

INSIDE

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- Ecological assets: commodities and programs in the environmental bank and trade system

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IN FUTURE ISSUES

- Agricultural liens under Revised Article 9 of the U.C.C.

Present interests for gift tax purposes

In *Hackle v. IRS*, Nos. 02-3093 and 02-3094, 2003 U.S. App. LEXIS 13936 (7th Cir. Jul. 11, 2003), Albert J. (A.J.) and Christine M. Hackl began a tree-farming business after A.J.'s retirement. The story begins with A.J. Hackl's search for a hobby that would allow him to keep his hand in the business world, diversify his investments, and provide a long-term investment for his family. Tree-farming fit the bill and, in 1995, A.J. purchased two tree farms (worth around \$ 4.5 million) and contributed them, as well as about \$8 million in cash and securities, to Treeco, LLC, a limited liability company that he set up in Indiana.

A.J. and his wife, Christine, initially owned all of Treeco's stock (which included voting and nonvoting shares), with A.J. serving as the company's manager. Under Treeco's operating agreement, the manager served for life (or until resignation, removal, or incapacity), had the power to appoint a successor, and could also dissolve the company. In addition, the manager controlled any financial distributions, and members needed his approval to withdraw from the company or sell shares. If a member transferred his or her shares without consent, the transferee would receive the shares' economic rights but not any membership or voting rights. Voting members could run Treeco during any interim period between managers, approve any salaries or bonuses paid by the company, and assumed to be correct, and the taxpayers bear the burden of proving otherwise. (See *Reynolds v. Comm'r*, 296 F.3d 607, 612 (7th Cir. 2002) citing *Pittman v. Comm'r*, 100 F.3d 1308, 1313 (7th Cir. 1996)).

The crux of the Hackls' appeal is that the gift tax does not apply to a transfer if the donors give up all of their legal rights. In other words, the future interest exception to the gift tax exclusion comes into play only if the donee has gotten something less than the full bundle of legal property rights. Because the Hackls gave up all of their property rights to the shares, they argued that the shares were excludable gifts within the plain meaning of § 2503(b)(1).

The government, on the other hand, interpreted the gift tax exclusion more narrowly. It argues that any transfer without a substantial present economic benefit is a future interest and ineligible for the gift tax exclusion.

The Hackls' initial argument was that § 2503(b)(1) automatically allows the gift tax exclusion for their transfers. The Hackls argued that their position reflects the plain—and only—meaning of “future interest” as used in the statute. The Hackls did not cite any cases that actually characterize § 2503(b)(1) as plain, and the term “future interest” is not defined in the statute itself.

The Hackls also argued that the Tax Court's reliance on materials outside the statute (such as the Treasury regulation definition of future interest and case law) was unnecessary. A number of cases (including *Stinson Estate v. United States*, 214 F.3d 846 (7th Cir.

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Retroactive application of right to farm law denied

In a private nuisance action brought by a business owner against a neighboring grain elevator, the Supreme Court of Nebraska has refused to retroactively apply amendments to the state's right to farm statute that became effective more than a year after the filing of the action and would have exempted the grain elevator from such a nuisance suit. *Soukop v. ConAgra, Inc.*, 653 N.W.2d 655 (Neb. 2002). The court determined that the amendments could not be retroactively applied because the state legislature did not clearly express the intention that the amendments be applied retroactively. See *id.* at 657-58.

On March 14, 1997, Lloyd Soukop filed a private nuisance against ConAgra, Inc., and Peavey Grain Company, Inc. (Peavey) in the Hall County district court. See *id.* at 656. Soukop owned a used car lot approximately one block from the grain elevator operated by Peavey. See *id.* Soukop alleged that “grain dust, chaff, and other materials”

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2000)) have looked beyond the language of § 2503(b)(1) for guidance. *See, e.g., United States v. Pelzer*, 312 U.S. 399, 403-04, 85 L. Ed. 913, 61 S. Ct. 659, 92 Ct. Cl. 624 (1941), and *Comm'r v. Disston*, 325 U.S. 442, 446 (1945) (stating that the regulatory definition of future interest has been approved repeatedly).

Furthermore, the fact that both the government and the Hackls have proposed different—yet reasonable—interpretations of the statute shows that it is ambiguous. Under these circumstances, it was appropriate for the Tax Court to look to the Treasury regulation and case law for guidance.

The Hackls also asserted that the applicable Treasury regulation supports the conclusion that giving up all legal rights to a gift automatically makes it a present interest. The applicable Treasury regulation states that a “future interest” is a legal term that applies to interests “which are limited to commence in use, possession, or enjoyment at some future date or time,” *Treas. Reg. § 25.2503-3*. The regulation also provides that a present interest in property is

“an unrestricted right to the immediate use, possession, or enjoyment of property or the income from property (such as a life estate or term certain).” The court did not think that this language automatically excludes all outright transfers from the gift tax. (*See also Hamilton v. United States*, 553 F.2d 1216, 1218 (9th Cir. 1977).

The issue of what is considered to be a future interest for purposes of the gift tax exclusion was considered in the Seventh Circuit in *Stinson Estate* 214 F.3d 846; 2000 U.S. App. LEXIS 11769. In *Stinson*, forgiveness of a corporation’s indebtedness was a future interest outside the gift tax exclusion because shareholders could not individually realize the gift without liquidating the corporation or declaring a dividend—events that could not occur upon the actions of any one individual under the corporation’s by-laws. In *Stinson*, the court said that the “sole statutory distinction between present and future interests lies in the question of whether there is postponement of enjoyment of specific rights, powers or privileges which would be forthwith existent if the interest were present.” *Id.* at 848-49 (quoting *Howe v. United States*, 142 F.2d 310, 312 (7th Cir. 1944)). In other words, the phrase “present interest” connotes the right to substantial present economic benefit. *See Fondren v. Comm’r*, 324 U.S. 18, 20 (1945).

In the *Hackl* case, Treeco’s operating agreement clearly foreclosed the childrens’ ability to realize any substantial present economic benefit. Although the voting shares that the Hackls gave away had the same legal rights as those that they re-

tained, Treeco’s restrictions on the transferability of the shares meant that they were essentially without immediate value to the children. Granted, Treeco’s operating agreement did address the possibility that a shareholder might violate the agreement and sell his or her shares without the manager’s approval. But, as the Tax Court found, the possibility that a shareholder might violate the operating agreement and sell his or her shares to a transferee who would then not have any membership or voting rights can hardly be called a substantial economic benefit. Thus, the Hackls’ gifts—while outright—were not gifts of present interests.

The Hackls argue that their LLC is set up like any other limited liability corporation and that its restrictions on the alienability of its shares are common in closely-held companies. Although that is true, the fact that other companies operate this way did not persuade the court that shares in such companies should automatically be considered present interests for purposes of the gift tax exclusion. The court closed by reiterating the rule that Internal Revenue Code provisions dealing with exclusions are matters of legislative grace that must be narrowly construed. The onus is on the taxpayers to show that their transfers qualify for the gift tax exclusion. The court noted this is a burden the Hackls did not meet. Thus, the Seventh Circuit affirmed the decision of the Tax Court in favor of the IRS.

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Right to farm law/Cont. from p. 1

discharged from the elevator settled on his inventory of used cars. *See id.* He also alleged that discharges from the grain elevator caused him to experience a loss of sales and diminished profits. *See id.* Soukop requested damages and injunctive relief. *See id.* Peavey denied that discharges from the elevator constituted a nuisance and asserted multiple affirmative defenses. *See id.*

Peavey filed a motion for summary judgment on June 4, 2001. *See id.* The county district court granted the motion, stating that § 2-4403 of the Nebraska Right to Farm Act as amended by L.B. 1193 in 1998, governed the dispute. *See id.* As a result of the 1998 amendment, § 2-4403 currently provides the following, with the language added by L.B. 1193 italicized:

A farm or farm operation or a public grain warehouse or public grain warehouse operation shall not be found to be a public or private nuisance if the farm or farm operation or a public grain warehouse or public grain warehouse operation existed before a change in the land use or occupancy of land in and about the locality of

such farm or farm operation or a public grain warehouse or public grain warehouse operation and before such change in land use or occupancy of land the farm or farm operation or a public grain warehouse or public grain warehouse operation would not have been a nuisance.

Id. at 657 (quoting Neb. Rev. Stat. § 2-4403 (Cum. Supp. 2002)).

The county district court noted that the grain elevator was built in 1936, and that Peavey had operated it since 1975 without any nuisance action being filed against it or receiving any written complaint about its operation. *See id.* at 656. The court also noted that Soukop had been a landowner near the elevator since 1967, but had only operated his used car lot since 1981. *See id.* In addition, it noted that there was no evidence that suggested that the grain elevator was a nuisance prior to the change in use of Soukop’s land. *See id.* Based on these facts, the county district court ruled that Peavey was entitled to judgment as a matter of law pursuant to § 2-4403. *See id.*

Soukop appealed the county district court’s decision arguing that § 2-4403 should

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Ecological assets: commodities and programs in the environmental bank and trade system

By Steve Melin

We all depend on clean water, air, and other natural amenities, which are often regarded as free. As the extent of environmental degradation becomes apparent, society is faced with increased pressure to improve environmental quality. Existing environmental policies have been designed to protect human health and welfare. However, quality of life improvements continue to be desired, and new environmental control measures are needed to facilitate progress.

Many regulatory controls have been put in place to protect the environment. Incentive-based markets have developed to protect environmental assets or ecosystem services and now exist because of the following regulatory controls:

- Clean Water Act (<http://www.epa.gov/npdps/pubs/cwatxt.txt>)
- Clean Air Act (http://www.epa.gov/air/oaq_caa.html)
- Endangered Species Act (<http://endangered.fws.gov/esa.html>)
- Safe Drinking Water Act (<http://www.epa.gov/safewater>)
- National Environmental Policy Act (<http://tis.eh.doe.gov/nepa/>)
- Mining Reclamation Act (<http://www.osmre.gov/smcra.htm>)
- Natural Resources Damage Claim Act (<http://www.epa.gov/oerrpage/superfund/programs/nrd/>)
- State Statutes – wetlands, water quality, flood control, rare species
- Montreal Protocol – SO₂ and NO_x (<http://www.epa.gov/history/topics/montreal/>)
- Kyoto Protocol and associated state and local statutes – CO₂ (<http://unfccc.int/resource/protintr.html>)

Because of the high costs associated with introducing new environmental controls, agencies are now turning to incentive-based, environmental management programs. These programs include bank and trade systems, tax incentives, and creative property easements, all of which encourage the private sector to become active in protecting and enhancing ecosystem services (EPRI, 2001).

Recent experience suggests that incentive-based environmental programs will likely play an increasingly important role in the United States (Newell et al., 2001). Currently, the approach to controlling pollution has been on a “point-by-point” or

“pollutant-by-pollutant” basis, which has been very effective in specific situations, but has failed to provide cost-effective compliance options. An arguably better approach is managing pollutants on a holistic or ecosystem-based approach (Frederick and Herd, 2001).

Since incremental improvement in existing environmental controls is both costly and politically difficult, agencies are now evaluating incentive-based strategies that are capable of improving environmental quality, satisfying regulatory requirements, meeting community goals and standards, and providing financial incentive to the stakeholder (Coleman, 2000).

Emission trading programs are one example of such approaches, with emission sources allowed to buy and sell tradable credits. Other examples include offset programs such as:

- Wetlands mitigation banking
- Stream mitigation banking
- Endangered species habitat bank and trade programs
- NO_x and SO_x trading programs
- TMDL trading programs
- Carbon sequestration programs

These programs expand the scope and level of environmental performance achieved by economic factors by providing financial incentives for involvement in accomplishing tangible performance beyond that which is required as a baseline. Under them, firms may compensate for permitted activities by creating or purchasing wetland or stream mitigation credits, equivalent effluent or emission reductions, or endangered species credits. The common feature of these programs is that they work to augment, not replace, existing regulatory compliance requirements.

Environmental credits (ecological assets)

Ecological assets (eco-assets) are the natural resources typically present on undeveloped land, such as forests and wetlands, streams, riparian corridors, and threatened and endangered species. Ecosystem services are the services that these healthy ecosystems provide to mankind, such as clean water, clean air, carbon sequestration by forests, water filtration and assimilation by riparian corridors and wetlands, and biodiversity afforded by thriving habitat. Applying an ecological asset perspective to land can result in the development of non-traditional values of property, which may include the following:

- Development of wetland mitigation credits,
- Development of stream mitigation credits,
- Management of habitat for rare, threat-

ened, and/or endangered species resulting in enhanced habitat and biodiversity values and the potential creation of species banking credits,

- Improvement of water quality and generation of waste load allocation credits,
- Management of agricultural and forest lands for carbon sequestration, and
- Development of the site to satisfy specific Natural Resource Damage Assessment (NRDA) claims against third parties.

These eco-asset credits can generate revenue, satisfy corporate ecological and environmental objectives, or be utilized to satisfy permitting or re-licensing requirements. Such practices represent an optimum balance of long-term ecological and economic returns-on-investment. By studying existing and potential land uses at the site with an eco-asset perspective in mind, it should be possible to obtain environmental compliance cost savings and create new revenues derived from the identification, appraisal, restoration, or enhancement of ecological assets (GreenVest, 2001).

Development of value from ecological resources can be accomplished by establishing individual projects for specific ecosystem services, from which ecological resource value mitigation “credits” can be produced. Eco-asset mitigation credits can be earned by preserving, enhancing, restoring, or creating valuable land ecosystem services associated with wetlands, riparian stream buffers, endangered/threatened/rare habitat, as well as the sequestration of nutrients and atmospheric carbon. The values from ecological asset banking and trade can come in the form of increased land appraisal value, developing tradable credits, or offsetting compliance obligations (Coleman, 1999).

Growth of ecological assets as tradable commodities is attributed to the increased cost of environmental compliance (\$155 billion for U.S. businesses in 1999, according to EPA estimates) and greater emphasis on preserving and enhancing clean air, clean water, and clean soil and protecting plant, animal, and bird habitats (GreenVest, 2001).

Types of ecological assets

Wetlands banking

Wetlands are vital ecosystems that are important to protecting and enhancing water quality, maintaining species biodiversity, mitigating floodwaters, providing fish nursery grounds, and providing human recreation.

During the early settlement of Colonial America, the United States contained an estimated 392 million acres of wetlands. Of this total, 221 million acres were located in the lower 48 states, and another 170 million acres were located in Alaska. Hawaii con-

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tained an estimated 59,000 acres. In the span of 200 years, the lower 48 states lost an estimated 53 percent of all original wetlands. "On average, the lower 48 states have lost over 60 acres of wetlands for every hour between the 1780's and the 1980's" (Dahl, 1990).

The Clean Water Act was passed by Congress in 1972 "to restore and maintain the chemical, physical, and biological integrity" of the Nation's waters. The concept of mitigation banking was later developed as a mechanism to compensate for unavoidable habitat losses primarily associated with federal Section 10 (Rivers and Harbors Act) and Section 404 (Clean Water Act) for wetland development projects.

Under the Clean Water Act, Congress authorized the U.S. Army Corps of Engineers to issue permits for the discharge of dredged or fill material into navigable waters and wetlands. Under the Clean Water Act's Section 404 Program, the Corps, as well as the Environmental Protection Agency, regulates the "discharge" of fill material into wetlands. To compensate for impacts to these waters, in some cases, permittees are required to mitigate for these impacts through the creation, restoration, enhancement, or preservation of wetlands. Historically, compliance with this requirement was undertaken one at a time on small, non-contiguous, and isolated pockets of ground, which were not tied hydrologically to any natural wetland system. These sites were difficult to properly monitor and were too numerous to properly regulate. Mitigation efforts frequently failed. Today, mitigation for impacts to wetlands is increasingly developed in advance of the actual need and put aside in "banks" or projects certified for the future by state and federal regulators. These banks, known as wetland mitigation banks, are subjected to strict design, construction, and success criteria, with the ultimate goal being to help prevent net loss of wetlands. This concept was first conceived almost two decades ago and in most cases has proven successful. Only since 1995, has guidance been available for the establishment, use, and operation of wetland mitigation banks (USACE, 1995). The issuance of this guidance helped establish a formal process for evaluating and approving projects as well as establishing a market for the banking, selling, and trading of wetland mitigation credits.

Stream mitigation

The United States has more than 3.5 million miles of rivers and streams that along with closely associated floodplain and upland areas, comprise corridors of great economic, social, cultural, and environmental value. Over the years, human activities contributed to changes in the equilibrium of stream systems in the US. These activities have altered stream courses for the purposes of water supplies, irrigation, trans-

portation, hydropower, waste disposal, mining, flood control, timber management, urban disturbances, and many others. The cumulative effect is significant, not only to stream corridors, but to degradation of water quality, decrease water storage potential, loss of habitat, and decreased recreational and aesthetic values.

Similar to wetlands, Section 404 of the Clean Water Act requires stream mitigation for unavoidable impacts to perennial streams of the U.S. Mitigation is required for impacts to greater than 300 linear feet of stream channel. Impacts less than 300 feet are allowed under the nationwide permit (NWP) system. Protecting and restoring streams benefits water quality, wildlife habitat, and aesthetics. The science of stream restoration is developing, and credits are being bought and sold in a number of states, including North Carolina, Maryland, California, and Colorado. Stream mitigation credits may be bought and sold by any individual and utilized by individuals to satisfy permit requirements for compensatory mitigation within a given region. As with wetland mitigation, the U.S. Army Corps of Engineers, along with other State and Federal agencies, reviews mitigation plans and projects used to create stream mitigation credits.

Endangered species habitat banking and trade

The Endangered Species Act was signed into law in 1973 and protects endangered species from harm or any act of "taking." Congress wanted this act to protect not only the listed species but also the ecosystem needed by these species to live and survive (<http://www.ti.org/History.html>). The administration of the Endangered Species Act is shared between the Fish and Wildlife Service (FWS) and the National Marine Fisheries Service (NMFS). Generally, the Fish and Wildlife Service coordinates Endangered Species Act (ESA) activities for terrestrial and freshwater species, while National Marine Fisheries Service is responsible for marine and anadromous species.

The banking of mitigation credits for endangered species is on the same historical trajectory as wetlands. Few banks have been developed, and no formal guidance or federal policy is in place (EDF, 1999). However, in order to meet the stated goals of the ESA and counter the increasing loss of habitat on private lands, there is an emerging need to develop such banks in the United States. Habitat conservation plans (HCPs), safe harbor agreements (SHAs), and candidate conservation agreements (CCAs) have been developed to meet the goals of the ESA.

HCPs allow a "taking" of some habitat by development or land management activities in exchange for a minimization of habitat disturbance or through protection or restoration of habitat elsewhere (mitiga-

tion). The development of habitat conservation plans (HCPs) was initiated in 1983 by Congress through Section 10 of the Endangered Species Act. HCPs were designed to promote habitat conservation through partnerships with private entities, state, federal, and local agencies. Under Section 10, states, local governments, and private landowners may impact a listed species or its habitat by means of an Incidental Take Permit. These permits are issued following a review of an HCP outlining minimization and mitigation plans for impacts to the listed species. These plans allow for the incidental taking of a species while ensuring its long term recovery.

The use of the HCP provision, as well as the development of the other types of conservation plans, has increased considerably within the last six years. As of July 15, 2003, 425 Habitat Conservation Plans have been approved within the U.S. that cover approximately 38 million acres and protect more than 532 endangered or threatened species (<http://endangered.fws.gov/hcp/>).

Safe harbors offer regulatory protection to landowners whose management could improve species habitat and attract additional individuals or species. Under these agreements, a landowner would be encouraged to maintain or enhance existing populations of listed species, to create, restore, or maintain habitats, and/or to manage their lands in a manner that will benefit listed species. In return, the Services would provide assurances that future landowner activities would not be subject to ESA restrictions above those applicable to the property at the time of enrollment of the program. Candidate Conservation Agreements (CCAs) use the same logic, but the difference is that they apply to species that are candidates or proposed for listing under the ESA.

NOx and SOx trading programs

Under the Clean Air Act, EPA developed several market-based programs as control remedies for SOx and NOx emissions. These programs offer distinct advantages over traditional command and control programs including:

- Reduced cost of compliance
 - Creation of incentives for early reductions
 - Creation of incentives for emissions reductions beyond those required by regulations
 - Promotion of innovation
 - Increased flexibility
- (<http://www.epa.gov/airmarkets>)

SOx

Under the Clean Air Act of 1990, a sulfur dioxide credit trading program was established as a means to reducing SO₂ emissions by 10 million tons below the 1980 level (25.9 M tons) and to protect public health and the environment. The Sulfur

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Dioxide (SO₂) Allowance Program, as it was called, allowed the trading of "allowances" among utilities where one allowance would be a limited authorization to emit one ton of SO₂. In 1995, the first year of the program, 445 utility programs were affected, thereby reducing SO₂ emissions by 7.9 million tons from the 1980 level (McLean, 1996).

Allowances can be bought and sold by any individual, corporation, municipality, broker, environmental group, or private citizen. Due to an emission cap set forth by EPA, new sources of emissions must acquire allowance credits from existing allowance holders or through government auctions. EPA maintains the central registry of allowances and handles transactions (<http://www.epa.gov/airmarkets>).

NOx

Nitrogen oxide emissions into the atmosphere have been documented to affect human health and the environment. Coal-fired utilities have been targeted for emission reductions under several programs: 1) Federal NOx Budget Trading Program, 2) NOx Budget Trading Program under the NOx SIP call, and 3) Ozone Transport Commission's NOx Budget Program. All three programs were established to utilize market-based strategies for reducing NOx emissions in a cost-effective manner from, for example, "upwind" states under Section 126 of the Clean Air Act. Clean Air Act Amendments of 1990 set a goal of reducing NOx by 2 million tons from 1980 levels. Under these amendments, EPA established the Acid Rain program to implement these emission reductions for coal-fired electric utility boilers (<http://www.epa.gov/airmarkets>).

As with the SOx emission reduction programs, allowances can be bought, traded, and sold by private individuals, governments, and corporations.

Total Maximum Daily Load (TMDL) trading programs

EPA issued regulations in 1985 and 1992 that implement section 303(d) of the 1972 Clean Water Act—the TMDL provisions. A TMDL is a calculation of the maximum amount of a pollutant that a waterbody can receive and still meet water quality standards, and an allocation of that amount to the pollutant's sources. Due to the large number of impaired water bodies across the country, TMDL programs have been initiated to minimize pollutant loadings. Over 40% of assessed waters in the country do not meet water quality standards set forth by states, territories, and authorized tribes (EPA, 1998).

Although TMDLs were required in the Clean Water Act of 1972, few states and other entities have developed these programs. Only recently, as a result of legal actions against EPA, have TMDLs started to develop. The courts have decided TMDLs

must be initiated by the states or EPA (<http://www.epa.gov/owow/tmdl/>).

TMDL credits can be bought, sold, and traded among entities, provided the trade does not produce adverse impacts to water quality, locally or downstream. Trading provides watershed managers with opportunities to facilitate implementing loading reductions in a way that maximizes water quality and ecological improvements (<http://www.epa.gov/owow/tmdl/>). TMDL credits or pollution credits can be derived through a variety of pathways whereby a nutrient reduction goal is met for a particular watershed. TMDL credits can be earned by establishing a baseline, and then systematically reducing sediment or nutrient loading into a waterway from a specific property. The goal of these programs, as with the NOx and SOx cap and trade programs, is least cost compliance with environmental goals for a region, in this case, goals for improving water quality.

Carbon sequestration programs

A great deal of controversy exists concerning the carbon credit market and the economics surrounding this market. In theory, there is no credit market since there is no binding agreement or requirement for emissions limitations through international treaty and/or domestic regulations. Nor has this obligation been officially imposed on the carbon emitters. Nonetheless, considerable activity has occurred in producing, trading, and banking "carbon credits" despite the breakdown of the Kyoto Protocol and the refusal of the U.S. to sign the agreement. Several states, municipalities, and other entities have instituted Kyoto-like requirements for offsets and promoted the hedging or speculation of a future national and international carbon market. These efforts have been done by those seeking a good public image and obtaining credits at a low initial price that can be used to offset their own or another company's greenhouse gas [GHG] emissions. While the outcome of pending legislation and treaties is uncertain, the probability that in the medium term, (10-15 years), legally binding GHG limitations will be imposed on U.S. companies is perceived by many companies to be a significant risk. Accordingly, companies with long capital stock planning horizons are beginning to take steps, commensurate with their perception of risk, to protect themselves and their shareholders from that possibility. Utility and mining companies have been active in this effort.

Though the carbon sequestration market is still emerging, trading is already taking place. This is despite not having firm regulations in place for sequestering carbon. During the first nine months of 2002, approximately 330 million tons of CO₂ were traded.

Currently, it is difficult to put a precise dollar/ton value on credits in the emerging

U.S. carbon market. However, by seeing the urgent need to mitigate the excessive amounts of CO₂ emitted by the U.S., and by comparing markets from nations already active in emissions trading, solid estimates of carbon credit value can be derived for potential investors. The World Bank predicts a \$10 billion GHG market by 2005 (<http://www.chicagoclimatex.com/pdf/Fortune.pdf>).

The President's FY '03 budget requests over \$3 billion—as the first part of a ten-year (2002-2011) commitment to enhance the natural storage of carbon. The President also directed the Secretary of Agriculture to provide recommendations for incentives aimed at forest and agricultural sequestration of greenhouse gases. The President further directed the Secretary of Agriculture, in consultation with the Environmental Protection Agency and the Department of Energy, to develop accounting rules and guidelines for crediting sequestration projects, taking into account emerging domestic and international approaches.

Conservation sale/donation

There are several strategies as to the disposition of land from a tax standpoint, including donation of the property, or sale of the property at less than fair market value (bargain sale) to a 501(c)(3) organization. In addition, taxes on the gain under bargain sale are eligible for deferral in certain circumstances. Below is an outline of the tax methods.

Donation of property to a qualified 501(c)(3) organization gives the company a tax write-off equal to the fair market value (FMV) of the property donated. To determine the FMV of the property, both a traditional appraisal and an ecological assessment are undertaken to see what approach gives the highest value. A qualified appraisal is necessary to give an opinion for tax purposes on the value under each approach. The appraisal of ecological assets is becoming more common, and the methodology is acceptable to the IRS (GreenVest 2002).

Under the bargain sale approach, the property is sold to a qualified 501(c)(3) organization for an amount less than the FMV of the property. The difference between the sale price and the FMV is considered a donation and treated in a manner described in the above paragraph. In this manner the company can realize cash, receive tax benefits, and gain the goodwill for the donation.

Another strategy available in a bargain sale disposition is to take advantage of the benefits Section 1031 of the U.S. Tax Code. This provision allows the property owner to defer the recognition of capital gain and payment of taxes that would ordinarily be realized upon the disposition of their investment property by converting the pro-

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Ecological assets/Cont. from page 6

ceeds received from the sale into additional equity for reinvestment. The “sale” therefore becomes tax-free so long as the sale proceeds are reinvested in another property (GreenVest 2002).

Canaan Valley, WV: a case study on eco-asset evaluation

Allegheny Power owns property in Canaan Valley, which is located in Tucker County, West Virginia. Allegheny owns over 20,000 acres of properties in this region, which were purchased in the 1920's to build a hydroelectric facility. The company was forced to cancel the project after it failed to obtain a permit from the U.S. Army Corps of Engineers, thus necessitating finding alternative uses for the land.

At an average elevation of 3,200 feet, the Canaan Valley is the most elevated lowland of its size east of the Rocky Mountains. The valley supports many unusual plants and animals, being home to forty different wetland and upland plant communities and supporting more than 580 plant species. These habitats support equally interesting wildlife populations, with 290 species of mammals, birds, reptiles, amphibians and fishes known or expected to occur there, including several endangered and threatened species.

Because of the great diversity and ecological importance of this land, the US Fish and Wildlife Service showed great interest in purchasing the properties. However Allegheny Power was not interested in a direct sale of the land. An innovative idea that incorporated ecological value into the land was used in order to place this land into conservation.

GreenVest, LLC, a leader in determining ecological values, helped develop a report and subsequent ecological appraisal that resulted in recognizing additional ecological values for the land. A certified independent appraiser was hired to determine the value of the land. Unlike traditional real estate land appraisals, this appraisal also took into account the worth of the land's ecosystems.

This approach used incentive-based strategies that utilize the environmental credit market. Value can be created from the creation of “banks,” which can be applied to wetlands, carbon sequestration, endangered species, nutrient trading, and others. For example, the Allegheny Power properties included 253 acres of degraded wetlands, which if restored and established into a wetland mitigation bank, could have a net value of up to \$8,000/ac (Washington Post, 2002). The value placed on habitat mitigation was based on the appraiser's estimate of the value of these lands for threatened and endangered species habitat. The carbon sequestration values were based on managing existing forests for maximum carbon sequestration.

The official appraisal covered twenty-

nine properties that totaled 12,380.19 acres. In a sale, Allegheny would sell the land for \$16 million, in line with prior estimates based on similar sales. Since the properties' value was estimated higher than that amount, Allegheny Power would inform the Internal Revenue Service that its true market value was more than \$32 million. The “bargain sale” of these lands would allow Allegheny Power to claim a charitable contribution of roughly \$16 million. This in turn would save the company several million dollars in taxes.

The eco-asset approach allows properties to be put into conservation that would

Right to farm law/continued from p. 2

not have been applied retroactively. *See id.* The Nebraska Supreme Court moved the case to its docket on its own motion and reversed the district court's decision. *See id.*

The court began its analysis by reviewing the amended right to farm statute. *See id.* at 657. It noted that the amendment became effective July 15, 1998, more than a year after Soukop filed his action. *See id.* Soukop argued that his action was governed by the pre-1998 statute, which only protected a “farm or farm operation.” *Id.* (quoting Neb. Rev. Stat. § 2-4403 (Reissue 1997)). Thus, Soukop argued that Peavey's grain elevator did not fall within the statutory protections. *See id.* The court noted that there was no dispute that the grain elevator was a “public grain warehouse or public grain warehouse operation” and not a “farm or farm operation.” *Id.* (quoting Neb. Rev. Stat. § 2-4403 (Cum. Supp. 2002)).

The court explained that “substantive statutes are generally not given retroactive effect unless the Legislature has clearly expressed an intention that the new statute is to be applied retroactively.” *Id.* (citing *In re Interest of Clifford M. et al.*, 626 N.W.2d 549 (Neb. 2001)(additional citations omitted)). The court stated that the 1998 amendment would not govern Soukop's action unless the legislature clearly intended that it should operate retroactively. *See id.*

The court explained that in *Abbou v. Papio-Missouri River NRD*, 571 N.W.2d 302 (Neb. 1997), it found clear legislative intent for the amended statute in that case to apply retroactively in the language of the statute itself and not in the legislative history. *See id.* It also explained that in *Young v. Dodge Cty. Bd. of Supervisors*, 493 N.W.2d 160 (Neb. 1992), and *In re Interest of J.M.N.*, 464 N.W.2d 811 (Neb. 1991), it declined to apply an amended statute retroactively because no language clearly evidenced such intent by the legislature. *Id.* (citations omitted). The court stated that “[t]he common thread of each of the above-cited cases is that an inquiry as to whether the Legislature intended retroactive application of a statute began and ended with an examination of the words on the face of the statute.”

not otherwise have been. This movement in the market will lead to more conservation in the long-run. Without this approach it is unlikely this parcel would be conserved.

Corporations such as Allegheny Power own vast amounts of real estate. These properties are part of ecosystems that generate a wide array of services valuable to the human economy. Property owners are discovering ways of “capturing” a portion of the value of these services.

Editor's note: references may be obtained from the author at sjmelin@earthlink.net.

Id. at 658.

The court concluded that after examination of § 2-4403 as amended in 1998, there was no clear legislative intent to apply the amended statute retroactively. *See id.* Thus, it ruled that the pre-1998 version of § 2-4403 governed Soukop's action, and that the county district court erred when it granted summary judgment in favor of Peavey. *See id.* The Nebraska Supreme Court reversed the county district court's decision and remanded the matter for further proceedings. *See id.*

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