



## TAX BENEFITS OF DONATING CONSERVATION EASEMENTS

Most people who protect land through the Vermont Land Trust (VLT) do so by donating a conservation easement. They retain title and control of their land while VLT ensures that the property is not used or developed in a manner that is inconsistent with the property's conservation values. **This summary describes the tax benefits associated with the donation of a conservation easement.**

### GENERAL PRINCIPLES.

There are a number of general principles that apply to donations of conservation easements:

- 1) In order to be deductible for income or estate tax purposes, the donation must be made to a qualified 501(c)(3) "public charity." The Vermont Land Trust meets this requirement.
- 2) The easement must be of a "qualified conservation interest" given "exclusively for conservation purposes." These requirements are discussed in the next section.
- 3) Because a conservation easement will usually have a value of more than \$5,000, the donor must obtain a qualified appraisal in order to claim a tax deduction. The appraisal must be prepared by an independent, qualified appraiser and must contain certain factual information specified by IRS regulations. The donor must file a summary report (IRS Form 8283), signed by the appraiser and VLT, with the donor's federal income tax return. For donations which are valued in excess of \$500,000, the complete qualified appraisal report must be appended to the tax return. For more information on these requirements, please refer to VLT bulletin "Appraisal Requirements for Conserving Land."
- 4) If there is an existing mortgage or lien on the conserved property, the mortgage or lien must be either discharged or subordinated to the easement. VLT's experience has been that most mortgage holders are willing to subordinate, so long as the bank determines that the "restricted value" of the property meets the bank's requirements for mortgage collateral.

### "QUALIFIED CONSERVATION INTEREST."

Generally, a conservation easement meets IRS requirements if the easement is perpetual and preserves land that meets the following criteria:

- the land will be used for public outdoor recreation or education, or
- the easement preserves an important natural habitat or ecosystem, or
- the easement maintains an historically important land area or building, or
- the easement results in a significant public benefit by preserving open space (including farmland and forestland) for the scenic enjoyment of the general public or pursuant to a clear governmental policy.

Most VLT easements fall into the last category because they fulfill the following requirements:

**SCENIC ENJOYMENT.** Development of the property would impair the scenic character of the local landscape or would interfere with a scenic panorama that can be enjoyed from one or more public locations.

**or**

**CLEAR GOVERNMENTAL POLICY.** Policies in Vermont which may fulfill this criterion include: lands enrolled or eligible for enrollment in the current use program; lands within a designated scenic highway corridor; projects approved for Vermont Housing and Conservation Board grant funding; conservation zones identified by a local town plan or zoning ordinance; primary and secondary agricultural soils and forest soils receiving protection under Act 250; lands inventoried in a LESA program; sites identified by the Vermont Heritage Program; lands mapped by the Vermont Department of Fish and Wildlife as deer yard, bear habitat, natural waterfalls, etc.

**and**

**PUBLIC BENEFIT.** The easement will yield significant public benefit, considering the following factors: the uniqueness of the property to the area; the likelihood that development of the property would degrade the scenic, natural, or historic character of the area; the opportunity of the general public to use the property or to appreciate its scenic values; the importance of the property in preserving a local or regional landscape or resource that attracts tourism or commerce to the area; whether VLT has or, in the future, will conserve other important resource lands in the vicinity.

IRS regulations provide more specific guidance concerning these and related requirements. A landowner seeking a charitable income tax deduction or estate tax benefits should consult a legal advisor concerning these requirements.

**Valuing the Easement.** Determining the value of a conservation easement is a two- or three-step process.

The first step is to establish the fair market value of the property before it is restricted.

The second step is to determine the fair market value after the property is restricted. This step requires that the landowner and VLT have agreed upon the terms of the conservation easement, so that the appraiser knows what rights the landowner is retaining and giving up. The difference between the “before” and “after” appraisals is considered to be the value of the conservation easement.

The third step applies only if the landowner or a member of the landowner’s family owns land in the vicinity of the conserved property that is not covered by the conservation easement. In this case, the appraiser must consider whether the value of the unrestricted property is being enhanced by the easement. If so, the easement value must be reduced by the amount of the enhancement.

*To illustrate these principles, suppose a donor owns a house and 200 acres of land valued at \$200,000. The donor also owns an adjacent 10-acre parcel valued at \$20,000. The donor conveys a conservation easement to VLT restricting the 200 acres to the existing home and one additional building site. An appraiser determines that under these restrictions, the 200-acre property now has a restricted value of \$140,000. However, the appraiser also determines that the 10-acre unrestricted parcel has increased in value to \$30,000 because it is now adjacent to conserved land. The donor's deduction is \$50,000 ( $\$200,000 - \$140,000 + \$10,000$ ).*

**Income Tax Benefits.** When the easement meets the criteria for deductibility and the value is established by a qualified appraisal, the donation of the easement will be deductible against the donor's federal and, in some cases, state income taxes. If the land has appreciated in value, the donor's income tax deduction is limited to 30% of the donor's Adjusted Gross Income in the year of the donation. If the easement value exceeds the 30% limit, the donor may carry over the unused deduction for up to five years.

This deduction can mean substantial tax savings. For example, suppose the donor in the previous example has an adjusted gross income of \$100,000. The easement value (after deducting the enhancement to the 10 acre lot) is \$50,000. Under the 30% rule, the donor can take a charitable deduction of \$30,000 in the year of the donation. The remaining \$20,000 may be carried over and deducted the following year. If the donor is a Vermont resident and pays a combined federal-state income tax rate of 33%, the donor will realize \$16,500 in income tax savings from the easement donation over a two-year period.

**Estate Tax Benefits.** It is possible to convey a conservation easement to VLT through a Will or a Living Trust. VLT would always like to have an opportunity to review and approve the easement before the Will or trust is signed, and a copy of the proposed easement should be attached to the will or trust as an exhibit. If the easement meets the requirements described above, the easement value is fully deductible from the donor's taxable estate. In other words, the land will be valued at its restricted value when calculating the federal estate tax.

This could be of great importance to the donor's heirs, because federal estate tax rates go as high as 47% today, and may spring back to 55% in 2011. Suppose, for example, a widow has a total estate valued at \$2 million, of which \$800,000 is the value of a farm that has been in her family for generations, and the balance is made up of life insurance policies, personal property and other assets. If the widow died with the land in her estate, her federal estate tax could be as high as \$225,000 (45% of the excess over \$1.5 million). Instead, if the widow placed a conservation easement on the farm during her lifetime or through her Will, which reduced the farm's value to \$300,000, her total taxable estate would be only \$1.5 million, and no estate tax would be due. The 30% limitation application to charitable gifts for income tax purposes does not apply for estate taxes.

At one time, it was essential that the owner conserve the property before she or he died. Otherwise, the farm would be assessed at its full fair market value, and the full estate tax would accrue, even if the heirs were willing to restrict the property. Fortunately, in the late 1990s, Congress amended the law to allow the estate to make two "post-mortem" elections, provided all of the heirs agree.

The first election is that if the property is not already subject to a “qualified conservation easement,” the estate can elect within nine months from the owner’s death to place an easement on the property. If that election is made, the property will be appraised at its restricted value for estate tax purposes.

The second election is that if the heirs intend to continue to hold the property, the estate can deduct 40% of the property value, excluding any reserved house sites or development rights, from the taxable estate. This deduction is limited to \$500,000. The disadvantage is that the heirs’ tax basis in the property continues at the same level of the original donor, rather than being “stepped up” to the value as of the donor’s death. This means that the heirs will have to pay a significant capital gains tax, if they subsequently decide to sell the property.

Two important requirements of these “post-mortem elections” are that (1) the heirs must unanimously agree to the election, and (2) the executor must make the election within nine months of the owner’s death. In the proper circumstances, these elections can be of enormous benefit to the family and the land, but the executor and the heirs need to begin considering the option very early in the probate process.

**Property Tax Benefits.** The desire to reduce property tax has rarely been the driving force behind a land conservation transaction. At this point the experience in Vermont is too mixed to predict with any certainty what impact a conservation easement may have on property taxes. In general, town listers are required to assess property at its full fair market value, without regard to how interests in the property may be divided. If a town or state government or a qualified non-profit organization like VLT holds a conservation easement, the land is supposed to be assessed on the basis of its conserved value. In the case of a non-profit easement holder, the organization must first file a certification request with the Vermont Tax Commissioner. The Commissioner’s certification must be on file with the town by April 1 in order to be effective for the coming tax year.

For further information about the impact of conservation easements on property taxes, please refer to VLT’s bulletin entitled “Property Tax Impacts of Land Conservation.”

**Conclusion.** This document summarizes complex federal and state tax laws. A summary of these laws must, by necessity, be an over-simplification. The Vermont Land Trust can provide more detailed information about the tax laws affecting donations of conservation easements and can often prepare preliminary calculations on the tax benefits. However, it is essential that landowners seek independent legal and tax advice before finalizing a land conservation transaction. This will ensure that the donor fully understands what is and is not permitted under the conservation easement, and what the anticipated tax benefits from the transaction will be.

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