of the gift.

The Ecological Gifts Program has specific appraisal requirements, which are set out in the *Guidelines for Appraisals*, a copy of which is enclosed for your reference. All appraisals must meet the requirements of the Canadian Uniform Standards of Professional Appraisal Practice (The Standards) [Or, in Quebec, Les normes de pratique professionnelle des évaluateurs agréés].

We refer you to the website of the Ecological Gifts Program at <http://www.cws-scf.ec.gc.ca/egp-pde/> for information about the Program and other useful references.

We require an appraisal from you that will be submitted to the Ecological Gifts Program as evidence of the fair market value of this gift. To assist you with this assignment, we enclose the following information:

- Full name and address of each registered Owner, with current contact information should you need to arrange access to inspect the property;
- Civic description of the property;
- Directions for locating the property;
- Legal description of the property;
- Copy of the title certificate with copies of all registered charges;
- The size of the property;
- Brief physical description showing all improvements;
- A map, a plan of the property, photos showing several aspects of the property and drawings of several important features;
- A summary of the baseline report for the property;
- A copy of the final version of the conservation easement [or, a copy of the draft conservation easement showing the date of the draft].

The *Income Tax Act* specifically provides that the fair market value of an ecological gift of a covenant, easement or servitude to which ecologically sensitive land is subject is the greater of

- its fair market value otherwise determined; and
- the amount by which the fair market value of the land is reduced as a result of the making of the gift.

In most cases, the second method (known as the before and after method) is used to determine whether, and to what extent, granting a conservation easement changes the value of real property. Simply put, the before and after valuation method involves forming an opinion as to two separate values—the value of the real property immediately before the grant of the conservation easement and its value immediately after the grant of the easement. The value of the conservation easement will be the difference between the two values.

Since this appraisal will be used as evidence of the fair market value of an ecological gift, it will be reviewed by the Appraisal Review Panel as part of the Appraisal Review and Determination Process.

We confirm that your professional fees, together with disbursements and expenses, will not exceed \$xxxxxxx, exclusive of GST. In addition, we confirm that your quotation includes time for answering questions about the appraisal, if necessary to clarify your opinion of value, during the Appraisal Review and Determination Process carried out by the Appraisal Review Panel and Environment Canada.

We confirm that you will provide us with 5 copies of the completed appraisal report no later than \_\_\_\_\_.

We look forward to receiving your report. If you require any further information or clarification about this assignment, please contact us as soon as possible.

Yours truly,

Jack and Sally Smith

[OR]

Harvey Green  
Director of ABC Land Conservancy

c.c. Donor [or recipient, as appropriate]

## Appendix D: Sample letter of transmittal and summary of conclusions

### Action Real Estate Appraisers Ltd.

4456 Birch Avenue  
Fairgrove, Ontario

September 15, 2005

[If donor retains appraiser]

Jack and Sally Smith  
4414 Treebark Lane  
Fairgrove, Ontario

[OR]

[If recipient retains appraiser]

ABC Land Conservancy  
123 Wildwood Street  
Fairgrove, Ontario

Dear \*\*\*:

#### **RE: Appraisal of Conservation Easement on Smith Property – SW 34-28-13-W2**

As you requested in your letter of July 10, 2005, we have prepared a full narrative appraisal report on the above referenced property. The purpose of the report is to estimate the fair market value as at the date specified below of a conservation easement registered [or, to be registered] against the above referenced property (the Conservation Easement). We have completed our appraisal using the “before and after” approach to value with the resulting difference estimated to be the fair market value of the Conservation Easement.

After inspecting the property and analyzing the available and most suitable market evidence, we are of the opinion that the market value of the Conservation Easement as of September 1, 2005, was:

**Two hundred and fifty thousand dollars (\$250,000)**

This appraisal report has been prepared for the purpose of determining the fair market value of a gift of the Conservation Easement under the Ecological Gifts Program. The supporting data on which this estimate is based are contained in the accompanying report, and the estimate of value is subject to the assumptions and contingent and limiting conditions set out in the appraisal report.

Yours truly,

Action Real Estate Appraisers Ltd.

John Doe, AACI

## Executive Summary

<b>Registered Owners</b>	Jack and Sally Smith
<b>Property Location</b>	Treebark Lane Fairgrove, Ontario
<b>Property Identification No.</b>	PID 000-111-222-333
<b>Legal Description</b>	SW 34-28-13-W2
<b>Size of Property</b>	5 hectares (12.35 acres)
<b>Interest Appraised</b>	Conservation Easement
<b>Zoning</b>	Rural
<b>Type of Property</b>	Vacant partly forested land
<b>Improvements</b>	Unimproved
<b>Conservation Easement Restrictions</b>	No subdivision; only one residence limited in size and location with limited ancillary buildings; no cutting, removal or destruction of native flora or fauna except as permitted
<b>Highest and Best Use Before Conservation Easement</b>	Rural residential building site with possibility of subdivision; limited agricultural use before eventual development
<b>Highest and Best Use After Conservation Easement</b>	Limited rural residential site; protected habitat
<b>Estimated Value of Fee Simple Interest Before Conservation Easement</b>	\$600,000
<b>Estimated Value of Fee Simple Interest After Conservation Easement</b>	\$350,000
<b>Estimated Value of Conservation Easement</b>	\$250,000
<b>Effective Date</b>	September 1, 2005

## References and resources

### *Useful websites*

The following websites contain information about the appraisal process, income tax or protecting private land.

#### **Canada**

Appraisal Institute of Canada <http://www.aicanada.ca/>

Association des techniciens en évaluation foncière du Québec <http://www.atefq.ca/>

Canada Revenue Agency <http://www.cra-arc.gc.ca/>

Canadian Wildlife Service <http://www.cws-scf.ec.gc.ca/>

Ducks Unlimited Canada <http://www.ducks.org>

Ecological Gifts Program <http://www.cws-scf.ec.gc.ca/egp-pde/>

The Land Centre (Real Estate Foundation of British Columbia)  
<http://www.realestatefoundation.com/landcentre.html>

The Land Conservancy of British Columbia <http://www.conservancy.bc.ca/>

Land Trust Alliance of British Columbia <http://landtrustalliance.bc.ca/>

Nature Conservancy Canada <http://natureconservancy.ca/>

North American Wetlands Conservation Council (Canada) <http://wetlandscanada.org>

Ontario Land Trust Alliance <http://www.ontariolandtrustalliance.org/>

Ordre des évaluateurs agréés du Québec <http://www.oeaq.qc.ca/>

Stewardship Canada <http://www.stewardshipcanada.ca>

West Coast Environmental Law <http://www.wcel.org/>

Wildlife Habitat Canada <http://www.whc.org/>

#### **United States**

American Society of Appraisers <http://www.appraisers.org/>

The Appraisal Foundation <http://www.appraisalfoundation.org/>

Appraisal Institute (U.S.) <http://www.appraisalinstitute.org/>

Land Trust Alliance <http://www.lta.org/>

National Trust for Historic Preservation <http://www.nationaltrust.org/>

The Nature Conservancy <http://www.tnc.org/>

The Trust for Public Land <http://www.tpl.org/>

### ***Useful publications***

Andrews, William J. and David Loukidelis. *Leaving a Living Legacy: Using Conservation Covenants in BC*. Vancouver, BC: West Coast Environmental Law Research Foundation, 1996.

*Appraising Easements: Guidelines for Valuation of Land Conservation and Historic Preservation Easements*. 3rd ed. Washington, DC: Land Trust Alliance, National Trust for Historic Preservation, 1999.

Atkins, Judy and Ann Hillyer. *Land Conservation Transactions: Tax Implications of Gifts of Land and Interests in Land*. Report No. 05-1. Ottawa, ON: North American Wetlands Conservation Council (Canada), 2004.

Atkins, Judy, Ann Hillyer and Arlene Kwasniak. *Conservation Easements, Covenants and Servitudes in Canada: A Legal Review*. Report No. 04-1. Ottawa, ON: North American Wetlands Conservation Council (Canada), 2004.

Attridge, Ian C. *Conservation Easement Valuation and Taxation in Canada*. Report No. 97-1. Ottawa, ON: North American Wetlands Conservation Council (Canada), 1997.

*The Canadian Ecological Gifts Program Handbook 2005*. Gatineau, QC: Environment Canada, Canadian Wildlife Service, Ecological Gifts Program, 2005.

*Capital Gains*, T4037, available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/>.

Denhez, Mark. *Giving Nature Its Due: Tax Treatment of Environmental Philanthropy: Recent Improvements, Remaining Barriers and Current Opportunities*. Sustaining Wetlands Issues Paper No. 2003-1. Ottawa, ON: North American Wetlands Conservation Council (Canada), 2003.

- Denhez, Mark. *You Can't Give It Away: Tax Aspects of Ecologically Sensitive Lands*. Sustaining Wetlands Issues Paper No. 1992-4. Ottawa, ON: North American Wetlands Conservation Council (Canada), 1992.
- Department of Finance. *Legislative Proposals and Draft Regulations Relating to Income Tax*, February 2004; available on the Department of Finance website at [http://www.fin.gc.ca/drleg/ita-1\\_1e.html](http://www.fin.gc.ca/drleg/ita-1_1e.html).
- Department of Finance. *Legislative Proposals, Draft Regulations and Explanatory Notes Relating to Income Tax*, February 2004; available on the Department of Finance website at <http://www.fin.gc.ca/toce/2004/ita04-introe.html>.
- Donation and Income Tax Scenarios*. Ottawa, ON: Environment Canada, Canadian Wildlife Service, Ecological Gifts Program, 2004; available from the Ecological Gifts Program website at <http://www.cws-scf.ec.gc.ca/egp-pde/default.asp?lang=en&n=104A9481>.
- Findlay, Barbara and Ann Hillyer. *Here Today, Here Tomorrow: Legal Tools for the Voluntary Protection of Private Land in British Columbia*. Vancouver, BC: West Coast Environmental Law Research Foundation, 1994; available on the West Coast Environmental Law website at <http://www.wcel.org/wcelpub/5110/>.
- Gifts and Income Tax*, P113; available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/E/pub/tg/p113/>.
- Gifts and Official Donation Receipts*, Interpretation Bulletin IT-110R3; available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/E/pub/tp/it110r3/>.
- Gifts of Capital Properties to a Charity and Others*, Interpretation Bulletin IT-288R2; available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/E/pub/tp/it288r2/>.
- Gifts to a Charity of a Residual Interest in Real Property or an Equitable Interest in a Trust*, Interpretation Bulletin IT-226R; available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/E/pub/tp/it226r/>.
- Hillyer, Ann and Judy Atkins. *Giving It Away: Tax Implications of Gifts to Protect Private Land*. Vancouver, BC: West Coast Environmental Law Research Foundation, 2004; available on the West Coast Environmental Law website at <http://www.wcel.org/resources/publications/default.cfm>.
- Hillyer, Ann and Judy Atkins. *Greening Your Title: A Guide to Best Practices for Conservation Covenants*. 2nd ed. Vancouver, BC: West Coast Environmental Law Research Foundation, 2005; available on the West Coast Environmental Law website at <http://www.wcel.org/resources/publications/default.cfm>.

*Income Tax Technical News*, No. 26, December 24, 2002 (Proposed Guidelines on Split-Receipting); available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/E/pub/tp/itnews-26/itnews-26-e.pdf>.

Kwasniak, Arlene. *Conservation Easement Guide for Alberta*. Edmonton, AB: Environmental Law Centre, 1997.

Kwasniak, Arlene. *Alberta's Wetlands: A Law and Policy Guide*. Edmonton, AB: Environmental Law Centre, for the North American Waterfowl Management Plan, 2001.

Kwasniak, Arlene. "Local Revenue Base and Conservation Lands: a Law and Policy Review," prepared for the Leading Edge Conference, Victoria, BC, July 2003.

*A Legacy of Land: Conservation Easements and Land Stewardship: Conference Proceedings*. Edited by Arlene J. Kwasniak and Donna Tingley. Edmonton, AB: Environmental Law Centre, 1999.

Ontario Land Trust Alliance. *Land Securement Manual*. September 2003.

*Part Dispositions*, Interpretation Bulletin IT-264R, IT-264SR; available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/E/pub/tp/it264r/> and <http://www.cra-arc.gc.ca/E/pub/tp/it264rsr/>.

*Private Conservancy: The Path to Law Reform*. Edited by Arlene J. Kwasniak. Proceedings and additional material from the Environmental Law Centre's Conference on Private Conservancy held on January 13, 1994, in Edmonton, AB.

*Profit, Capital Gains and Losses from the Sale of Real Estate, Including Farmland and Inherited Land and Conversion of Real Estate from Capital Property to Inventory and Vice Versa*, Interpretation Bulletin IT-218R; available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/E/pub/tp/it218r/>.

*Registered Charities and the Income Tax Act*, RC 4108(E) 1204, available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/E/pub/tg/rc4108/>.

*Registering a Charity for Income Tax Purposes*, T4063(E) Rev. 01; available on the Canada Revenue Agency website at <http://www.cra-arc.gc.ca/E/pub/tg/t4063/>.

Silver, Thea M., Ian Attridge, Maria MacRae and Kenneth W. Cox. *Canadian Legislation for Conservation Covenants, Easements and Servitudes: The Current Situation*. Report No. 95-1. Ottawa, ON: North American Wetlands Conservation Council (Canada), 1995.

Stewardship Centre for British Columbia. *Green Legacies: A Donor's Guide for B.C.*; available on the B.C. Stewardship Centre website at <http://www.greenlegacies.ca/>.

Stewardship Centre for British Columbia. *The Stewardship Series*. Victoria, BC: British Columbia Ministry of Environment, Lands and Parks and Environment Canada, 1994–2002; available on the B.C. Stewardship Centre website at <http://www.stewardshipcanada.ca>.