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University of Arkansas
System Division of Agriculture

NatAgLaw@uark.edu | (479) 575-7646

An Agricultural Law Research Article

Conservation Easements: Minimizing Taxes and Maximizing Land

by

Stephanie L. Sandre

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CONSERVATION EASEMENTS: MINIMIZING TAXES AND MAXIMIZING LAND

Stephanie L. Sandre

| | | |
|------|---|-----|
| I. | Introduction..... | 357 |
| II. | Basic Objectives of Section 508 of the Taxpayer Relief Act of 1997.... | 358 |
| | A. General Comments on Section 508 | 358 |
| | B. The Effects of Section 508 on the Farmer and Land Conservation Groups | 360 |
| III. | The Purpose of Conservation Easements | 361 |
| | A. Conservation Easement Defined | 361 |
| | B. Reasons for Utilizing Conservation Easements | 362 |
| IV. | Estate Benefits Available Through Section 508 of the Taxpayer Relief Act of 1997 | 363 |
| | A. Further Explanation of the Section 508 Exclusion | 363 |
| | B. Property Not Subject to the Estate Tax Exclusion | 364 |
| | C. Recent Adjustments to Section 508 | 366 |
| | D. Criticism of Section 508..... | 366 |
| V. | Other Tax Benefits Available Through Conservation Easements..... | 368 |
| | A. Income Tax Benefits | 368 |
| | B. Property Tax Benefits..... | 370 |
| VI. | Conclusion | 371 |

I. INTRODUCTION

The Taxpayer Relief Act of 1997 granted a potentially substantial gift to farmers by enacting section 508.¹ This section allows farmers who choose to donate land for conservation easements to receive a dual tax benefit.² Along with a federal income tax deduction, farmers are also granted a large estate tax reduction.³ Although anyone who chooses to donate a conservation easement will receive benefits from this new provision, it is the family farmer who potentially stands the most to gain. The decrease in estate taxes may be substantial enough to allow generations of farmers to preserve their land. Rather than inevitably becoming

1. See Taxpayer Relief Act of 1997, Pub. L. No. 105-34, § 508, 111 Stat. 788, 859.

2. See *id.*, 111 Stat. at 859.

3. See *id.*, 111 Stat. at 859.

victims to the previous tax traps, farmers have now been afforded the option to choose whether to sell their farms or keep them within their families.

The purpose of this Note is to highlight section 508 of the Taxpayer Relief Act of 1997 and emphasize the estate tax benefits now available to potential donors of conservation easements. Part II of this Note briefly introduces section 508 of the Taxpayer Relief Act of 1997 and discusses the effects of this section on farmers and conservation groups.⁴ Next, Part III explains the purpose of conservation easements and the reasons why they have become an integral part of farmland preservation.⁵ Part IV describes in detail how section 508 of the Taxpayer Relief Act operates, the estate tax benefits currently available through conservation easements, and criticism of section 508.⁶ Finally, Part V discusses other additional tax benefits available through the donation of conservation easements, including an income tax deduction and a reduction of property taxes.⁷

II. BASIC OBJECTIVES OF SECTION 508 OF THE TAXPAYER RELIEF ACT OF 1997

A. General Comments on Section 508

As environmental and conservation issues gain public interest, farmers look for ways to address the issues and reap tax benefits at the same time.⁸ When President Clinton signed the Taxpayer Relief Act on August 5, 1997, he provided simultaneous relief to farmers and land conservation groups by implementing section 508, formerly the American Farm and Ranch Protection Act.⁹ Adjustments to 26 U.S.C. § 2031(c) allow "an executor to exclude from an estate 40 percent of the value of land subject to a conservation easement, but will apply only to donated conservation easements, not to easements sold under farmland preservation programs."¹⁰

This tax provision appears to have two separate objectives. First, farmers will not face pressure to sell off their land to pay for excessive estate taxes.¹¹ In addition, environmentally valuable family lands will be preserved.¹² There are, however, strict requirements land must meet to qualify for this potentially lucrative

4. See discussion *infra* Part II.

5. See discussion *infra* Part III.

6. See discussion *infra* Part IV.

7. See discussion *infra* Part V.

8. See Jesse J. Richardson, Jr., *Maximizing Tax Benefits to Farmers and Ranchers Implementing Conservation and Environmental Plans*, 48 OKLA. L. REV. 449, 449 (1995).

9. See *Estate Tax Relief for Donated Easements, Other Benefits for Inherited Farmland*, FARMLAND PRESERVATION REP., Sept. 1997, at 6, 6.

10. *Id.*

11. See Julie Tripp, *Conservation Easements*, PORTLAND OREGONIAN, Mar. 16, 1998, at B01.

12. See *id.*

exclusion.¹³ Most importantly, the land must be given specifically for “conservation purposes.”¹⁴ Land transferred for a “conservation purpose” is defined by the Internal Revenue Code (I.R.C.) as:

(i) the preservation of land areas for outdoor recreation by, or the education of, the general public, (ii) the protection of a relatively natural habitat fish, wildlife, or plants, or similar ecosystem, (iii) the preservation of open space (including farmland and forest land) where such preservation is: (I) for the scenic enjoyment of the general public, or (II) pursuant to a clearly delineated federal, State, or local governmental conservation policy, and will yield a significant public benefit, or (iv) the preservation of an historically important land area or a certified historic structure.¹⁵

A contribution will not be treated as “exclusively for conservation purposes unless the conservation purpose is protected in perpetuity.”¹⁶ However, for the purposes of the estate tax exclusion, an historic land area or a “certified” historical building does not qualify as a conservation purpose.¹⁷ A perpetual restriction on the use of real property must also include, for purposes of the estate tax exclusion, “a prohibition on more than a de minimis use for commercial recreational activity.”¹⁸

In addition to serving a conservation purpose, a land subject to a qualified conservation easement must be located:

(I) in or within 25 miles of an area which, . . . is a metropolitan area . . .
 (II) in or within 25 miles of an area which, . . . is a national park or wilderness area designated as part of the National Wilderness Preservation System . . . , or
 (III) in or within 10 miles of an area which, . . . is an Urban National Forest¹⁹

Furthermore, the “qualified conservation easement” has to be made by the decedent, a member of the decedent’s family, or the executor of the decedent’s estate.²⁰ A member of the family includes an ancestor, a spouse, a “lineal descendant” of the individual, the individual’s spouse, the individual’s parent, or

13. See I.R.C. § 2031(c)(8) (West Supp. 1998).

14. See *id.* § 170(h)(4)(A).

15. *Id.*

16. *Id.* § 170(h)(5)(A).

17. See *id.* § 2031(c)(8)(B).

18. *Id.*

19. *Id.* § 2031(c)(8)(A)(i)(I)-(III).

20. See *id.* § 2031(c)(8)(C).

lastly, the spouse of any "lineal descendant described immediately above."²¹ A partnership, a corporation, or a trust can also be eligible for the exclusion if the decedent owned at least thirty percent of the property.²² It is important to note that section 508 of the Taxpayer Relief Act only applies to estates of decedents who die after December 31, 1997.²³

B. *The Effects of Section 508 on the Farmers and Land Conservation Groups*

Conservation easements are a relatively new measure used for the conservation and preservation of land.²⁴ Non-profit organizations have used conservation easements to protect soil that has potential to erode farmland, wildlife, and wetlands.²⁵ When farmers donate conservation easements to land preservation groups, there are multiple benefits. The Taxpayer Relief Act allows "the next generation to continue farming and, at the same time, assures that many thousands of acres of the best agricultural land and ecologically important areas will remain open and productive."²⁶ While protecting farmers from disposing of their livelihoods, this measure also protects vital environmental values from disappearing.²⁷

Furthermore, landowners are still afforded flexibility when a conservation easement is granted.²⁸ Easements are shaped to satisfy individual landowners. Landowners can "retain the right to subdivide, fish, even reserve timber rights or allow the construction of an additional home."²⁹ However, landowners should be cautious when choosing to retain developmental rights to retain.³⁰ Tax benefits decrease when the landowner chooses which developmental rights.³¹ It is important to note that "most or all of the residential development rights" must be given up for the easement to qualify.³²

21. *Id.* § 2032A(e)(2).

22. *See id.* § 2031(c)(9).

23. *See id.* § 2031(c)(3).

24. *See* Keith Wiebe et al., *Managing Public and Private Land Through Partial Interests*, 15 CONTEMP. ECON. POL'Y 35, 36 (1997).

25. *See id.*

26. *PEC Federal Estate Tax Change Boosts Landscape Protection*, PR NEWSWIRE (Charlottesville), Aug. 11, 1997, available in LEXIS, News Library, PR Newswire File.

27. *See id.*

28. *See* George G. Jones & Mark A. Luscombe, *A Win-Win Situation: Conservation Easements*, 10 ACCT. TODAY, Apr. 27, 1998, at 10, 11.

29. Robert Lenzner, *Hard Assets: "Asphalt Is Always the Last Crop": Here's a Nifty Way to Get a Big Tax Break and Protect Valuable Property: Grant a Conservation Easement*, FORBES, June 15, 1998, at 186, 187.

30. *See id.*

31. *See id.*

32. *Id.* A "developmental right" is defined as "any right to use the land subject to the qualified conservation easement in which such right is retained for any commercial purpose which is

III. THE PURPOSE OF CONSERVATION EASEMENTS

A. Conservation Easement Defined

An easement is “a legal agreement between the landowner and the trust that restricts development of privately owned property.”³³ For centuries, individuals have allowed others to use their land through easements.³⁴ However, it has taken some time for taxpayers to realize that donating conservation easements can be an extremely lucrative option.³⁵

In general, conservation easements are “restrictions on private land use designed to preserve open spaces and other environmental resources or to preserve historically significant structures.”³⁶ A conservation easement is simply a “transfer of an interest in land.”³⁷ The grantor—the person transferring the land—will still have rights to the land and be able to maintain it just as before the easement was granted.³⁸ These rights include “the right to use and sell the land.”³⁹

Conservation easements can be drafted so that the landowner still may “build one or more houses, farm the land and hunt wild animals.”⁴⁰ “The public will never be given access to [the landowner’s] land.”⁴¹ Only the landowner’s rights to future development of the land by the grantor or any other purchaser of the land are transferred to a non-profit organization group or a government agency.⁴²

A conservation easement should be carefully drafted to ensure that the grantor’s rights and the grantee’s rights are clear.⁴³ The easement should identify every right the grantor wants to reserve, even though in most situations certain rights are always reserved in the conveyance of property through an easement.⁴⁴ The rights in an easement need to be carefully stated, otherwise selling the property in the future could be difficult.⁴⁵ A “Baseline Document Report” must be drafted,

not subordinate to and directly supportive of the use of such land as a farm or for farming purposes.” I.R.C. § 2031(c)(5)(D) (West Supp. 1998).

33. Aurelia C. Scott, *Saving the Land*, 24 COUNTRY J. 20, 20 (1996).

34. See Wiebe et al., *supra* note 24, at 36.

35. See Ruth S. Flynn & H. Kay Cross, *A Home Where Bighorn Roam*, LEGAL TIMES, Apr. 14, 1997, at S38.

36. *Id.*

37. Mark A. Miller & William M. Nance, *Observations—Conservation Easements*, 8 J. FIN. PLAN. 158, 158 (1995).

38. *See id.*

39. *Id.*

40. Ronald Lipman, *Want to Keep Land in Family? Try Conservation Easement*, HOUS. CHRON., Nov. 2, 1998, available in 1998 WL 16779914.

41. *Id.*

42. *See* Miller & Nance, *supra* note 37, at 158; Tripp, *supra* note 11, at B01.

43. *See* Miller & Nance, *supra* note 37, at 158.

44. *See id.*

45. *See id.*

in addition to the actual easement, in order to verify the condition of the property at the time the property in the easement was granted.⁴⁶ After the necessary documents are filed with the deed recorder, the landowner's rights in the land are forever limited.⁴⁷

B. *Reasons for Utilizing Conservation Easements*

Conservation organizations use conservation easements to protect and preserve a variety of resources.⁴⁸ When a landowner chooses to grant land rights through a conservation easement,

[T]he client receives an immediate income tax reduction, an eventual estate tax reduction, a potential real estate tax reduction, and continued use and preservation of an asset in the condition the client desires. At the same time, a charitable group is assisted in achieving its mission, the public derives a benefit, and often, endangered wildlife has a better chance at survival.⁴⁹

Conservation easements are uniquely lucrative because the needs of the private landowner and the general public are simultaneously met.

Besides the obvious tax benefits, there are numerous reasons for a person in possession of environmentally important property to give a conservation easement to a government agency or a conservation organization. An owner may want to retain an historic home or a small farm in a metropolitan area, and this approach is the most cost-effective way to remain in possession of the property.⁵⁰ Other reasons may include wanting to "give a family vacation home to his or her decedents[,] or to protect inhabiting flora or fauna."⁵¹ A corporation may choose to go this route because it wants to preserve open space around its headquarters and, at the same time, boost its reputation as an environmentally aware organization.⁵²

As previously mentioned, a conservation easement can be donated to any organization that qualifies as a "conservation purpose" if it meets the requirements of a "charitable contribution."⁵³ If a grantor knows he wants to donate a conservation easement but is not sure to which organization or entity, he may want

46. *See id.*

47. *See* Lipman, *supra* note 40.

48. *See* Wiebe et al., *supra* note 24, at 36.

49. Flynn & Cross, *supra* note 35, at S38.

50. *See id.*

51. *Id.*

52. *See id.*

53. *See generally* I.R.C. § 2031(c) (West Supp. 1998) (listing the requirements for a qualified conservation easement).

to consider donating land to a local land trust conservancy.⁵⁴ Donating land to a local trust “permits the owners to continue to use the land as is, as well as to preserve, alter, or improve within the specified limits on the structure of the land.”⁵⁵

For example, if a family in a western state were interested in preserving the migration paths of bighorn sheep, the family could donate a conservation easement to a local land conservancy.⁵⁶ Through the easement, the migration routes could not be changed, and fences could not be built that would affect the bighorn sheep’s migration.⁵⁷ The public benefit from this easement would be the preservation of the sheep’s migration path; therefore, it would not be required that the public be permitted to directly access the land.⁵⁸

IV. ESTATE TAX BENEFITS AVAILABLE THROUGH SECTION 508 OF THE TAXPAYER RELIEF ACT OF 1997

A. *Further Explanation of the Section 508 Exclusion*

Prior to the Taxpayer Relief Act of 1997, there was no existing estate tax exclusion for the land that qualified as a conservation easement. Section 508 is the government’s “first tax incentive for voluntary land conservation in 20 years.”⁵⁹ Now, section 508 has the ability to eventually double the federal estate tax savings for “the typical easement donor.”⁶⁰

The most significant change enacted through section 508 is that the executor is now allowed to exclude from an estate forty percent of the value of land subjected to a conservation easement.⁶¹ When donating land, the value of an easement is significant because the rights to develop the land are transferred, thereby significantly reducing the value of the land.⁶² For example, “[a] farm in the suburbs or parklike property within an urban area can be worth millions if it is subdivided. Those millions go into the value of the estate.”⁶³ The estate tax exclusion compensates the landowner for the rights that were given away.⁶⁴

However, there are limits placed on the estate tax exclusion. The exclusion from the total estate is “(A) the applicable percentage of the value of the land

54. See Flynn & Cross, *supra* note 35, at S38.

55. *Id.*

56. *See id.*

57. *See id.*

58. *See id.*

59. *PEC Federal Estate Tax Change Boosts Landscape Protection, supra* note 26.

60. *Id.*

61. See I.R.C. § 2031(c)(2) (West Supp. 1998).

62. See Tripp, *supra* note 11, at B01.

63. *Id.*

64. *See id.*

subject to a qualified conservation easement, reduced by the amount of any deduction under section 2055(f) with respect to such land, or (B) the exclusion limitation.”⁶⁵ The “applicable percentage” means the forty percent “reduced by 2 percentage points for each percentage point . . . by which the value of the qualified conservation easement is less than 30 percent of the value of the land”⁶⁶ The exclusions are determined by the year when the decedents of the estates become deceased.

| In the case of estates of decedents dying during: | The exclusion limitation is: |
|---|------------------------------|
| 1998..... | \$100,000 |
| 1999..... | 200,000 |
| 2000..... | 300,000 |
| 2001..... | 400,000 |
| 2002 or thereafter..... | 500,000 ⁶⁷ |

B. Property Not Subject to Estate Tax Exclusion

The \$500,000 exclusion does not apply to the extent that the land is “debt-financed property.”⁶⁸ “[D]ebt-financed property means any property with respect to which there is an acquisition of indebtedness . . . on the date of the decedent’s death.”⁶⁹ Acquisition of indebtedness is considered the unpaid amount of:

- (I) the indebtedness incurred by the donor in acquiring such property,
- (II) the indebtedness incurred before the acquisition of such property if such indebtedness would not have been incurred but for such acquisition,
- (III) the indebtedness incurred after the acquisition of such property if such indebtedness would not have been incurred but for such acquisition and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition indebtedness, and
- (IV) the extension, renewal, or refinancing of an acquisition indebtedness.⁷⁰

65. I.R.C. § 2031(c)(1). Section 2055(f) states the special rule for “irrevocable transfers of easements in real property.” I.R.C. § 2055(f) (1994). The rule reads that “[a] deduction shall be allowed under subsection (a) in respect of any transfer of a qualified real property interest . . . which meets the requirement of section 170(h).” *Id.*

66. I.R.C. § 2031(c)(2). This is “determined without regard to the value of such easement and reduced by the value of any retained developmental right (as defined in paragraph (5)).” *Id.*

67. *Id.* § 2031(c)(3).

68. *Id.* § 2031(c)(4)(A).

69. *Id.* § 2031(c)(4)(B)(i).

70. *Id.* § 2031(c)(4)(B)(ii).

The exclusion is also not available for donor-retained development rights.⁷¹ A “development right” is defined as “any right to use the land subject to the qualified conservation easement in which such right is retained for any commercial purpose which is not subordinate to and directly supportive of the use of such land as a farm for farming purposes. . . .”⁷² In order to apply the exclusion, the retained development right has to be terminated.⁷³ Section 2031(c)(5)(B) states:

If every person in being who has an interest (whether or not in possession) in the land executes an agreement to extinguish permanently some or all of any developmental rights . . . retained by the donor on or before the date for filing the return of the tax imposed by section 2001, then any tax imposed by section 2001 shall be reduced accordingly. Such agreement shall be filed with the return of the tax imposed by section 2001. The agreement shall be in such form as the Secretary shall prescribe.⁷⁴

Section 2031 also states that a failure to execute the agreement “shall result in the imposition of an additional tax in the amount of the tax which would have been due on the retained developmental rights subject to such agreement.”⁷⁵ If an additional tax is imposed, it is due the last day of the sixth month following the two dates listed above.⁷⁶ Therefore, if developmental rights are retained, payment of estate taxes can be delayed for up to two years or until property is sold, whichever occurs first.⁷⁷

All conservation easements must have been “donated” rather than sold to qualify for the estate tax exclusion.⁷⁸ Therefore, land sold under a farmland preservation program is excluded from section 508.⁷⁹

It is important to remember that the estate tax exclusion is determined by calculating the value of the property after the conservation easement has been granted.⁸⁰ Again, the exclusion does not apply to developmental rights retained.⁸¹ However, as previously discussed, payment for estate taxes on retained developmental rights may be deferred for two years or until the disposition of the property.⁸²

71. See *id.* § 2031(c)(5)(A).

72. *Id.* § 2031(c)(5)(D).

73. See *id.* § 2031(c)(5)(B).

74. *Id.*

75. *Id.* § 2031(c)(5)(C).

76. See *id.*

77. See *id.* § 2031(c)(5)(C)(i), (ii).

78. See *Estate Tax Relief for Donated Easements, Other Benefits for Inherited Farmland*, *supra* note 9, at 6.

79. See *id.*

80. See I.R.C. § 2031(c)(1).

81. See *id.* § 2031(c)(5)(A).

82. See *id.* § 2031(c)(5)(C).

C. Recent Adjustments to Section 508

The Internal Revenue Service Restructuring and Reform Act of 1998 made a few slight changes to section 508 of the Taxpayer Relief Act.⁸³ In section 2031(c), paragraph (9) was inserted that states:

(9) TREATMENT OF EASEMENTS GRANTED AFTER DEATH—In any case in which the qualified conservation easement is granted after the decedent's death and on or before the due date . . . for filing the return of tax imposed by section 2001, the deduction under section 2055(f) with respect to such easement shall be allowed to the estate but only if no charitable deduction is allowed under chapter 1 to any person with respect to the grant of such easement.⁸⁴

Prior to this legislation, section 2031 did not specifically allow "a deduction for post-mortem conservation contributions by a decedent's executor or trustee of a trust holding real property."⁸⁵

Another subtle change to section 508 was made in regards to section 2031(c)(6).⁸⁶ The first sentence of section 2031(c)(6) was changed by "striking all that follows 'shall be made' and inserting 'on or before the due date (including extensions) for filing the return of tax imposed by section 2001 and shall be made on such return.'"⁸⁷ This section clarifies that the election "must be made by the due date of the estate tax return, including extensions."⁸⁸

D. Criticism of Section 508

The maximum amount of the exclusion available under section 508 was a debated issue prior to the enactment of the Taxpayer Relief Act.⁸⁹ Originally, the proposed maximum for the estate exclusion was \$1 million, but during the legislative battles, the exclusion was reduced to \$500,000.⁹⁰ Tim Lindstrom, Piedmont Environmental Council's staff attorney, explained that "[f]or a husband and wife using a standard estate plan, the maximum amount excluded could be

83. See Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, § 6007(g), 1998 U.S.C.C.A.N. (112 Stat.) 685, 810-11.

84. *Id.* § 6007(g), 112 Stat. at 811 (to be codified at I.R.C. § 2031(c)(9)).

85. Bernard Barnett et al., 1998 *Tax Legislation: "The Child of TRA 1997,"* 138 TR. & EST., Jan. 1, 1999, available in 1999 WL 10683388.

86. See Internal Revenue Service Restructuring and Reform Act of 1998 § 6007(g), 1998 U.S.C.C.A.N. (112 Stat.) at 811 (to be codified at I.R.C. § 2031(c)).

87. *Id.*, 1998 U.S.C.C.A.N. (112 Stat.) at 811.

88. Barnett et al., *supra* note 85.

89. See *Estate Tax Relief for Donated Easements, Other Benefits for Inherited Farmland*, *supra* note 9, at 7.

90. See *id.*

doubled to \$1 million."⁹¹ However, William Sellers of the Brandywine Conservancy viewed the \$500,000 exclusion as a "big disappointment," stating that a \$1 million exclusion would have had a much more immediate impact on land preservation.⁹²

Some conservation organizations believe that conservation easements exchanged by "sale or bargain sale" should have been included in the section 508 exclusion.⁹³ Chuck Beretz of the American Farmland Trust hopes to convince the legislature that a conservation easement given by a donation, gift, or "otherwise" should encompass a sale or bargain of a sale.⁹⁴ However, other conservation organizations feared that if they pressed too hard for the inclusion of sales, this portion of the Act could fail altogether.⁹⁵

There are further restrictions in section 2031 that may not appeal to all landowners. If the conservation easement is not at least ten percent of the value of the land minus the easement, then the exclusion is zero.⁹⁶ An important restriction to note is that the "basis of the land acquired at death will be a carryover basis to the extent that the value of the land has been excluded."⁹⁷ For example, "although heirs may inherit a vacation property with little initial tax cost because of a conservation easement, capital gains tax must be paid based on the original decedent's tax cost should the heirs desire to sell the property down the road."⁹⁸ Therefore, it is important to weigh both the long-term and short-term benefits of section 2032 before choosing to donate a conservation easement.

Conservation organizations campaigning for this bill included the American Farmland Trust, the Chesapeake Bay Foundation, the Brandywine Conservancy, the Land Trust Alliance, and the National Woodlands Owners Association.⁹⁹ It is unclear to most of these organizations whether section 508 is strong enough to have a long-term impact on conservation efforts, but most supporters feel it has the potential to have widespread effects.¹⁰⁰ The president of the Land Trust Alliance, Jean Hocker, feels it is too soon to tell if the new provision will have a positive impact on land trusts, but she is aware that it has the potential to be a "major new tool to encourage voluntary land conservation."¹⁰¹

91. *PEC Federal Estate Tax Changes Boosts Landscape Protection*, *supra* note 26.

92. *See Estate Tax Relief for Donated Easements, Other Benefits for Inherited Farmland*, *supra* note 9, at 6-7.

93. *See id.* at 6.

94. *See id.*

95. *See id.*

96. *See Jones & Luscombe*, *supra* note 28, at 11.

97. *Id.*

98. *Id.*

99. *See PEC Federal Estate Tax Changes Boosts Landscape Protection*, *supra* note 26.

100. *See Estate Tax Relief for Donated Easements, Other Benefits for Inherited Farmland*, *supra* note 9, at 7.

101. *Id.*

Despite the \$500,000 exclusion, Sellers believes the new provisions could be very helpful to farmers, and he stated that "in a Metropolitan region where land prices have escalated wildly, the farming community has been inflicted . . . the relief provided in the bill will make it possible for [farmers] to see that land can be passed to the next generation and a decision to protect the farm [can be a viable one]." ¹⁰²

The American Farmland Trust, the largest farmland protection organization in the United States, "believes the provision sends a strong signal in support of incentive-based conservation policy." ¹⁰³ Similarly, Lee Epstein of the Chesapeake Bay Foundation believes that "section 508 will help curb urban sprawl which has contributed significantly over the years to non-point source pollution of the Bay." ¹⁰⁴

V. OTHER TAX BENEFITS AVAILABLE THROUGH CONSERVATION EASEMENTS

The dominating incentive for individuals to choose to donate land through conservation easements is the numerous tax benefits. Under the Taxpayer Relief Act of 1997, farmers can potentially "save over \$1.6 billion per year in federal income taxes and between \$150 and \$200 million in Federal estate taxes through a number of general and targeted tax relief provisions." ¹⁰⁵

Conservation easements can conserve property and at the same time: (1) reduce property-tax burdens associated with owing valuable; (2) create a significant income-tax deduction; (3) ease future estate-tax burdens; and (4) preserve the land's natural features for future generations to enjoy. ¹⁰⁶ Specifically, conservation easements help rural family farmers retain ownership of their land by cutting the tax burden that accompanies the family farm in three ways. ¹⁰⁷ "First, the gift of development rights to the trust is a charitable, federally tax-deductible, donation; second, local property taxes are lower on non-developable land; and third, inheritance taxes are less on land that has a decreased market value because its development rights have been relinquished." ¹⁰⁸

A. Income Tax Benefits

In addition to the estate tax exclusion to an individual donating a conservation easement, an income tax deduction is also available. Generally, a taxpayer cannot

102. *Id.*

103. *PEC Federal Estate Tax Change Boosts Landscape Protection*, *supra* note 26.

104. *Id.*

105. *Id.*

106. *See Miller & Nance*, *supra* note 37, at 159.

107. *See Scott*, *supra* note 33, at 20.

108. *Id.*

take an income tax deduction for the "contribution of a partial interest."¹⁰⁹ However, the I.R.C. does allow an exception when a taxpayer makes a "qualified conservation contribution."¹¹⁰ Section 170(h)(1) of the I.R.C. allows a deduction for this type of charitable contribution.¹¹¹ In § 170, a "qualified conservation contribution" means a contribution "(A) of a qualified real property interest, (B) to a qualified organization, [and] (C) exclusively for conservation purposes."¹¹²

First, in order for the donation to be a "qualified real property interest," the land must be "the entire interest of the donor" or "a remainder interest" or as most relevant here, "a restriction (granted in perpetuity) on the use which may be made of the real property."¹¹³ Second, the contribution must be a "qualified organization" listed in I.R.C. § 170(b)(1)(a). Examples of "qualified organizations" include a church, an educational organization, a governmental unit, an organization that receives a substantial amount of its support through donations, or a private foundation.¹¹⁴ Essentially, any governmental units or publicly supported charities are included as "qualified organizations."¹¹⁵

Third, the conservation must be made exclusively for "conservation purposes," as previously defined.¹¹⁶ Also, the easement must run in perpetuity according to § 170(h)(2)(C).¹¹⁷ This means that "any interest in the property retained by the donor must be subject to legally enforceable restrictions preventing the use of that interest for purposes inconsistent with the conservation purposes of the contribution."¹¹⁸

An example of a transfer of an easement that is not exclusively for conservation purposes is an easement which is transferred with an expectation of an economic benefit for the donor's trade or business.¹¹⁹ In this case, the charitable contribution is not a deduction.¹²⁰ However, the contribution will be deductible if the taxpayer does gain "a mere incidental benefit" from the contribution, and it is to be shared by members of the general public.¹²¹

The taxpayer must be able to value accurately the contribution in order to deduct a contribution of a conservation easement.¹²² If possible, the value of a

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109. Flynn & Cross, *supra* note 35, at S38.
110. See I.R.C. § 170(f)(3)(B)(iii) (West Supp. 1998).
111. See *id.* § 170(h)(1).
112. *Id.*
113. *Id.* § 170(h)(2).
114. See *id.* § 170(h)(1), (3).
115. See Flynn & Cross, *supra* note 35, at S38.
116. See I.R.C. § 170(h)(1), (4).
117. See *id.* § 170(h)(2)(C).
118. Flynn & Cross, *supra* note 35, at S38.
119. See *id.*
120. See *id.*
121. See *id.*
122. See *id.*

“restriction in perpetuity” is determined by reference to previous sales with similar restrictions.¹²³ Unfortunately, these comparisons seldom exist.¹²⁴ Therefore, the most common method of valuing the property is “by calculating the difference between the fair market value of the property before and after the restriction is granted.”¹²⁵

To qualify for an income tax deduction, “a significant amount of research and information on conservation values (including conservation laws, wetland designations, local planning and developmental policies . . .) is necessary.”¹²⁶ These types of deductions will be strictly reviewed because this opportunity has the potential for abuse by taxpayers.¹²⁷

B. Property Tax Benefits

Many states have also passed legislation requiring “conservation restrictions be considered in valuing land for real estate tax purposes or in granting property tax credits for certain types of easements.”¹²⁸ If it appears that the easement restrictions will result in a reduction of the value of property, a “qualified appraisal” should be done on the property to find out for tax purposes how much the value of the property was reduced.¹²⁹ It is important to seek out an appraiser that has experience with conservation easements, and it can even be beneficial to talk with the appraiser before the easement is donated.¹³⁰ Then, an assessment can be made as to which restriction could provide the most reduction in the property’s value, and also as to which parts of the property can be included in the easement without drastically changing the tax deduction.¹³¹

A reduction in the value of property will “depend[] on a variety of factors, including the terms of the easement and the nature of the property.”¹³² Studies have shown that the range of the reductions on conservation easements has been anywhere from five percent to ninety-five percent.¹³³ The following chart shows how substantial savings through conservation easements can be when estate tax deductions, income tax deductions, and property tax deductions are added together:

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123. *See id.*
 124. *See id.*
 125. *Id.*
 126. Miller & Nance, *supra* note 37, at 159.
 127. *See id.*
 128. Flynn & Cross, *supra* note 35, at S38.
 129. *See* Miller & Nance, *supra* note 37, at 159.
 130. *See id.*
 131. *See id.*
 132. Flynn & Cross, *supra* note 35, at S38.
 133. *See id.*

| | <i>No Easement</i> | <i>Easement</i> |
|---------------------|--------------------|----------------------------|
| Property Value | \$3,000,000 | \$2,000,000 |
| Annual Property Tax | \$33,000 | \$22,000 |
| Income Tax Savings | 0 | \$400,000 |
| Estate Tax | \$1,650,000 | \$1,100,000 ¹³⁴ |

VI. CONCLUSION

Conservation easements are legally binding and allow owners to retain ownership of their property, but also transfer interest in their land. This mechanism allows the owners of the land to still control exactly how the land is utilized and to ensure that the land is used for preservation purposes.

Conservation easements are an inventive and profitable way to assist the state in farmland preservation or aid conservation organizations. They have become a highly advocated conservation tool. Estate workshops are now being offered to landowners in areas where land conservation is a priority.¹³⁵ The Virginia General Assembly has enacted "The Open Space Lands Preservation Act of 1997" that enables the Virginia Outdoors Foundation to pay landowners legal fees, appraisals, and other costs resulting from donating a conservation easement.¹³⁶

Section 508 of the Taxpayer Relief Act of 1997 further advocates for the use of conservation easements. It is a gift to farmers and others interested in preserving their land and saving tax dollars simultaneously.¹³⁷ For the first time, transferors are allowed to exclude up to forty percent of the value of their land that qualifies as a conservation easement.¹³⁸ This law provides an immense estate tax exclusion that may allow farmers to keep their farms within their families rather than selling them off to avoid imposing a tax burden onto surviving members of the family.

In order to qualify for estate benefits, it is important for landowners to first determine whether they possess land that is a "qualified conservation easement." To determine whether their land meets the required definition, landowners must examine the location and characteristics of the land and the type of transfer that had occurred to determine whether the land has been donated for a "conservation purpose."

134. See Miller & Nance, *supra* note 37, at 159.

135. See, e.g., Ted Bell, *Estate Workshop Set*, SACRAMENTO BEE, Sept. 13, 1998, at B2; *Rhode Island Journal Workshop Tonight on Land Preservation*, PROVIDENCE J.-BULL., Feb. 10, 1998, at B06; Brian Williams, *Upcoming Conferences to Examine Farmland Preservation*, COLUMBUS DISPATCH, Aug. 9, 1998, at 02H.

136. See Ron Nixon, *Easements Can Bring Landowners Tax Breaks, with Some Conditions*, ROANOKE TIMES & WORLD NEWS, Dec. 27, 1998, available in 1998 WL 25156015.

137. See I.R.C. § 2031(c) (West Supp. 1998).

138. See *id.* § 2031(c)(2).

In addition to estate tax benefits, donating a conservation easement may also provide income tax and property tax benefits. It is important to determine whether any additional legislation regarding conservation easements has been passed in the state where you intend to make the donation. Once again, it is imperative to research whether the potential donation qualifies as a “qualified conservation easement” for “conservation purposes.”

In many cases, it may be beneficial to seek the advice of a tax attorney to insure that you are able to reap all of the tax benefits available. Donating a conservation easement is an accessible option that serves a genuine purpose and at the same time benefits donors. This type of donation can make a difference to both the environment and the livelihood of farmers and other individuals.