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New Deductions For Conservation Easements

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Conservation easement reforms have hitched a ride on the Pension Protection Act of 2006, H.R. 4, which President Bush signed on August 17, 2006. As a result, conservation easements are more attractive.

Even without the latest enhancements, however, conservation easements already had unique and powerful benefits that may now be noticed as a result of the new attention. Make no mistake, the income tax

and property benefits of a conservation easement are useful up front, but the long-term estate-planning significance of this arrangement is profound.

Is a conservation easement the device of the hour or of the quasi-repeal era of estate taxation? Can a conservation easement protect against a showdown with eminent domain? Let's review the current status of conservation easements.

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The Net Results

Before exploring the background and context of conservation easements, the practical financial planner needs to know just what tax advantages are at stake with this arrangement.

Your classic conservation easement consists of Landowner donating an easement of the future development rights on a segment of property to a not-for-profit land trust. Landowner retains the right to use the land for hunting, fishing, camping, [houses](#), [tennis courts](#), [agricultural buildings](#), [garages](#), [storage sheds](#), and [swimming pools](#) and whatever else Landowner happens to want. Who gets what? Let's break it down right now:

1. The Land Is Preserved: The land is thereafter protected from development—forever. No housing subdivisions, strip malls, land fills, parking lots, asphalt. That's a significant accomplishment, with permanence, and the donor can take great satisfaction during his or her lifetime for that.

2. Public Image: The land trust entity receiving the donation of the easement is grateful and happy and undoubtedly provides a press release about generous Landowner.

3. Property Tax: The land remains on the tax rolls for property tax purposes. Since the land was previously undeveloped and was presumably valued as such, and since the land remains undeveloped, there is no change in the property tax valuation of that land. However, with development constraints in place, the property may qualify for various state or local property tax programs for property used in agriculture, timber, or other natural pursuits.

4. Landowner's Use: As described above, Landowner continues to use the land for those purposes carved out under the terms of the conservation easement that was donated.

5. Charitable Deductions: The amount of deduction generally equals the fair market value of the contributed property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.¹

Qualified conservation contributions are not subject to the "partial interest" rule, which generally bars deductions for charitable contributions of partial interests in property. A qualified conservation contribution has to meet requirements on the type of property, the recipient of the property, and the future uses contemplated. Specifically, under section

170(h)(1), a "qualified conservation contribution," requires a gift to be of a qualified real-property interest, donated to a qualified organization, and exclusively for conservation purposes.

Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat for fish, wildlife, plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated Federal, State, or local governmental conservation policy; and (4) the preservation of a historically important land area or a certified historic structure.

Qualified conservation contributions of capital gain property are subject to the same limitations and carryover rules of other charitable contributions of capital gain property.

Under previous law, there was a 30% limit on contributions of capital gain property by individuals. Now, for 2006 and 2007 only, individuals may deduct the fair market value of any qualified conservation contribution to an organization described in section 170(b)(1)(A) to the extent of the excess of 50% of the contribution base over the amount of all other allowable charitable contributions.

Conservation easement donations are not taken into account in determining the amount of other allowable charitable contributions. Individuals are allowed to carry over any qualified conservation contributions that exceed the 50% limitation for up to 15 years.

In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100% of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions.

A qualified farmer or rancher means a taxpayer whose gross income from the trade of business of farming (within the meaning of section 2032A(e)(5)) is greater than 50 percent of the taxpayer's gross income for the taxable year.

The new rules apply to contributions made in taxable years beginning after December 31, 2005, and before January 1, 2008 (i.e., only for 2006 and 2007).

Note: The new rules also restrict the use of conservation easements for buildings in registered historic districts, now requiring an easement for the entire exterior of the building, not just the facade.

The Asset of Kings

It's all about the land. Land is not like any other object that can be bought and sold; land is the king of assets. It is natural in origin, finite in quantity, and each parcel of property is unique in content and location.

Land represents home. Land represents wealth. Whoever owns land is king, both figuratively as in "a man's home is his castle," and literally as in English law. Only the Monarch held "allodial" title, and a fee simple grant of land from a king or feudal lord involved the potential reversion of the land to the king.

Even in modern day America, failure to pay property taxes will cause a State to reclaim land. A key measure of would-be world emperors from Alexander to Genghis Kahn is the area of land within their dominion. Many wars have been fought over territory and even the enlightened nations of this 21st century incur bloodshed over boundary disputes defining national sovereignty.

A Limited Supply

Real estate is a natural asset that is in limited supply; they just aren't making any more.² People, on the other hand, are multiplying in abundance. World population is currently 6.535 billion, double that of 1963, and has quadrupled in the last century. The United States population has reached 300 million, an increase of 50 million from 1990 and 100 million since 1968. We have doubled in population since 1949.³

As a result, development is currently consuming two million acres a year in the United States. There will also be increasing pressure to develop raw land to provide housing and economic benefits. The laws of economics are in play.⁴

Eminent domain may be invoked to seize and develop (or preserve) private land for public purposes. In fact, in, *Kelo v. City of New London*, the Supreme Court upheld economic need as a legitimate basis for seizing private land.⁵ Nor should such strong-arm tactics come as a shock. America was expanded from coast to coast based on principles of manifest destiny.

A Notion to Preserve

In 1890, a landscape architect named Charles Eliot wrote a letter to a New England periodical, *Garden and Forest*, that proposed legislation to create a nonprofit entity that could hold undeveloped land for the public "just as a Public Library holds books and an Art Museum holds pictures." As a result, the Massachusetts Legislature created the nation's first land trust in 1891.

Land trusts increased in number gradually for the next century. By 1982, there were fewer than 450 such trusts nationwide. But during the 1990s, there was an explosion of interest that prompted Congress to include an estate tax deduction for conservation easements in the Taxpayer Relief Act of 1997.

When *The Estate Analyst* last covered this subject (*Conservation Easements after TRA '97*, Feb., 1998) we reported that land trusts had doubled in number during the previous decade, reaching about 1,300 in all. Today, there are 1,500 land trusts in the United States, about 1,000 of which are members of the Land Trust Alliance.

A more significant statistic: The number of acres of land protected by these trusts has doubled from 4.7 million acres in 1998 to 9.4 million acres in 2003. For conservation easements, the numbers are even more eye opening. There were 7,392 conservation easements in 1998, but by 2003, that number had jumped to 17,847. And the increase in acreage protected by conservation easements nearly quadrupled during that period, jumping from 1,385,000 acres to 5,067,929 acres.⁶

Value, Value, and Value

Aside from the value associated with location, land has many types of value associated with it. Land has intrinsic value in its natural state, potential agricultural use, potential development for homes or commercial structures, and natural resources such as oil, gems, precious metals, or forests. Such interests may be held by more than one owner. And ownership can be divided between current owners and those with future interests.

At common law, there were five classes of rights that one could have on the land of another:

Easements—the right to enter on and have access through land

Profits a prendre—the right to share in the profits or bounty from the soil through present day

Personal licenses—the bare right or authority to do an act on the property without an estate or interest in the property

Customary rights—such as a town’s custom in which every inhabitant of a town shall have a way over certain land either to church or to market

Natural rights—such as the right to lateral support or the flow of water

A property that is subject to more of these rights held by others is diminished in exclusivity and value. An easement over all future development of the property accounts for a significant share of the value associated with the parcel of land.

Diminished Effervescence

Yes, some of the “fizz” has gone out of a real estate market that in the recent past resembled a newly opened bottle of champagne. Considering the preceding discussion, any current slow down in the American real estate market needs to be placed in context. Was there a bubble and has it burst yet? Is this a consideration for real estate transactions occurring in the next 10 to 15 years?

Submitted for your approval, a less ominous euphemism such as “diminished effervescence” should be substituted for the bursting of a “real estate bubble.”

Let’s all agree not to refer to the current American real estate market in terms of a bubble for several good reasons:

1) The real estate market is resilient. The consensus among experts is that we do not have a single American real estate bubble, just a few hot spots. Overall, real estate may cool and plateau, and give ground, but not crash and burn.

2) American real estate has never been inflated to the bizarre extremes that took place in Japan prior to their real estate/stock market bubble burst—those were conditions reminiscent of the great tulip crash. What the two events had in common was extremely inflated values based on speculative value.

3) Talk enough about a real estate bubble and it will become a self-fulfilling prophecy. There is a market psychology element to this equation and the direction of the stock market and real estate market is intertwined.

But assuming for the sake of argument that there was a slight bubble in real estate that was driven by low interest rates and a stagnant stock market for the past four years, where are real estate prices heading next? It depends on whom you ask.

Even a dip in average housing sale prices is subject to debate. When markets are slow, moving higher priced homes takes longer, so the average home price drops, reflecting only the sale of homes that were lower priced to begin with.

Conservation Pays

By donating a conservation easement that prevents future development of a property, the value of the property is diminished for estate tax purposes and charitable deductions are secured. But conservation plans begin with a motive to protect land in its natural state, in perpetuity.

TECHNICAL REFERENCES

1. Gerzog, Wendy, *Conservation Easements Under Turner and Glass* (2006) (available on *TaxAnalysts*). Reviews *Turner v. Comm’r*, 126 T.C. No. 16, Doc 2006-9514, 2006 TNT 95-10 (2006); and *Glass v. Comm’r*, 124 T.C. 258, Doc 2005-11571, 2005 TNT 101-11 (2005). In *Turner*, the Court concluded that no public benefit was accomplished because the land that was donated could not have been developed. The author concludes, “It is likely that *Turner* is part of the increased IRS scrutiny of abusive conservation easements.”
2. According to the Bible, Book of Genesis, God differentiated a firmament from the waters creating the sum total of land in existence on earth during the second day of creating things. Mankind, however, has since tried to improve upon that. Landfill extends coastlines of cities such as Chicago, New York, and Hong Kong. Much of the Netherlands was wetlands drained by Dutch windmills. A man-made island supports Kansai International Airport in Osaka Bay, Japan. Huntington Harbour California, is an upscale community on five manmade islands. Taking that concept to its ultimate conclusion, the nation of Dubai is building hundreds of manmade islands in the shape of palms and a map of the world.
3. The U.S. POPClock Projection website, using Censue Bureau data, projected U.S. population to 08/20/06 at 299,519,854. Our population grows by one person every 10 seconds.
4. An Inquiry into the Nature and Causes of the Wealth of Nations by economist Adam Smith was published in 1776.
5. More than 30 state legislatures are considering limits on the power to condemn private property to spur economic growth. Lawmakers are responding to a Supreme Court ruling in June that permitted eminent domain powers to be used in, *Kelo v. City of New London*, 125 S. Ct. 2655 (2005), to confiscate waterfront homes in Connecticut to build an office complex and condominiums.
6. Data from the National Land Trust Census. See LTA website.