Conservation Trust for Florida
Protecting Our Rural Lands

Tax Benefits of Conservation Easements

Reference: Byers, Elizabeth and Karin Marchetti Ponte. *The Conservation Easement Handbook, Second Edition, revised, and expanded.* Washington DC: Land Trust Alliance and The Trust for Public Land, 2005. Land Trust Alliance website: www.lta.org. *All information (except for information on Alachua County property tax assessment) was excerpted from this book.*

Federal Income Tax Benefits
The Internal Revenue Service (IRS) treats gifts of conservation easements in the same manner that it treats other gifts of land to qualified recipients – taxpayers can deduct the present value of their easement gifts as charitable deductions from income.

The value of a donated conservation easement for tax purposes generally equals the difference between the property's value before and immediately after the easement is granted. This difference is, in effect, the market value of the property rights the landowner extinguishes, and is the same whether the easement is donated or sold. If a landowner wishes to claim this amount as a charitable contribution, the valuation must be determined by an appraisal prepared by a qualified appraiser and commissioned by the landowner.

A landowner need not donate the entire easement value. In order to achieve a mix of tax benefits and cash, the easement may be sold for an amount less than the fair market (appraised) value. Then the difference between the easement's appraised value and the sale price is considered a donation. A part donation and part sale is called a bargain sale.

The level of income tax benefit that accrues to an easement donor depends on numerous variables, including the donor's income, the size of the gift in relation to the donor's income and the amount of other deductions claimed. Accordingly, the landowner must determine not only the value of the donation but also how the donation will impact his or her tax liability.

Also, a landowner can elect to deduct the easement gift more quickly, at a rate of 50 to 100% percent of adjusted gross income per year, if the easement value claimed is equivalent to the tax basis (usually, cost) of the gift. The tax basis excludes any appreciation in value.

On August 17, 2006 the President signed the Pension Protection Act which increased the tax benefits of protecting your land by donating a voluntary conservation agreement. These enhanced incentives expired in 2009, but were reauthorized in the 2010 Legislative session and currently apply until the end of 2011. These incentives make it easier for average Americans, including working family farmers and ranchers, to donate land. The legislation allows:

- A conservation agreement donor to deduct up to 50% of their adjusted gross income in any year;
- Qualifying farmers and ranchers to deduct up to 100% of their adjusted gross income; and
- Donors to take deductions for their contribution over as many as 16 years.

These changes allow many modest income landowners to deduct much more than they could under the old rules, bringing increased fairness to the tax code.

Federal Tax Code Requirements for Easement Donations**
Internal Revenue Code (IRC) Section 170(h) is the federal law that sets forth the requirements a conservation easement must meet to qualify for federal income and estate tax deductions. The legal term for easement gifts that

meet the 170(h) standards is *qualified conservation contributions.* The statute outlines three basic tests an easement donation must meet to be considered a qualified conservation contribution. It must be:

- A qualified real property interest (a conservation easement must be perpetual)
- Granted to a qualified organization (a government agency or public charity with conservation goals)
- Granted exclusively for conservation purposes (it must meet at least one of the following four purposes):
    1) Provides outdoor recreation or educational use for the general public.
    2) Protects a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem.
    3) Preserves open space (including farmland and forest land) where such preservation:
        (a) Provides scenic enjoyment for the general public, *or* is pursuant to a clearly delineated federal, state, or local government conservation policy, *and*
        (b) Yields significant public benefit.
    4) Preserves a historically important land area or a certified historic structure.

***Excerpted and condensed from the Land Trust Alliance's Standards and Practices Guidebook: An Operating Manual for Land Trusts (Washington, DC, 1997).*

Section 1.170A-14 of the Treasury Regulations defines each of the basic terms outlined in IRC Section 170(h). These detailed requirements explain the crucial elements of deductible conservation easement gifts. (CTF can provide you with a copy of the regulations, if requested.)

Gift Tax Savings
Easements also can reduce or eliminate gift tax on gifts of property made during a property owner's lifetime. For example, a landowner who wants to give land to his or her children must carefully structure the gift over time, or possibly face a substantial gift tax on the transfer. In 2003, an individual could give up to $11,000 in land value or cash per year ($22,000 for a married couple) to an unlimited number of people without incurring gift taxes, and up to $1 million could be gifted during a lifetime without incurring gift taxes. By granting an easement to a qualified organization before making the gift, the landowner may reduce the value of the land so that the gift tax is substantially less or even eliminated, and it may allow the annual partial gifts to be completed more quickly.

Tax Savings on Easement Sales
A gain on a sale of a conservation easement is the difference between the amount realized on the sale (less any costs directly related to the sale) and the seller's cost basis in the easement. In one case involving the purchase of an easement for its full market value, IRS Revenue Ruling 77-414 (1997) allowed the entire basis of the land (excluding the basis allocated to improvements), up to the amount of the sale proceeds, to be allocated to the easement sale. This revenue ruling reduced the capital gains tax on an easement sale, creating more favorable tax circumstances for easement sales. Advisors disagree on whether to rely on this revenue ruling for determining the level of tax savings, so landowners should seek professional tax counsel.

Estate Tax Benefits
When land passes from one generation to the next, heirs can be faced with enormous tax bills. For example, although a family may want to continue ranching on its 500 acres of mountain pasture, the estate taxes due when the land passes to the heirs are based on the property's "highest and best (economic) use," which may be 50 ten-acre lots. The amount of the estate tax could be high enough so the heirs would have no choice but to sell the property to pay it.

The estate tax is levied on the total value of an individual's nonexempt transfers of wealth, based on the market value at the time of death, and is generally due within nine months of the death. The taxes have been levied at rates as high as 55 percent, although the Economic Growth and Tax Relief Reconciliation Act of 2001 progressively phases out estate taxes through 2010. The legislation also revised the amount of an estate's value that is exempt from estate taxes to increase every year from $1 million in 2002 to $3.5 million in 2009. The estate tax rate decreases during this period from a maximum of 50 percent in 2002 to a top rate of 45 percent in 2009. The pre-

2001 estate tax is slated to be reinstated in 2011 with a $1 million exemption and a top tax rate of 55 percent, but Congress could change this outcome. Although a taxpayer may be able to transfer highly valued land to heirs without being subject to estate or gift taxes – because of the exemption – a family with a sizable or appreciated property may still gain a significant tax advantage from the reduction in value due to a conservation easement.

By donating an easement during his or her lifetime, the owner may realize the income tax savings of a charitable gift *and* lower estate taxes for the heirs. Alternatively, a landowner may choose to donate an easement upon his or her death by specifying in his or her will that an easement gift be made. The terms of the easement and the designated recipient are spelled out in the will, and IRC Section 2055(f) allows the value of a donated qualifying easement to be deducted from the taxable value of the estate. If the easement is not donated during the owner's lifetime, of course, the owner recaps no income tax benefits. Even if an easement donation is not part of the landowner's will, an executor (with the consent of the heirs, in most states) or heirs can donate a post-mortem easement. Although the future of estate taxes is uncertain, conservation easements will continue to play an important role as an estate planning tool.

IRC Section 2031(c): Additional Estate Tax Benefits

In 1997, Congress passed the Taxpayer Relief Act, which added IRC Section 2031(c) – "Estate Tax with Respect to Land Subject to a Qualified Conservation Easement." Under IRC Section 2031(c), if land is subject to a qualifying conservation easement, one that meets the requirements of IRC Section 170(h) and meets the additional requirements (see below), an additional 40 percent of the land's restricted value can be excluded from estate tax, up to $500,000. IRC Section 2031(c) must now be taken into account for every new easement that is drafted – even recorded easements should be reviewed to check for IRC Section 2031(c) eligibility. This provision does not apply to easements on certified historic structures, although such properties may benefit from its use if the easement serves one of the other conservation purposes.

There is still no case law on IRC Section 2031(c), and Treasury Regulations have not been written as of the time of this publication. Because the law has many complexities, a landowner and holder should consult an experienced tad or estate planning attorney. These are some of the key conditions an easement must meet:

- The land must have been owned by the decedent or a member of the decedent's family for at least three years prior to the decedent's death.
- The easement must have been donated by the decedent, a member of the decedent's family, executor of the decedent's estate, or certain trustees.
- The easement must prohibit all but "de minimis" (minimal) commercial recreational use of the land.
- The easement must reduce the value of the land by at least 30 percent or the applicable exclusion will be reduced.

Post-mortem Easement Donations

The IRC Section 2031(c) provision was clarified and amended under the IRS Restructuring and Reform Act of 1998 (IRC Section 2031[c][9]) to also allow an estate tax charitable deduction for the gift of a qualified conservation easement made after the death of a decedent and before the decedent's estate tax return is filed. This is known as a post-mortem easement. The provision that allows post-mortem easements to be deductible from estate taxes is especially valuable when a landowner dies before finalizing a conservation easement, or before following through on the intent to grant a conservation easement or include an easement in his or her will.

Even though the post-mortem provision allows heirs to place an easement on the property after the decedent's death, it is best for landowners to donate conservation easements during their lifetime, or in their wills, when there is adequate time to work through the easement provisions. If an easement is crafted during the landowner's lifetime, the owner is able to make decisions about how the lands' conservation resources will be protected, and can also benefit from income tax reductions. Also, the holder usually has more certainty that the easement will be granted if it works with the landowner instead of the heirs.

State law determines whether estate executors have the authority to grant a post-mortem conservation easement. While the law can of course vary from state to state, it now appears that post-mortem easements are possible in every state. Landowners should check with experienced advisors.

Property Tax Exemptions

Florida has recently passed a law to implement the 2008 Amendment 4 voter referendum. The new law reduces property taxes on land that is forty acres or greater and is under a permanent conservation easement beginning in 2010.

Now State law, sections 196.26(2)&(3), Florida Statutes, created new two classes of property tax exemptions:

- 100% exemption, for those lands protected with an irrevocable easement, (dedicated in perpetuity), provided that any income generated from the land be returned to the land in land management activities, (e.g. no net profit made from the land).
- 50%, exemption, the same rules apply, but there is no restriction on the profits made from the land.

It is important to note that in either case, agriculture is generally an allowed commercial use on conservation easements, and that the exemption does not apply to non-conservation uses on the land (such as a home, which will be assessed separately and taxed per usual). Also, for parcels less than 40 contiguous acres, it order to qualify for either of these exemptions, the conservation easement must be approved by the Florida Acquisition and Restoration Council (ARC), who will evaluate such lands utilizing a set of conservation-based criteria established by the Legislature. If over 40 acres, or approved by ARC, these exemptions become effective once the land owner has submitted form DR-418 (and renewed annually with DR-418CR) to their County Property Appraiser's office. Applying for the exemption (or reduction) is the taxpayer's responsibility.

For more information, please contact Conservation Trust for Florida, Inc.
P.O. Box 134, Micanopy Florida 32667-0134
Phone & Fax: 352-466-1178 www.conserveflorida.org info@conserveflorida.org

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