

Tax Considerations Associated With the Granting Of Conservation Restrictions or the Donation of Property

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The fact sheet is designed to educate the reader and is not to be considered legal advice. Before making any plans or arrangements or taking other steps regarding your assets, it is imperative that you contact competent professional help to advise you on your own special circumstances.

Tax implications of your conservation decisions depend on several factors, including the value of the gift, the IRS tax rules regarding the nature and amount of the gift, your own financial status and other factors that come into play on a case by case basis. Because you are looking at a possible transaction that is worth many thousands of dollars, it is essential that you contact professional help to lead you through the process. The information below is for educational purposes and is not intended to be legal advice.

What Tax and Other Considerations Should a Landowner Be Aware Of When Donating Land or a Conservation Restriction?

Landowners who place conservation restrictions on their property or donate their property to a governmental agency or conservation organization may realize significant federal (and, in some cases, state) income tax savings, potential reduced estate taxes and, possibly, reduced property taxes. The gift of land or an interest in the land (the conservation restriction) must meet IRS requirements for deductibility. And the recipient of the gift must also qualify under IRS rules. Qualified recipients include governmental bodies and religious, charitable, educational and scientific organizations that have been determined tax exempt by the IRS (Section 501(c)(3), IRC)

When a landowner places a conservation restriction on his or her property or donates the property to a proper recipient, he or she is making a charitable donation. The value of this donation, in the case of a conservation restriction, is measured by calculating the difference between the fair market value of the property before the restriction is in place and the value after the restriction is granted. In the case of an outright donation of land, the charitable donation is the market value of the property. A donation of a partial interest in land must meet specific IRS requirements to be deductible.

It is also necessary to subordinate a mortgage on a property on which a conservation restriction is being placed in order to pass IRS muster. Subordination involves the lending institution lessening its priority interest in the property to a second place position behind the restriction.

Other considerations that must be taken into account include identifying the cost basis of the property when doing a bargain sale, obtaining an acknowledgement from the recipient of the charitable gift, and following strict IRS procedures for the appraisal of the gift.

Federal Income Tax Advantages

The amount of the federal income tax deduction available for an outright donation of land or a donation of a conservation restriction depends upon the value of the donation and the landowner's adjusted gross income. As a general rule, IRS regulations allow a charitable donor to deduct a percentage of his or her adjusted gross income in any one year up to the full amount of the deduction. Since you may not be able to take the entire deduction in one year, you can carry forward any excess contribution into future years.

You must claim the maximum deductible portion of your donation deduction each year, i.e., you cannot hold back in early years in order to address a larger than usual income in a later year of the period. You can, however, phase the donation of the property or the restriction over a number of years, effectively increasing the period within which you may take a deduction.

In 2006, the Pension Protection Act of 2006 became law. This law included the first major new income tax incentives for land conservation since 1980. In 2008, Congress extended the incentives which now apply to donations made in 2008 and 2009. For more information on the new Conservation Tax Incentives, see *Federal Conservation Tax Incentives Extended* by Stephen J. Small, Esq, at www.stevesmall.com/uploads/1.pdf

Federal Estate Taxes

Over the past 20 years there have been substantial changes in the laws affecting federal estate taxes. For a number of years, the amount of assets in an estate exempt from estate taxation stood at the \$600,000 level. This figure started to rise slowly with changes enacted by Congress in 1997. In 2001, President Bush signed legislation that provides for a significantly increasing exemption, reaching a maximum of \$3,500,000 in 2009 but culminating in the repeal of the estate tax at the end of 2009. The exclusion for tax years 2002 and 2003 is \$1,000,000. In 2004 and 2005, it is \$1,500,000. In 2006, 2007 and 2008, it is \$2,000,000 and in 2009 it is \$3,500,000. As things now stand, the repeal would last for only one year, expiring at the beginning of 2011. At that time the determination of estate taxes will be dependent upon the tax rates and exclusion amounts in effect prior to the 2001 changes. As of the writing of this document, the general wisdom is that there will be additional significant changes in the future.

You also want to be aware of state estate taxes. These may differ from the federal tax rates and could play an important role in your decision making. Massachusetts, for example, broke ranks with the federal tax rates by passing legislation to set the individual exemption at \$700,000 as of January 1, 2003. It is best to consider your estate tax situation by conferring with your tax attorney or accountant when preparing your estate plan.

Since there are several major reasons for estate planning, the fact that your estate tax potential may now be reduced or eliminated altogether will not reduce the need for detailed estate planning, but it may very well alter some of the goals or techniques utilized. Keep in mind that ensuring after your death that your land is used as you wish and reducing the potential for conflict between surviving family members over how the land should be used or disposed of remain as paramount goals of a wise estate plan.

Post Mortem Tax Exclusion

The 1997 Tax Payer Relief Act created a post mortem election of conservation restrictions on qualifying property. The decedent's estate can place a conservation restriction on a property before the due date for the filing of the federal estate tax return (normally, nine months after death, but extendable). The essence of this provision is that 40% of the value of the restricted land can be excluded from the gross value of the decedent's estate. The maximum amount of the exclusion is \$500,000. This exclusion is in addition to the normal deductions available for placement of a conservation restriction on a property. The restriction must be placed on the property prior to the filing of the estate tax return and the property must have been owned by the decedent or the decedent's family for the previous three (3) years in order to take advantage of this election.

Current Use Valuations

Under federal estate tax law and IRS regulations an income-producing farm that is currently run by a decedent's family may be valued at its agricultural value (its current use value) for

estate tax purposes, rather than at the higher fair market value. The family must continue to run the farm for at least 10 years and the maximum reduction in the value is \$750,000 (though indexed for changes in the cost of living). Failure to continue the farming use of the property can result in a recapture of the estate taxes that were saved by taking advantage of this provision. Real estate held in closely held businesses other than farms may also be able to take advantage of this provision, provided that it meets the IRS standards.

Local Property Taxes

In many circumstances the landowner's property taxes may also be reduced if the property is being taxed at its development value and the restriction will prevent development. Certainly, if you donate a property outright to a charitable organization, you will no longer be responsible for property taxes. The degree of reduction in the property tax will be based upon the amount of rights that you relinquish and the remaining development right that is retained. In Massachusetts, in 1986, the Massachusetts Supreme Judicial Court determined that a property owner who had donated a valid conservation restriction was eligible for and entitled to an abatement of the property taxes in proportion to the reduction in the development value of the property (*Parkinson v. Board of Assessors of Medfield* 398 Mass. 1126, 495 N.E. 2d 294). Keep in mind that Massachusetts has current use¹ programs that significantly reduce taxes on real estate while that property is under the current use program. In Massachusetts, if the proposed sale or development (with certain exceptions for personal use) removes the property from the current use program, the community in which the property is located has a 120 day right of first refusal option to match the contract price (if a sale is in progress) or the market value (if removal does not involve a sale) for the property. The right of the municipality to purchase the property may be assigned to a non-profit conservation organization.

Other Costs and Considerations

One of the costs associated with the donation of a piece of property or a conservation restriction on a property is that of an appraisal of the value of the donation. If the value exceeds \$5,000, a landowner must obtain an appraisal by an independent real estate appraiser qualified in accordance with IRS regulation. This appraisal can be made no more than 60 days before the property or restriction is donated, or anytime thereafter. The cost of the appraisal is itself tax deductible. The recipient of the gift cannot perform the appraisal, but, often, land trusts can provide you a list of appraisers who are familiar with the specific issues necessary to performing an appraisal on a property that will be permanently protected. Costs in the range of \$1,000 to \$5,000 or more for conservation appraisal can be expected.

Many conservation groups may also request that you make a voluntary contribution to the organization's endowment fund. This contribution helps defray the expenses of executing the restriction and the long term costs associated with the monitoring and stewarding of the property or the restriction.

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1. Massachusetts current use programs (Ch. 61, Ch. 61A, and Ch. 61B) were created to give preferential tax treatment to those landowners who maintain their property as open space for the purposes of timber production, agriculture or recreation.