

## Financial Benefits of Conservation Easements

Both federal and Mississippi laws provide tax benefits to landowners who protect natural or historic land with qualifying conservation easements. Conservation easements are not suited for every situation. It is important that landowners consult tax professionals for more specific information.

A conservation easement donation can qualify as a charitable contribution if:

- A. it is granted in perpetuity
- B. it is granted to a qualified organization, either
  - 1. a nonprofit, 501(c)(3) charitable organization (i.e., a land trust) with a conservation purpose and the means to enforce the easement, or
  - 2. a local, state or federal public agency
- C. it achieves a least one of the following:
  - 1. preserves land for public outdoor recreation or education,
  - 2. protects relatively natural habitats of fish, wildlife or plants,
  - 3. preserves open space including farms, ranches or forests either for scenic enjoyment or in keeping with an adopted public policy (such as a local open space plan), or
  - 4. preserves historically important land or certified historic structures.

For a conservation easement donation to qualify for a federal income tax deduction, the following instruments usually need to be prepared:

- 1. the conservation easement document;
- 2. an inventory (including photographs) of the property's condition at the time of donation listing man-made structures, water resources, agricultural and ecological features;
- 3. a qualified appraisal of the conservation easement prepared by an independent real estate appraiser working for the donor, completed no more than 60 days prior to the donation and no later than the time the tax return claiming the deduction is filed;
- 4. title report, copy of the deed and copies of any mortgages with subordination agreements from the mortgage holder;
- 5. a legal land survey; and
- 6. IRS Form 8283 (an attachment to the federal income tax return of anyone claiming charitable contributions of more than \$5,000).

### Federal Income Tax Deduction

The federal income tax benefits of donating a conservation easement are similar to those of other charitable contributions. A landowner may deduct up to the full value of the conservation easement from his or her federal income taxes.

Tax laws require that the value of the conservation easement be determined by a qualified appraiser. A conservation easement donation is greater in areas where development pressure is intense and lower in remote areas. Likewise, a conservation easement that prohibits any development will have a higher value than an easement that permits a property to be divided or developed.

A tract of land may be worth \$120,000 as a potential residential development, but worth only \$20,000 as open space or recreational property. If a landowner donates a conservation easement to a land trust that prohibits new construction on his or her property, he or she makes a charitable contribution of \$100,000. The landowner may then be eligible for up to \$100,000 in federal income tax deductions.

If the conservation easement meets IRS criteria, the landowner may deduct the full value of the conservation easement donation from his or her adjusted gross income, up to 30 percent of the landowner's income for the year of the gift. If the donation exceeds this amount in the year of the donation, the balance of the donation may be deducted for up to five succeeding years, subject to the same 30 percent limitation.

A landowner with a \$60,000 adjusted annual income might donate a conservation easement worth \$100,000 to a land trust. The landowner could deduct 30 percent of his \$60,000 income, or \$18,000, in each of years 1-5 and the remaining \$10,000 in year 6.

In some situations landowners may opt to use the "step down election" which increases the limit of the deduction from 30 percent to 50 percent of an individual's annual adjusted gross income. However, the step down election generally requires that the deduction be based on the property's "tax basis," which is usually the amount paid for the property when purchased. Landowners should discuss the implications of both the 30 percent and 50 percent deduction limits with tax professionals.

Conservation easements may be phased on portions of a property over time, should the value of the charitable donation exceed a landowner's ability to use the income tax deduction over the allowed six years. Subject to certain limitations some of the expenses incurred by a landowner in the donation process, including the costs for appraisals, surveys, legal review and title insurance, can also be tax deductible.

## Estate Taxes

Estimated federal estate taxes for an individual:

Value Of The Estate	Total Estate Taxes Paid (2000)
\$600,000	\$0
\$1,000,000	\$153,000
\$2,000,000	\$588,000
\$2,500,000	\$833,000
\$5,000,000	\$2,198,000
\$10,000,000	\$4,948,000

To calculate the value of inherited property for estate taxes purposes, federal law requires that the value of the land be based on that property's "highest and best use," instead of actual use. For example, a landowner might own a small family ranch near a growing city which might be more valuable as a residential development. When the landowner dies, taxes on the property will be based on the land's value as potential home sites, even if the heirs do not intend to develop the land for home sites.

A conservation easement can place restrictions on the use of a property that limit its "highest and best use." Because the property's "highest and best use" is restricted, its value and the estate taxes are reduced accordingly. If the landowner in the example above donates a conservation easement on the family ranch that prohibits the construction of new home sites, estate taxes on his or her land would be based on the land's value as a ranch, rather than a potential residential development. As noted earlier, there are limits on the income tax deduction for a conservation easement donation, but there are no such limits for estate tax purposes. Therefore, the savings on estate taxes can be substantial.

To realize estate tax benefits, a landowner must donate the conservation easement during his or her lifetime or in a legal will. Heirs cannot donate easements to avoid payment of estate taxes. A landowner intending to convey a conservation easement by will must contact the potential holder to ensure that the organization will accept the donation.

A widowed landowner purchased a property 30 years ago that has appreciated significantly. The property, which is located near a growing suburban community, has a current fair market value of \$900,000. The landowner donates a conservation easement to a local land trust that reduces the property's value to \$500,000. Assuming the landowner has \$100,000 in taxable assets in addition to the property and that no prior taxable gifts have been made, the effect of the conservation easement on estate taxes for heirs would be as follows.

	<b>Without Easement Donation</b>	<b>With Easement Donation</b>
<b>Value of the land</b>	\$900,000	\$500,000
<b>Other valuable assets</b>	\$100,000	\$100,000
<b>Total taxable estate</b>	\$1,000,000	\$600,000
<b>Total federal estate taxes</b>	\$153,000	\$0

### **Local Property Taxes**

Conservation easements may reduce property taxes. However, property taxes on agricultural land in Mississippi are reduced because they are based on a property's productivity rather than fair market value. Conservation easements on land not classified as agricultural may reduce property taxes to the extent the value of the land is reduced. But it is important to remember that property taxes are determined by the county tax assessor/collector.