

# An Introduction to Conservation Easements



## What is a Conservation Easement?

A conservation easement is the legal glue that binds a property owner's good intentions to the land in perpetuity. Donors of conservation easements retain title to their property. They grant conservation easements to protect their land from inappropriate development. A conservation easement runs with the title to the property regardless of changes in future ownership.

Granting an easement can yield tax savings. Think of land ownership as holding a bundle of rights that may include the right to subdivide, construct buildings, irrigate, harvest timber or restrict access. A landowner may sell or donate the whole bundle of rights or just one or two of those rights. To give away certain rights for the purpose of conservation, while retaining others, a property owner grants a deed of conservation easement to a land trust like the Sheridan Community Land Trust (SCLT). The donation of an easement may qualify as a charitable contribution. As such, it may reduce income, estate and gift taxes.

## What are the Terms of a Conservation Easement?

A conservation easement spells out the uses that are consistent and inconsistent with the conservation values desired by the landowner. It is a voluntary agreement between a landowner and the Sheridan Community Land Trust. No two conservation easements are alike. Each is tailored to the unique character of the land and the conservation desires of its owner(s).

The following are general examples of the types of uses that can be **allowed** by a conservation easement:

- Continued agricultural use
- Construction of buildings, fences, water improvements, etc., necessary for agriculture and compatible with conservation objectives
- Sale, devise, gifting or other method of transferring parcels, subject to terms of the easement
- Landowner control of access
- Additional family and employee residences compatible with conservation objectives
- Wildlife and fisheries protection, restoration and enhancement projects
- Any and all uses not specifically prohibited

Types of uses that are generally **restricted** by a conservation easement include:

- Subdivision for residential or commercial activities
- Construction of non-agricultural buildings
- Nonagricultural commercial activities
- Dumping of non-compostable or toxic waste
- Surface mining

A conservation easement assigns three "positive rights" to SCLT:

1. The right to preserve and protect the property according to mutually agreed upon terms.
2. The right (with proper advance notification to the landowner) to enter the property to monitor activities (usually once a year).
3. The right to "enjoin and restore," which assures that the landowner's desires, as spelled out in the easement, are enforceable.

The terms of the easement do not in any way negate or modify state or federal law. Specifically, a conservation easement cannot prevent condemnation.

## What are the Legal Requirements?

Wyoming law authorizes the grant of conservation easements to qualified private organizations. It requires that the deed of conservation easement be duly recorded.

Federal law governs only the tax treatment of a conservation easement as a charitable gift. While you should consult your attorney or a person knowledgeable of federal requirements, in general the following major rules apply in order to receive a tax benefit:

- ✓ The conservation easement must be granted in perpetuity;
- ✓ Any mortgage and/or contract holders must agree to subordinate to the easement;
- ✓ The easement must provide at least one of the following three conservation purposes:
  - Protection of natural habitat for fish, wildlife, plants or similar ecosystems,
  - Preservation of open space (including farmland or forest land) for (1) scenic enjoyment of the general public and/or (2) significant public benefit pursuant to a clearly delineated government policy,
  - Preservation of land areas for the education of or outdoor recreation by the general public.
- ✓ The easement must be granted to a qualified organization.
- ✓ The easement must prohibit all surface mining. If the easement donor does not own all of the mineral rights, the possibility of surface mining must be determined "so remote as to be negligible."
- ✓ Resource data documenting the conservation values of the property must be collected prior to donation of the easement.

## Potential Tax Benefit Overview

When a conservation easement meets federal requirements as a charitable gift, the donor of the easement may be entitled to a reduction in income and/or estate taxes.

### Income Tax

The value of the easement as a charitable gift is determined by a qualified appraiser who values the property before and after the easement restrictions are applied. The difference between these two values is the amount of the charitable gift for tax purposes. This gift amount is treated as a regular charitable contribution. There are limiting provisions. If the basis (usually purchase price) of the property is used as the before-easement value of the property, the deduction is limited to a maximum of 50 percent of the donor's adjusted gross income in that year. Any unused balance of the gift is limited to a maximum deduction of 50 percent of the adjusted gross income each year for the next five years. If the before-easement value of the property is determined by a qualified appraisal (rather than the basis as above), then the deduction is limited to a maximum of 30 percent of the donor's adjusted gross income in the year of the donation and each year for the next five years. Generally, where property has appreciated in value, the 30 percent option may be more advantageous. The 50 percent election is generally more appropriate for taxpayers whose property has been recently acquired and has appreciated little.

### Estate and Gift Taxes

Conservation easements will ordinarily result in a reduction of the property value for estate and gift purposes. This can ease the financial burden of passing the property on to heirs. Conservation easements are a significant and useful estate planning tool. The amount of value reduction is unique to each property, but is generally the difference between its subdivision development value and its agricultural value.

**Corporate Income Tax** In the event that the property owner is a corporation, the easement gift may be deducted against 10 percent of the corporation's annual net income before the year of donation with any unused balance limited to 10 percent of the annual net income each year for the next five years.

## **Specific Tax Implications of Conservation Easements**

### **Estate & Income Tax Considerations**

Tax incentives help many landowners take advantage of conservation opportunities. The potential tax benefits of a donated conservation easement are two-fold. First, income tax benefits may accrue at the federal level. Second, the conservation easement works as an estate planning tool to reduce estate tax liability, thereby allowing family ranches, farms, and recreational property to be passed from generation to generation with the potential of a substantially lower tax burden. Conservation easements do not currently affect Wyoming property tax levels.

### **Qualifying for a Tax Deduction**

To qualify for a tax deduction, your donation must be considered a charitable gift by the Internal Revenue Service. To ensure your gift meets IRS requirements, it is strongly recommended the proposed gift be reviewed by an experienced attorney or accountant. A deductible, charitable donation can be made only to an IRS-qualified, tax-exempt organization. It must be a gift motivated by a charitable intent and not granted as a requirement for getting something in return. For example, a conservation easement donated by a developer, in exchange for government approval of a subdivision, is not considered a gift. A gift must also be complete and irrevocable, without strings or contingences.

### **Qualifying for a Conservation Easement Appraisal**

For tax deductions on gifts worth more than \$5,000 (other than cash and publicly traded securities), landowners must obtain a “qualified appraisal” by a “qualified appraiser.” (These terms are defined by the tax code, check with your attorney or accountant for details.) You should consult with a professional appraiser who has direct experience with charitable gifts or easements. The Sheridan Community Land Trust can refer you to appraisers with experience in this field, but cannot provide the appraisal. The appraisal cost is a necessary expense if you wish to pursue a charitable tax deduction.

# INCOME TAX

## Contribution Value

For illustrative purposes, let's assume you are the owner of a ranch and you would like to donate a conservation easement on the property. Working with SCLT, you negotiate the terms of the easement, which continues agricultural use, protects wetlands and important wildlife habitat, allows for potential construction of an additional residence, precludes commercial development, subdivision and surface mining, and prevents any commercial waste dumping.

To quantify the value of the charitable contribution generated by the donation of the easement, you must obtain a "qualified appraisal" by a "qualified appraiser." As recipient of the donated conservation easement, SCLT needs to be detached from the appraisal process. In this example, the appraisal sets the fair market value of the ranch at \$2 million. This is the value of the property before the conservation easement.

The appraisal also consists of data on sales of comparable properties already under conservation easement, data on the sale of developed and undeveloped comparable properties, information on appraised values of other conservation easements, and the specific terms of this conservation easement. All of this information is used to arrive at the market value of the property after the conservation easement is in place.

<b>Before conservation easement property value</b>	=	<b>\$2,100,000</b>
<b>After conservation easement property value</b>	=	<b>\$1,400,000</b>
<b>Value of charitable contribution</b>	=	<b>\$700,000</b>

Note: The before value of a conservation easement donated within the first 12 months of purchasing a property must be your basis, or what you paid for the property.

## **The 50% Limitation (new in 2006, extended through 2011)**

Federal tax law generally allows a maximum deduction of 50 percent of your Adjusted Gross Income (AGI) in any given year through the donation of a conservation easement on a property. However, you can use the 50 percent deduction for up to 16 years until the value of the charitable contribution is used up. In our example, the value of the charitable contribution generated

through the donation of the conservation easement is \$700,000. Let's assume that the landowner's annual AGI is \$140,000, which remains constant. The deduction resulting from the easement is as follows: (50 percent of \$140,000 = \$70,000).

### Easement Deduction

Year 1	\$70,000	The actual tax reduction is a function of your income tax bracket. In this case, in Year 1 the landowner would apply his or her tax rate to a \$70,000 AGI instead of \$140,000 AGI.
Year 2	\$70,000	
Year 3	\$70,000	
Year 4	\$70,000	
Year 5	\$70,000	
Year 6	\$70,000	
Year 7	\$70,000	
Year 8	\$70,000	
Year 9	\$70,000	
Year 10	\$70,000	
Year 11	\$0	
<b>Total</b>	<b>\$700,000</b>	

### 100% Deductibility For Qualified Farmers & Ranchers

The second important change provided by the new federal tax provision entitles a landowner who meets the tests for “qualified farmers and ranchers” is allowed to take the **deduction up to 100% of AGI (for individuals), or up to 100% of taxable income (for corporations), also with a 15-year carry-forward.**

According to the **new statute**, “qualified farmer or rancher” means a taxpayer whose “gross income” from the business of farming (as defined under Section 2032A(e)(5) of the tax code) is greater than **50% of the taxpayer's gross income for the taxable year in which the conservation easement is**

**donated.** This definition applies to individuals, partnerships, and to corporations. For purposes of this incentive, farming, ranching, other kinds of agricultural activities, and forestry use will satisfy the requirements of the statute.

## **Deductibility of Easement Costs**

Some of the costs incurred in making a charitable contribution are themselves deductible. Legal and appraisal fees and costs associated with compilation of the “Resource Documentation Report” can generally be deducted as business expenses if, in combination with other miscellaneous deductions, they exceed 2 percent of your adjusted gross income. Any cash or securities given to endow stewardship of a conserved property are considered charitable contributions.

## **Estate Tax — Succession Planning**

Federal estate tax is based on the fair market value of the property at the time of the landowner’s death, not the original purchase price or current use value. This can be a significant and potentially debilitating tax burden for farm and ranch families whose land values have appreciated over time, particularly if the appreciated value is due largely to increased development value. Sometimes caught unaware and without the benefit of estate planning, ranch families may have to subdivide and sell some of their land just to meet the estate tax obligations. Conservation easements can be a useful estate planning tool to reduce estate tax liability and allow ranches to remain in the family.

The following is an example of how the estate tax has operated in the recent past:

Generally, estate tax has operated with the first \$2,000,000 in assets (including land) that an individual gives during his or her lifetime, or holds at the time of their death, is not subject to estate tax. Married couples may pass on \$4,000,000 of property tax-free to their heirs through their estate. The estate tax exclusion increased from \$2,000,000 in 2008 to \$3,500,000 in 2009, \$0 in 2010 and \$5,000,000 in 2011. The federal estate tax rate levied on the amounts that exceed these exemptions is 46% in 2006 and 45% for years 2007–2009. Conservation easements reduce the fair market value of the property by restricting the amount and kind of development that may occur. This reduction in fair market value also reduces the value of the estate.

## Changes In Individual Estate And Gift Tax Exclusions

Year of Death	Estate Tax Exclusion*
2006	\$2,000,000
2007	\$2,000,000
2008	\$2,000,000
2009	\$3,500,000
2010	\$0
2011	\$5,000,000
*Exclusion amount is per individual	

### Post-mortem Election

The federal tax law allows estate beneficiaries and/or the executor to elect to place the land under conservation easement after death, but before filing an estate tax return.

### Estate Planning

Conservation easements are only one component of several estate-planning options available to effectively pass on a ranch or farm, as well as other assets, to the next generation. Proper planning with a qualified estate planning team is essential.

### What Happens after the Easement is in Place?

Once a conservation easement is signed, SCLT and the landowner begin a working relationship to assure that the intended conservation becomes a reality. **SCLT is not in the day-to-day land management business.** Landowners continue to make all of their property management decisions while the easement limits only the broad parameters of land use, such as subdivision, commercial development, construction and surface mining. Annual monitoring visits are conducted by SCLT staff and stewardship volunteers. These visits foster good communication with the landowner and an opportunity to answer questions or respond to concerns. In many ways the conservation easement is a working partnership for the land. Mutual respect and clear understanding of easement terms help to avoid potential conflict.

## Questions? Comments?

Interested in pursuing a conservation easement?

Please contact SCLT at your convenience.



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### **Office and Staff**

306 N Main St 2<sup>nd</sup> Floor  
P.O. Box 7185  
Sheridan, WY 82801

Colin Betzler, Executive Director

Phone: 307-673-4702  
Email: [director@sheridanclt.org](mailto:director@sheridanclt.org)  
Website: [www.sheridanclt.org](http://www.sheridanclt.org)