



Conservation Easements, Taxes, and Estate Planning

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Conservation Easements, Taxes, and Estate Planning

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Anyone using information contained in this presentation should always research original sources of authority and update this information to ensure accuracy when dealing with a specific matter. No person should act or rely upon the information contained in this presentation without seeking the advice of an attorney.

- **You know what a conservation easement is, right?**
- **"Conservation easement" is a nonpossessory interest of a holder in real property.**
- **Effected by a voluntary instrument conveying an interest in real property from a landowner to a grantee that restricts future uses of the real estate as negotiated between the parties**
- **The land subject to the easement may be thereafter sold, exchanged, given or devised by the landowner subject to the easement**

But what are the financial consequences of a conservation easement?

How is a conservation easement part of financial and estate planning?

Agenda

- **Income Tax Deduction**
- **Income Tax Consequences**
- **Reinvestment of Proceeds**
- **Estate and Gift Tax Reduction**
- **Property Tax Reduction**

Who can be the grantor of a conservation easement?

- Individual
- Corporation
- LLC
- Partnership
- Executor
- Trustee
- Agent under POA

Grantor's advisor team

- **Tax, Trusts and Estates and Real Estate Lawyer**
- **Tax Return Preparer - run the numbers!**
- **Financial Planner** (how does easement fit within overall financial plan)
- **Appraiser** (maybe not grantee's appraiser)
- **Surveyor?**
- **Engineer?**
- **GRANTEE**

Income tax consequences in four contexts:

- **Sale of Easement: Sale Price = Easement Value**
- **Donation of Easement: Sale Price = 0**
- **Bargain Sale of Easement:**
Sale Price < Easement Value
- **Like Kind Exchange**
Sales Proceeds Reinvested in Real Estate

Sale - Generate Cash From Proceeds

- **Gross income includes gains derived from dealings in property.**
- **Gain realized is determined by comparing amount received to basis in the easement.**
- **Basis in conservation easement is a proportion of the pre-easement basis in the land bearing the same relationship as the value of the conservation easement to the before value of the land.**

Sale - Generate Cash From Proceeds - Example

- Before easement value = \$500,000
- Before easement basis = \$200,000
- After easement value = \$200,000
- Easement sale price (easement value) = \$300,000
- Easement basis = \$120,000 (3/5 of \$200,000)
- Gain on sale = \$180,000 (\$300,000-\$120,000)
- AGI before gain on sale = \$100,000
- Federal income tax bracket = 28%
- Capital Gain Rate = 20%
- CG Tax = \$36,000
- State Tax = \$11,000
- After tax proceeds = \$253,000
- Basis in fee subject to easement = \$80,000

Donation - Generate Cash From Income Tax Savings

- **The requirements of Enforceability and Deductibility are not the same**
- **Grantee most interested in former and grantor interested in latter**

Donation - Generate Cash From Income Tax Savings

Requirements for Federal Income Tax Deduction - available since 1980

Special rules under IRC § 170(h) because a donation of a conservation easement is only a partial interest contribution.

A deduction does not arise simply because the grantor gives away value.

Requirements for Federal Income Tax Deduction

- **To become entitled to a charitable deduction grantor must make a qualified conservation contribution.**
- **What does that mean?**
- **That is the subject of at least another hour-long presentation**
- But I will discuss one topic that comes up often when the goal is to obtain a charitable income tax deduction.

Requirements for Federal Income Tax Deduction

The grantor must:

- **Obtain a qualified appraisal report, which**
 - **Is made as of the date of the donation of the easement and delivered to grantor no more than 60 days before the transfer and no later than the due date of the tax return including extensions**
 - **Is prepared, signed and dated by a qualified appraiser**
 - **States the date (or expected date) of contribution**
 - **Includes a copy of deed of easement**
 - **Includes statement that the appraisal was prepared for income tax purposes**

Requirements for Federal Income Tax Deduction

The grantor must:

- **Attach completed IRS Form 8283 signed by grantor, grantee and qualified appraiser to income tax return.**
- **The signature of the grantee on the appraisal summary does not represent concurrence in the appraised value of the contributed property. Rather, it represents acknowledgment of receipt of the property on the date specified in the appraisal summary. Treas. Reg. § 1.170A-13(c)(4)(iii)**

Measure of Income Tax Deduction

- **Fair Market Value of Conservation Easement**
- **Using before and after approach.**
- **Take into account any enhanced value of adjoining property.**

Donation - Generate Cash From Income Tax Savings

- **Effect on basis**
- **Proportionate amount of basis is transferred with the easement.**

Increased Limits on Annual Amount of Charitable Deduction

- **Adjusted Gross Income Limits for qualified conservation contribution – general rule**
- **the amount of the deduction is the value of the easement limited to 50% of AGI (instead of 30%).**
- **Fifteen year carry-forward by grantor of unused deduction (instead of 5).**

Increased Limits on Annual Amount of Charitable Deduction

- **Adjusted Gross Income Limits for qualified conservation contribution – special rule for farmers and ranchers**
- **the amount of the deduction is the value of the easement limited to **100% of AGI****
- **Fifteen year carry-forward by donor of unused deduction (instead of 5).**

Increased Limits on Annual Amount of Charitable Deduction

- **How to qualify for 100% deduction**
 - The property must be used in (or available for) agriculture or livestock production
 - The deed of easement must require that the property remain available for agriculture or livestock production by prohibiting:
 - (1) construction or placement of buildings (except those used for agriculture or livestock production purposes, or dwellings used for family living by the qualified farmer or rancher, a lessee that operates the property, or their employees); (2) removal of mineral substances in any manner that adversely affects the property's agriculture or livestock production potential; and (3) other uses detrimental to retention of the property for use in agriculture or livestock production.

Increased Limits on Annual Amount of Charitable Deduction

How to qualify for 100% deduction

Donor's gross income from farming must be more than one-half of total gross income. Farming includes

- cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, training, and management of animals) on a farm
- handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated
- the planting, cultivating, caring for, or cutting of trees, or
- the preparation (other than milling) of trees for market.

Increased Limits on Annual Amount of Charitable Deduction

- **How to qualify for 100% deduction**

- Income from farming does not include (1) income from a sale (including a bargain sale) of a conservation easement, because selling easements is not the trade or business of farming or (2) income from fees to permit hunting or fishing on the property. Income from the trade or business of farming does include income from the sale of timber.
- When a qualified conservation contribution is made by a pass-through entity, such as a partnership or S corporation, one looks to the partners, shareholders, or other members to determine whether it is a gift made by a qualified farmer or rancher.

Donation - Generate Cash From Income

Tax Savings

- Before easement value = \$500,000
- Before easement basis = \$200,000
- After easement value = \$200,000
- Easement value = \$300,000
- Easement basis = \$120,000
- AGI (\$91,000 from farming) = \$100,000
- Federal income tax bracket = 28%
- Maximum annual deduction for farmer = \$100,000
- Number of Years deduction allowed = 15
- Total deductions = \$300,000
- Total Federal income tax savings over 3 years = \$84,000
- Basis in fee subject to easement = \$80,000



Bargain Sale - Generate Cash From Proceeds and From Income Tax Savings

- **Conservation easement is donated and sold. That is, the sale price is less than the value of the easement.**
- **Caps placed by grantees on amount to be paid for easements does not establish the value of a particular easement.**
- **Apportion basis to donation element and sale element.**

Bargain Sale - Generate Cash From Proceeds and From Income Tax Savings

Bargain Sale - Generate Cash From Proceeds and From Income Tax Savings

- Example (continued)
- Easement donation value = \$150,000
- Donation basis = \$60,000
- Maximum deduction Year 1 = \$150,000
 - Regular AGI of \$100,000 plus \$90,000 Gain
- Number of Years deduction allowed = 15
- Total deductions = \$150,000
- Total Federal income tax savings in year 1 = \$42,000
- Basis in fee subject to easement = \$80,000

Variation on Sale or Bargain Sale - Like-Kind Exchange

- Grantor uses gross cash proceeds from sale or bargain sale of conservation easement to buy more real estate.
- Grantor defers capital gains on sale.
- Qualify for 100% deduction limit if bargain sale.
- No gain or loss is recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment. IRC § 1031
- Be aware of depreciation recapture.

Variation on Sale or Bargain Sale - Like-Kind Exchange

- **Basic Requirements of a Deferred, Forward Like-Kind Exchange**
 - **Execute Exchange Agreement with Qualified Intermediary**
 - **QI receives proceeds at sale closing**
 - **Grantor has 45 days from sale closing to identify replacement property to QI in writing.**
 - **QI uses proceeds to close on purchase of replacement property within earlier of 180 days after sale closing or the due date with extensions for grantor's taxable year of the sale closing.**
 - **File IRS Form 8824 to report LKE**
- **Effect on basis - Basis of replacement property = basis in relinquished property**

Estate Planning

- **Estate, Gift or Generation-Skipping Transfer Tax consequences in four contexts:**
 - **Gift of property subject to easement, directly or indirectly**
 - **Devise of property subject to easement, directly or indirectly**
 - **Direction to or authority of executor or trustee to create easement**
 - **Creation of easement by one or more beneficiaries**

Estate Planning

- **Basic Estate Tax Rules**
- **Gross Estate - the value at the time of death of all property, real or personal, tangible or intangible, wherever situated.**
- **Taxable Estate - the gross estate less deductions.**
- **Charitable Deduction.**
- **Marital Deduction.**

Estate Planning

- **Basic Estate Tax Rules (continued)**
- **Applicable Exclusion Amount.** The sum of the basic exclusion amount and in the case of a surviving spouse after 2010, the deceased spousal unused exclusion amount.
- **Basic Exclusion Amount.** \$5,000,000 indexed for inflation after 2011. The amount is \$5,450,000 for 2016
- **Estate Tax Rate = 40%.**
- **Tax is paid by executor from estate.**
- **Portability of Deceased Spousal Unused Exclusion (DSUE).** If timely file federal estate tax return

Estate Planning

- **Basic Gift Tax Rules**
- **Taxable Gift - total amount of gifts made during the calendar year, less the deductions.**
- **Charitable Deduction.**
- **Marital Deduction.**
- **Unified Applicable Exclusion Amount.**

Estate Planning

- **Basic Gift Tax Rules (continued)**
- **Annual Exclusion from taxable gifts.**
- **Per person, per year**
- **\$10,000 indexed for inflation after 1998**
- **\$14,000 in 2016**
- **Gift-splitting permitted.**
- **Rate = 40%**
- **Tax is paid by donor.**

Estate Planning

- **Basic Basis Rules**
- **Property received by gift. Carry-over basis**
- **Property received by inheritance. Step-up (or down) basis**

Estate Planning

- **Special Use Valuation - IRC § 2032A**
- **If certain conditions are met, and if a federal estate tax return is filed and election is made, a farm may be valued as a farm for estate tax purposes.**
- **Reduction in value is capped at \$1,110,000 in 2016**
- **Election should be made only if estate tax savings would result**
- **If election is made income tax basis of beneficiaries is farm value.**
- **Conditions include that farming use continue for 10 years and that property not be conveyed to unrelated parties.**

Estate Planning

- If have made 2032A election for farm, donation of a conservation easement is not considered a conveyance to an unrelated party.
- Is a sale or bargain sale a conveyance to an unrelated party? Not entirely clear. IRC § 2032A(c)(8) states “A qualified conservation contribution (as defined in section 170(h)) by gift or otherwise shall not be deemed a disposition under subsection (c)(1)(A).” (emphasis added) IRS has ruled that a sale is a conveyance to an unrelated party. PLR 200884018

Estate Planning

- **Entity planning**
- **Farm owned by partnership or LLC**
 - **Gift interests in entity to spouse and children, etc.**
- **Grantor should consider retaining at least 30% interest in entity**
- **This is sophisticated planning and care must be taken to consider all laws that apply - which is beyond the scope of this presentation**
- **Equalizing Shares Among Beneficiaries**

Estate Planning

- **Value Replacement**
- **Both a donation and a bargain sale entail a gift of value to the grantee**
- **That value may be immediately replaced for the benefit of the grantor's family by using the tax savings or net proceeds to purchase life insurance on the grantor**
- **Advisable to use ILIT to buy policy if grantor's estate is large enough to be subject to estate tax**

Gift and Estate Tax consequences of Conservation Easement

- **Donation of conservation easement that meets 170(h) requirements qualifies for charitable deduction from Gift Tax.**
- **Gift during life or devise at death of property subject to a previously granted conservation easement is valued in light of easement.**

Gift and Estate Tax consequences of Conservation Easement

- Devise of conservation easement at death by express terms of will or trust (W.Va. Code § 8A-12-11(a)), or
- grant of conservation easement by executor or trustee (PLR 200418005), or
- grant of conservation easement by beneficiaries,
- after death and before due date with extensions of estate tax return, gives rise to charitable deduction from gross estate as long as no income tax deduction is taken by anyone.
 - Devise of an easement or planning for beneficiaries to donate easement is risky.
 - If devise, the exact terms of the conservation easement must be in the last will or trust. Beneficiaries may not timely come to agreement on terms of easement.
 - Unless involve grantee in planning, chance that grantee will not accept easement. W.Va. Code § 20-12-4(b) states “No right or duty of a holder . . . named in the easement deed . . . arises under a conservation . . . easement before the easement's acceptance by the holder . . . and a recordation of the acceptance.”

Property Tax Consequences

- **W. Va. Code § 11-1A-1(a) states “the tax commissioner shall appraise all property so as to ascertain the value thereof for assessment purposes.”**
- **W. Va. Code § 11-1A-3(i) states "Value," "market value" and "true and actual value" shall have the same meaning and shall mean the price at or for which a particular parcel or species of property would sell if it were sold to a willing buyer by a willing seller in an arm's length transaction without either the buyer or the seller being under any compulsion to buy or sell.”**
- **W. Va. Code § 11-1A-3(i)(3) states that in determining market value for purposes of property taxation the Tax Commissioner must consider the extent to which the property is burdened by dominant or servient estates.**

Property Tax Consequences

- **W.Va. Code § 8A-12-19 provides “For ad valorem property tax purposes, any property held or coheld by a holder under a perpetual conservation or preservation easement as defined by this article, regardless of ownership, shall be taxed as "agricultural lands" without further requirement, restriction or disqualification.”**
- **W.Va. Code § 8A-12-11(c) provides that “Farm, farmland or agricultural land” means “A tract, or contiguous tracts of land, of any size, used or useable for agriculture, horticulture or grazing and includes all real property designated as wetlands that are part of a property used or useable as farmland.”**



Thank you for your time!

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