

SOME TAX BENEFITS OF A CONSERVATION EASEMENT

by
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Donating a conservation easement to a qualified land trust can create income tax benefits at the federal and state levels, as well as federal estate tax and state property tax benefits. These are the basics of how it works.

A conservation easement has value, because the landowner gives up most of the right to develop the land having the conservation easement. Land often has value because of its development potential. With a conservation easement, the landowner gives up some or all of the development rights forever, so that the land will remain much as it is in perpetuity. If the landowner gives up most of the development rights through a conservation easement, it stands to reason that the land will be worth less. The difference in value of the land with and without the conservation easement is the value of the conservation easement. The values before and after must be determined by a qualified conservation easement appraiser.

As an example, suppose that 500 acres of undeveloped land is worth \$5,000 per acre or \$2.5 million because of its development potential. If the landowner were to give up the right to subdivide and develop the land, the land might only be worth \$2,000 per acre or \$1 million. The difference between those numbers, \$1.5 million, is the value of the conservation easement.

INCOME TAX BENEFITS

Creating the conservation easement and giving up the right to develop the property is giving up \$1.5 million in the landowner's value. It is much like donating a similar amount of money to a church or school. The landowner could claim a \$1.5 million charitable income tax deduction on her federal income tax return. Currently, this type of charitable deduction may be used to offset up to 50% of the landowner's adjusted gross income in the year the gift is made. If the landowner is a farmer or rancher, the landowner may use the deduction to offset as much as 100% of adjusted gross income. Not many landowners have an income high enough to use up a \$1.5 million deduction in one year. So, any unused portion of the deduction may be carried forward for up to 15 additional years to be used as deductions in those years in the same way.

In Colorado, the donation creates a significant, additional benefit. Colorado allows an income tax credit against Colorado income tax equal to 50% of the value of the conservation easement up to \$750,000. The maximum amount of the Colorado tax credit is therefore \$375,000. Sometimes grant funds are available to purchase some of the value of the conservation easement. The part purchased is treated as a taxable sale of real estate¹. The part donated is still treated as a charitable contribution.

¹ Precisely how receipt of money for sale of a Colorado income tax credit has not yet been resolved.

For Colorado landowners who don't have enough income to use such a generous tax credit, Colorado permits them to sell the tax credit to a taxpayer who can. If the State budget is in surplus (not likely in the near term!), the landowner may request a refund of up to \$50,000 per year until the credit is used up. Any portion of the Colorado income tax credit that is not used or sold can be carried forward and used to offset Colorado income taxes for up to twenty more years.

ESTATE TAX BENEFITS

Today, the estate tax only impacts estates of more than \$5 million. In 2011 and 2012 estates of more than \$5 million are taxed at 35%. A qualifying conservation easement in such an estate could make a significant difference. Using the example above, the property without a conservation easement would be valued at \$2.5 million in the estate if the owner were to die. If the landowner had an additional \$3 million in assets, the taxable estate might be \$5.5 million, and the estate tax could be \$175,000. With a conservation easement, that same estate would be valued at less than \$5 million, and there would be no estate tax. For estates of an even higher value, a conservation easement can provide an additional estate tax benefit. If the conservation easement qualifies under certain provisions of the Internal Revenue Code, then the value of the land for estate tax purposes can be reduced by an additional 40%, up to a maximum exclusion of \$500,000. In our example, the \$1 million remaining value of the property after granting the conservation easement could be reduced by an additional \$400,000, if this easement qualifies under the special rules. In this case, land that would have been valued at \$2.5 million without a conservation easement for estate tax purposes, could be valued in the estate as low as \$600,000 with a conservation easement. That could mean the difference between the heirs having to sell the property to pay estate taxes or keeping the property in the family.

PROPERTY TAX BENEFITS

A conservation easement will sometimes lower property taxes due to the reduced value of the property subject to the conservation easement. For Colorado agricultural properties of a certain size, a landowner is entitled to maintain agricultural classification after a conservation easement is placed on the property, even if agricultural use later ceases.

The various tax rules are complex. No one should assume that the rules stated here will apply as stated to them. They are given only as examples without the complex analysis that any actual situation would require. Maximizing the benefits takes skilled professionals, lawyers and accountants, who know how and when the rules apply.

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