



April 6, 2011

### Mineral Rights and Conservation Easements-A Guide for Landowners

**The information contained in this Guide is for general background and planning only. Mineral rights issues and concerns will vary with each individual property. Consult an attorney for guidance and advice on how mineral rights issues might affect a conservation easement donation on your specific property.**

Maryland Environmental Trust (MET) has prepared this guide for landowners who may be interested in donating a conservation easement to MET but who have questions about the possibility of doing so based on the mineral rights status of their properties. This guide is provided as a service of MET but should not replace advice from your own legal counsel.

A conservation easement is a legal agreement between a landowner and a government entity or land trust that permanently limits the uses of the land in order to protect its conservation attributes. An easement allows landowners to continue to own, use, and manage their property, and sell it or pass it on to their heirs. Landowners may be eligible for a number of tax benefits associated with an easement donation. To learn more about conservation easements visit <http://www.dnr.state.md.us/met/>.

Since there are potential federal tax benefits associated with a conservation easement donation, the Internal Revenue Service (IRS) has guidelines and regulations governing their use. It is important to identify the status of a property's mineral rights because the exercise of mineral rights has the potential to adversely affect the permanence of a property's conservation attributes. If MET takes a perpetual conservation easement, the language in the document must clearly protect the cited conservation attributes from a future exercise of mineral rights, whether by the landowner or a third party.

#### STATUS OF MINERAL RIGHTS

There are three categories your property may fall into in regards to the status of mineral rights.

**Intact**-Your mineral rights are **intact** if you own 100% of the mineral rights to your land and that they are not owned, previously leased by you or a predecessor in title, or otherwise encumbered by another party.

**Leased**-Your mineral rights are intact and also **leased** if you own 100% of the rights but you or a predecessor in title leased some or all of the mineral rights associated with your property to another party and that lease is not expired.

**Severed**-Your mineral rights have been **severed** if you do not hold title to some or all of the mineral rights of your property.

The status of your mineral rights is important in determining whether and how you can protect your property with a conservation easement. In order to determine the status of your mineral rights, MET may require a title report.



April 6, 2011

Here, in question and answer format, are several scenarios to explain the effect of intact, leased, and severed minerals on the possibility of an MET-held conservation easement.

Scenario 1-Your mineral rights are **Intact**.

Question: Can we retain our mineral rights for ourselves (or to be subsequently leased to someone else) and donate a conservation easement to MET?

Answer: If you are considering both retaining your mineral rights for yourself (or to be subsequently leased to someone else) and then donating a conservation easement, it is important that you consult with MET early in the process. The answer depends on what type of minerals you wish to reserve. If you wish to reserve for yourself (or later lease to someone else) minerals that are extractable via *surface* mining (ex. coal), and you will want to seek a federal tax deduction in connection with the donation of your conservation easement, MET cannot accept a conservation easement because it won't be able to assure the IRS that the conservation purposes are protected in perpetuity since there is the possibility of extraction by a surface mining method. If you wish to reserve for yourself (or later lease to someone else) minerals that are extractable via *subsurface* mining (ex. oil, natural gas) and you will want to seek a federal tax deduction in connection with the donation of your conservation easement, MET can allow this subject to its approval. It will need to find that the impact will be limited, localized and not irretrievably destructive of conservation attributes. It will also review the proposed activity against Treasury Regulation 1.170A-14(g)(4). Other alternatives available to MET include (1) taking an easement on a portion of your property but excluding the place where the subsurface extraction will occur; or (2) taking an easement on your whole property but noting GIS locations in the field so that you and MET agree that disturbance will happen in certain area(s) but not bleed into other areas and thus jeopardize conservation attributes. MET might also want the right to review/approve any lease you execute after its conservation easement, such as requiring a surface use agreement to ensure that the conservation attributes to be protected under the conservation easement will be protected by any mineral extraction activity that may occur.

Scenario 2- Your mineral rights are **Intact**.

Question: We do not want any mineral extraction activity to occur on our property. Can a MET conservation easement prohibit this activity now and in the future?

Answer: MET's standard model conservation easement prohibits *surface* mining methods but allows sub-surface mining or drilling in accordance with Treasury Regulation 1.170A-14(g)(4) and subject to MET's approval, in which latter case MET would also have to consider whether the impact would be limited, localized, and irretrievably destructive of conservation attributes. If you are interested in prohibiting *sub-surface* mining



April 6, 2011

methods, too, MET would work with you to add this provision to your conservation easement.

Scenario 3-You (or a predecessor in title) have already **Leased** the mineral rights.

Question: Can we donate a conservation easement to MET even though our mineral rights are already leased?

Answer: If your mineral rights are already leased and the lease has not yet expired, there are a few options that you may explore. MET will need to see a copy of the lease and a surface use agreement, if any, to look at what types of minerals can be extracted and to evaluate whether the conservation attributes MET intends to protect are already protected by these documents. If you or your predecessor in title has already leased minerals that are extractable via *surface* mining (ex. coal), and you will want to seek a federal tax deduction in connection with the donation of your conservation easement, you can negotiate with the lessee to terminate the lease, thus uniting the mineral rights in you, the surface owner, or you can negotiate with the lessee to subordinate the lease to MET's conservation easement. Barring either of these, MET cannot accept a conservation easement because it won't be able to assure the IRS that the conservation purposes are protected in perpetuity since there is the possibility of extraction by a surface mining method.

If you or your predecessor in title has already leased minerals that are extractable via *subsurface* mining (ex. oil, natural gas), and you will want to seek a federal tax deduction in connection with the donation of your conservation easement:

1. If you wish to terminate the right for future mineral extraction (not a requirement), you can negotiate with the lessee to terminate the lease, thus uniting the mineral rights in you, the surface owner and then do a conservation easement.
2. Assuming you want to leave the lease in place, you can negotiate with the lessee to subordinate the lease to MET's conservation easement.

If the lessee will not terminate or subordinate its lease, MET's ability to take a conservation easement on your property will depend on the terms of the lease. (The issue is that neither you as landowner nor MET as easement holder can control what a third party can do). Even though the conservation easement might contain provisions against excavation, etc., these would not be binding on a lessee of a lease that existed prior to the conservation easement because the lessee is not party to the conservation easement. If the minerals are those extractable via *surface* mining method, MET can't take a federally-deductible easement. If the minerals are those extractable via a *subsurface* method, if the lease does not appear to conflict with the terms of the proposed conservation easement and if the impact of the *subsurface* mining will be



April 6, 2011

“limited and localized” and not irretrievably destructive of conservation attributes, it may be possible to donate a conservation easement. MET will review the proposed activity against 1.170A-14(g)(4). MET might also want the right to review/approve any lease (or amendment or extension of lease) for subsurface materials you execute *after* its conservation easement, such as requiring a surface use agreement to ensure that the conservation attributes protected by the conservation easement will be protected by any mineral extraction activity that may occur. If the lease does not contain provisions that will be protective of the conservation attributes once mineral extraction begins, MET may decline to accept a conservation easement or ask the landowner to wait until the lease ends and then evaluate the conservation attributes at that time before entering into a conservation easement.

**Scenario 4- Your mineral rights are Severed.**

**Question:** Is there any way to donate a conservation easement if the mineral rights are already severed?

**Answer:** If the mineral rights on/below your property are severed, you may be able to donate a conservation easement but you will need to determine if the reserved mineral rights are extractable by *surface* or *subsurface* methods.

1. If by *surface* (ex/coal, gravel), the issue is that neither you as landowner nor MET as the land trust can control what a third party can do. If the minerals were first severed after June 12, 1976, no deduction is permitted unless surface mining is completely prohibited. The IRS will not permit a deduction unless:
  - (a) You as landowner approach the mineral rights owner and buy back the mineral rights, thus uniting the mineral rights in you, the surface owner, who then grant a conservation easement; or,
  - (b) Same as (a), but accomplish unity of surface and mineral rights by establishing that mineral estate owner has “abandoned” mineral rights\*; or,
  - (c) Same as (a), but if mineral rights owner(s) won’t sell back rights to you as the surface owner, see if you as surface estate owner can negotiate with mineral rights owner(s) to agree to certain geographic “carve outs” for extraction, then exclude entirely from the conservation easement those areas where drilling would take place (“carve outs”); or,
  - (d) You as landowner approach the mineral rights owner and have them subordinate the mineral rights to the effect of the conservation easement, then grant a conservation easement.

\*Refer to Maryland Dormant Minerals Interests Act- Md. Ann. Code, Environment Article, 15-1201 et seq.



April 6, 2011

If the minerals were first severed after June 13, 1976, the easement can be federally deductible if:

- (a) you show that the minerals were first severed after June 13, 1976; and,
- (b) Surface and mineral owners are not “related persons” 1.170 A-14(g)(4)(ii)(A)(2); and,
- (c) You as landowner obtain a minerals assessment report (“remoteness letter”) to demonstrate that the probability of surface mining is “so remote as to be negligible” before you can proceed to a conservation easement. A remoteness letter looks at geological, geophysical, economic data, and commercial feasibility (1.170A-14(g))

2. If by *subsurface* (ex/ Oil, Gas by hydrofracing, deep coal)- It’s hard to demonstrate (with mineral rights held by a third party who could theoretically show up at anytime and start drilling in a way that neither you as landowner nor MET as easement holder could control) that conservation attributes will be protected in perpetuity as the statute requires. MET may be able to take an easement if the impact will be limited, localized and not irretrievably destructive of conservation attributes. Other alternatives are:

- (a) You as landowner approach the mineral rights owner and buy back the mineral rights, thus uniting the mineral rights in you, the surface owner, who can then grant a conservation easement; or,
- (b) Same as (a), but accomplish unity of surface and mineral rights by establishing that mineral estate owner has “abandoned” mineral rights\*; or,
- (c) Same as (a), but if mineral rights owner(s) won’t sell back rights to you as the surface owner, see if you as surface estate owner can negotiate with mineral rights owner(s) to agree to certain geographic “carve outs” for extraction, then exclude entirely from easement those areas where drilling would take place (“carve outs”); or,
- (d) You as landowner approach the mineral rights owner and have them subordinate the mineral rights to the effect of the conservation easement, then grant a conservation easement.

\*Refer to Maryland Dormant Minerals Interests Act- Md. Ann. Code, Environment Article, 15-1201 et seq.