

Chapter VIII

Conservation Easements: Valuing Property Subject to a Qualified Conservation Contribution

A. Overview and Purpose

Forest landowners planning their estates may consider selling or donating a conservation easement as a way to receive income and estate tax relief and at the same time ensure that their land remains as forest. A conservation easement is a legally binding agreement that permanently restricts the development and future use of the land to achieve a conservation objective. An easement can either impose limitations on an owner or create obligations that a landowner must meet to avoid sanctions or penalties for the violations. Conservation easements are created for a variety of purposes, including:

1. Retaining or protecting for the public and economic benefit the natural, scenic, or open space values of real property;
2. Ensuring its availability for agricultural, forest, recreational or open-space use;
3. Conserving or managing the use of natural resources;
4. Protecting wildlife;
5. Maintaining or enhancing land, air or water quality; or
6. Preserving the historical, architectural, archeological or cultural aspects of real property.

Landowners who grant easements give up some of their full ownership rights in the property. The result is shared ownership involving the owner of the land and the holder of the conservation easement.

The agreement between the landowner and the organization that holds the easement will be embodied in an easement agreement. Elements of this easement agreement should include its purpose, how it achieves certain conservation objectives, and all restrictions and obligations placed on the land uses. Landowners should also recognize the importance of considering what rights they wish to retain in the property after the easement is granted. The nature of the landowner's rights will affect the owner's qualification for income tax and estate benefits. A conservation easement should be individually tailored to the desires of each property and its owner.

An easement has important economic considerations attached to it if it is donated to a government body or a charitable corporation or trust that is exempt from taxation under Internal Revenue Code requirements and is created for the purpose of promoting conservation goals. Such transactions offer the landowner an opportunity for an income tax deduction against current income when the donation is made and additional deductions in calculating federal estate tax.

There are numerous legal and economic considerations about easements that landowners should be aware of. This chapter discusses the requirements for forestland qualifying for a conservation easement and the tax advantages that apply. To receive favorable tax treatment there must be a qualified real property interest, a qualified organization to receive the easement, and a qualified

conservation purpose that yields a significant public benefit. The following discussion will describe basic aspects of conservation easements, the income tax deduction requirements and a discussion of the estate valuation deduction requirements.

B. Lesson Objectives

When you have successfully completed this chapter you will be able to accomplish the following objectives:

1. Explain what the concept of a conservation easement is and how it affects a property owner.
2. Discuss the income and estate tax benefits arising from donation of a conservation easement.
3. Discuss the requirements for the donation of a conservation easement to qualify for income and estate tax benefits.

C. Conservation Easements

Conservation easements (CE) have become an attractive tool for achieving land conservation objectives. Rising real estate values of the past 25 years and the resulting higher property taxes threaten sale of forest and farmland for development. Most landowners want to do what is right for their land, but their decisions must also make economic sense. A conservation easement is one tool that can be used to accomplish both objectives. It is a voluntary action of the landowner intended to save various types of taxes, preserve the inherent productivity and character of property, and ensure that the lands remain in their current use forever, free from the threat of development. A conservation easement is a legally binding agreement that permanently restricts the development and future use of the land to ensure protection of its conservation values. As described above conservation purposes are many and varied, so landowners have a wide variety of ways that conservation easements can be used.

The rapidly growing conservation land trust movement was sparked by changes to the Internal Revenue Code that promote tax incentives for the preservation of land. Many conservation easements are held by or acquired by land trusts and turned over for management to government agencies. The conservation easement is a formal document that is recorded in the same office where documents that prove ownership of land are recorded. Because the transfer of the easement is a transfer of an interest in the land, it continues in effect after the owner who donated the easement transfers the remaining interest to someone else. Conservation easements are attractive to both land use planners and landowners for a number of reasons, including: (1) it is voluntary (it is not a regulation, but is restrictive); (2) each easement is tailored to the desires of each property and individual owner; (3) it keeps the property in private hands and on tax rolls; and (4) it costs less than an outright acquisition of full ownership of the land. Tax benefits depend on whether the easement was donated or sold, the income of the landowner, and the difference between the land value before and the land value after the easement.

When considering whether to grant a conservation easement, landowners should carefully consider the terms of the easement they will grant and the organization to which they will grant it. Many different organizations exist. Each may have a different objective or perspective on preserving land. Therefore, it is very important for landowners to fully explore the organization's philosophy about land conservation. Only then can an owner decide if it matches the owner's philosophy. Major mistakes and considerable heartache can be avoided, by making well informed and well reasoned decisions.

D. Tax Aspects of Conservation Easements

1. In General - IRC Section 170

Lifetime transfer of a **qualified conservation contribution** is the contribution of a qualified real property interest to a qualified organization exclusively for a conservation purpose. Such transfers qualify the landowner to take an income tax deduction under Section 170 of the Internal Revenue Code (IRC) for the value of the contribution. As will be seen below, such transfers also enable the landowner's estate to take an additional deduction under Section 2031(c) of the IRC against the value of the remaining property interest retained by the landowner at the owner's death. In order to take advantage of the deduction against the value of the property in the decedent's estate, the transfer must first qualify for the income tax deduction.

A **qualified real property interest** can be one of several different property interests. It can be the landowner's entire interest in the property, other than a qualified mineral interest. A qualified mineral interest is the landowner's interest in subsurface oil, gas, or other minerals and the right of access to them. A qualified real property interest can also be a remainder interest in property, or a perpetual conservation restriction on the use that can be made of the property. For the most part, the terms, **easement, conservation restriction and perpetual conservation restriction** have the same meaning.

A **qualified organization** to be eligible to hold the conservation contribution must have a commitment to protect the conservation purposes of the donation, and have the resources to enforce the restrictions. Such an organization is either a governmental unit, an organization created and operated primarily or substantially for one of the conservation purposes specified in Section 170, a charitable organization that meets the public support test of the IRC, or a charitable organization that is controlled by an organization that meets any one of these requirements.

A **qualified conservation purpose** can mean one of several different things: (1) it can mean the preservation of land areas for outdoor recreation by, or the education of the general public; (2) it can mean the protection of the natural habitat of fish, wildlife, plants, or similar ecosystems; (3) it can mean the preservation of open space, including farmland and forest land, where such preservation is for the scenic enjoyment of the general public, or the action is pursuant to a clearly defined and described federal, state, or local government conservation policy, and the action will yield a significant public benefit; and (4) it can mean preservation of a historically important land area or a certified historic structure.

Qualified conservation contributions that will generate the greatest interest in private forest landowners are likely to be those intended to preserve open space. In order to qualify for the favorable income tax treatment of section 170, the contribution must meet additional requirements described in the third item of the preceding paragraph. In this statement are three distinct standards, viz. **clearly defined and described public policy, scenic enjoyment, and significant public benefit.**

Preservation of land for the scenic enjoyment of the general public is directed at preventing development or use of the property that would impair the scenic character of the local rural or urban landscape or would interfere with a scenic panorama that can be enjoyed from a park, nature preserve, road, water body, trail, historic structure, or land area, and such land area or way is open to or used by the public. Access by the public can be accomplished by visual access to or across the property, rather than physical access. How much visual access is needed satisfy the public access requirements may depend upon the nature of the scenic character to be preserved.

A clearly defined and described government conservation policy is one that is intended to protect the types of properties that are identified by representatives of the general public as worthy of preservation or conservation. A general statement of conservation goals by a single official or legislative body is not sufficient, but legislation or ordinances that provide for site-specific conservation projects would meet the requirement. Acceptance of an easement by a government agency tends to establish that the donation is consistent with a clearly delineated government policy, but without more it may not meet the requirement. The more rigorous the review process by the government agency, the more the acceptance of the conservation contribution tends to establish the requisite clearly defined and described government policy.

A conservation contribution must demonstrate that it will yield a significant public benefit in order to qualify for the section 170(h) income tax deduction. This requirement attempts to identify whether the primary benefits of the contribution flow either to the landowner or to the public. In determining the nature and extent of the benefit a variety of factors are considered in light of the facts and circumstances associated with the contribution. For example, preservation of an ordinary tract of land would not in and of itself yield a significant public benefit, but the preservation of ordinary land areas in conjunction with other factors that demonstrate such benefit or that preserve a unique land area for public enjoyment would yield a significant public benefit. Preserving woodland along a public highway pursuant to a government program to preserve the appearance of the area to maintain the scenic view from the highway would, absent countervailing factors, yield a significant public benefit.

Although the requirements of a clearly defined and described government policy and significant public benefit are independent of each other, they are related. The more specific the government policy with respect to the particular site to be protected, the more likely the government decision will tend to establish the significant public benefit associated with the contribution. For example, a state statute allowing for preservation of forest reserves is an example of government policy, but additional information would be needed to identify the public benefit to be gained from a conservation contribution on the forest reserve land. In contrast, a statute that names a specific river

as a valuable state resource and is accompanied by appropriations to acquire conservation contributions would more easily meet both requirements.

Example: A particular state contains large tract forests that are desirable recreation and scenic areas to the general public. The forest's scenic values attract millions of people to the state each year. However, due to the increasing intensity of land development in the state, the continued existence of forest land parcels in excess of 45 acres is threatened. A property owner grants a perpetual easement on a 100-acre parcel of forest land that is part of one of the state's scenic areas to a qualifying organization. The easement imposes restrictions on the use of the parcel for the purpose of maintaining its scenic values. The restrictions include a requirement that the parcel be maintained forever as open space devoted exclusively to conservation purposes and wildlife protection and that there be no commercial, industrial, residential, or other development use of the parcel. The law in this state recognizes a limited public right to enter private land, particularly for recreational pursuits, unless such land is posted or the landowner objects. The easement specifically restricts the landowner from posting the parcel, or from objecting, thereby maintaining public access to the parcel according to the custom of the state. The owner's parcel would provide the public with the opportunity to enjoy the use of the property and appreciate its scenic values. The conservation contribution would qualify for an income tax deduction under IRC section 170.

A certified appraiser determines the value of the land before and after the easement. Under section 170, if the easement is sold the landowner is liable for capital gains tax on the value of the easement. If the easement is donated the landowner can deduct the value of the easement against taxable income. This deduction is up to 30% of adjusted gross income up to 6 years. Estate tax benefits come into play since the asset value of the land subject to the easement is reduced.

2. IRC Section 2031(c)

Land that is owned by a decedent and subject to a qualified conservation contribution may be entitled to take advantage of a special opportunity to exclude a portion of the value of the land subject to the easement from the gross estate of the deceased property owner. In order for this Section 2031(c) deduction to apply, the conservation contribution must qualify under Section 170 described above. Note that the reverse is not true. A Section 170 qualified conservation contribution need not qualify for Section 2031(c) treatment.

In order to be eligible for the section 2031(c) exclusion for the estate of a person who died after December 31, 2000, the land must be: (1) located in the United States or any possession of the United States; (2) be owned by the decedent or a member of the decedent's family during the three-year period ending on the decedent's date of death; (3) be a qualified conservation contribution of a qualified real property interest granted by the decedent or a member of the decedent's family under Section 170 described above; and (4) restricted by an easement that prohibits all but minimal commercial recreational use of the land.

The exclusion amount can be up to 40% of the value of the land, but is subject to maximum limits of \$400,000 in estates of decedents dying in 2001 and increases to \$500,000 for estates of decedents dying in 2002 or later. This benefit is available to each land owner.

Example: A property owner owns a tract of forest land that is worth \$1,500,000. In 1999, the owner donates a qualified conservation contribution to a qualifying organization and takes an appropriate income tax deduction. The transfer of the contribution reduces the value of the land to \$900,000. In 2001, the landowner dies. At his death, the land is valued at \$1,000,000. By electing to take advantage of the exclusion, the executor can exclude \$400,000 of value from the land for purposes of calculating the owner's federal gross estate.

If at the time of the easement contribution the value of the easement is less than 30% of the value of the land without the easement, less the value of any retained development rights, the amount of the exclusion is reduced according to a formula that reduces the exclusion by two percentage points for each point that the percentage falls below 30%. For example, if the value of the conservation easement is 20% of the original value of the land, less the value of any retained interests, the amount of the maximum exclusion is 20% ($40\% - 2(30\% - 20\%) = 20\%$).

To the extent this deduction reduces the value of the property, the income tax basis of the property is not adjusted after the owner's death.

3. Post-Death Easement Donation Opportunities

In the event the land owner had not made a qualified conservation contribution before death, Section 2031(c) provides an opportunity for the estate's personal representative and the heirs to make a contribution after the owner's death and still take advantage of the Section 2031(c) exclusion in the decedent's estate. An important consideration that must be addressed in this case is whether title of the decedent's land passes to the owner's heirs or to his personal representative following the owner's death. This will determine who has authority to grant the desired easement.

A second consideration is whether state law allows the donation of a conservation contribution without specific language authorizing this transfer in the deceased owner's will or other written document that controls the transfer of property after the owner's death. State law requiring that such authority be expressly granted will eliminate this option where an owner fails to plan his estate during his lifetime. Owners who are concerned about allowing such post-death decisions to be made might be better off making these decisions during their lifetime rather than waiting for a post-death decision to take advantage of the opportunity.

Student Exercises – Multiple Choice Question

- (1) A private forest landowner is considering participating in the Forest Legacy Program by donating a conservation easement on his forest land. Which of the following objectives would not be served by the donation of the easement?

- a. Gain income and estate tax advantages
 - b. Preserve the productivity of the forest land.
 - c. Ensure that the forest land permanently remains in that use.
 - d. Each of the land owner's heirs will receive an equal share of the owner's land following the owner's death.
- (2) Which of the following elements is not one of the elements that is needed for a transfer to be considered a qualified conservation contribution under the Internal Revenue Code?
- a. The contribution must be made by a qualified land owner who is less than 65 years old.
 - b. The contribution must be considered a qualified real property interest.
 - c. The interest must be contributed to a qualified organization.
 - d. The contribution must be made for a qualified conservation purpose.
- (3) Which of following statements would not be a qualified conservation purpose in the case of a conservation contribution made by a private forest land owner that is intended to preserve open space?
- a. The general public must be able to enjoy a benefit of the contribution.
 - b. The contribution is made under the terms of a clearly defined government conservation policy.
 - c. The land that is the subject of the contribution must contain critical habitat of three or more endangered plant species.
 - d. The benefit received by the public must be considered to be substantial.
- (4) In order for the estate of a land owner to take advantage of an estate tax exclusion of a portion of the value of land subject to qualified conservation contribution, several requirements must be met. Which of the following statements is not one of the requirements?
- a. The land being valued must be located anywhere in the world.
 - b. The deceased owner or a member of the decedent's family must have owned the land for at least three years before her death.
 - c. The contribution must be considered a qualified conservation contribution under income tax law requirements.
 - d. The land must prohibit all but minimal commercial recreational use of the land.
- (5) An owner's land is worth \$2,000,000. Following the owner's death in 2002, the owner's personal representative and heirs decided to grant a qualified conservation easement on the land that will pass to the heirs under the deceased owner's estate. The state in which this land is located allows this procedure if the land owner authorized the estate personal representative to make this decision. In this case, the owner did authorize the owner to do so. By making this contribution, the value of the land will be reduced by 40%. As a result of making this contribution, the value of the land will be reduced to \$1,200,000.

Based on Section 2031(c) of the Internal Revenue Code, what is the maximum amount of the Section 2031(c) exclusion of the value of land subject to the conservation easement that can be taken from the gross estate of the decedent?

- a. \$0
 - b. \$1,200,000
 - c. \$2,000,000
 - d. \$500,000
- (6) Willis Ruth is a single individual whose total wealth is approximately \$900,000. In 2002, one of his assets is a wooded tract of land that is valued at \$400,000. Ruth is considering donating a conservation easement on the land to C.A.R.E., the Concerned Area Residents for the Environment. C.A.R.E. is a non-profit corporation that has qualified as an Internal Revenue Code 501(c)(3) charitable organization. C.A.R.E.'s principal purpose is to preserve historically important land areas and structures that are located in the community. The land on which the conservation easement is being considered for placement was the scene of an important civil war battle in 1863.

Based on the benefits and opportunities of granting conservation easements, discuss the advantages and disadvantages to Ruth of making the conservation easement donation.