

ABOUT CONSERVATION EASEMENTS

Editor's note: One question that our education collaborative has fielded consistently throughout the years is about conservation easements. Many landowners have asked, "Is it a good way to go?" The utility of the conservation easement as an effective tool in your farm transfer planning depends on your goals and financial needs, which are discussed earlier in this workbook and explored further in the narrative below.

Conservation easements are a land "protection" tool authorized by state law and recognized by the Code of Virginia and the Internal Revenue Code to protect and conserve land. Conservation easements are used to protect a variety of landscapes including farmland, forestland, ridgetops, historic structures, wetlands and beaches. They are a specific exception to the common law rule that one cannot create a permanent interest in real property.

Because conservation easements are a relatively recent legal concept, many landowners are unfamiliar with their use and particulars. At its most basic, a conservation easement allows a landowner to continue to own the land while placing certain voluntary restrictions on its current and future use. These restrictions can include limitations on subdivisions and development. In exchange for these restrictions, landowners can receive payment or tax benefits (sometimes a combination of the two).

This narrative should answer basic questions that a landowner -- particularly of farm and forest land -- might have about conservation agreements, and whether they are something to explore further. Remember that a conservation easement is a real estate transfer of certain rights and interests, and should be seriously considered with the help of a legal and tax adviser experienced with such transactions.

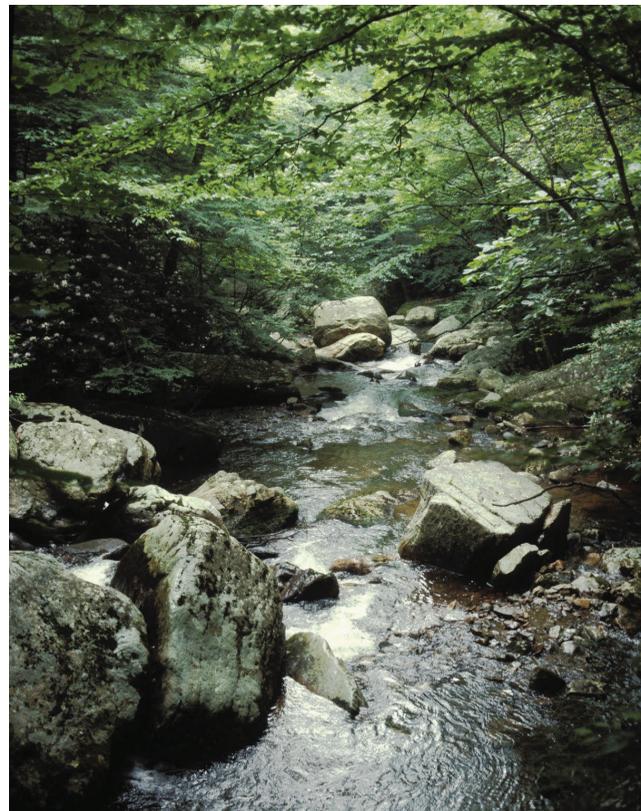
What is a conservation easement?

A conservation easement is a voluntary written agreement between a landowner and a qualified private non-profit organization, such as a land trust or conservancy, or a public body authorized to hold easements.

The conservation easement has two essential elements:

1. The landowner (grantor or donor) agrees to protect certain conservation values on the land, such as open space, scenic and historic resources, water quality, and wildlife habitat.
2. The conservation organization or public body (grantee) is granted the right to monitor the property and enforce the covenants of the agreement in perpetuity (forever). While the landowner may sell the land, the covenants of the easements continue to apply to all future landowners.

Many folks often ask whether a simple deed restriction can protect the conservation values of land. The key challenge is that there is no permanent mechanism of enforcing the terms of a simple deed restriction. The nature of a conservation easement is to grant another party the right to ensure that the conservation (or working) values are not threatened by actions to the land, such as uses that negatively impact the conservation values of the property.



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These types of restrictive easements can be called by a number of names, including deed of conservation easement, open-space easement, a sale or grant of development rights, a working forest easement, or an agricultural conservation easement.

Conservation easements are intended to protect property from residential or non-farm commercial development, thus providing a benefit to the public by conserving open space vistas, making farmland available, protecting against water pollution from runoff, or protection of scarce natural resources such as wildlife habitat or rare species.

In exchange for this public benefit, there are sometimes funds available to pay for the diminution in property value caused by such restrictions, though in recent years of fiscal tightening these funds are less available. There are however significant federal, state, and local tax incentives for a landowner if he or she donates the right to enforce restrictions to a qualified organization. To qualify for these tax incentives, the terms of the conservation easement, though flexible, must conform to the regulatory requirements of these tax deductions, as well as the standards and expectations of the recipient of the easement, and any use exceptions -- particularly for farms and forests -- must not significantly diminish the land's conservation values.

In general, a conservation easement can be a useful tool to landowners who a) have a strong desire that the land not be further developed or used more intensively than at present (i.e. in farming), and b) are able to utilize attendant tax deductions and credits.

Conservation Purposes

A key feature of a donated conservation easement to understand is that it is perpetual and does not expire or revert back to the landowner at some appointed time. You may hear people refer to this as "forever protected," which, though difficult to imagine, means that as long as an entity exists to enforce the terms of the conservation easement, it will protect the land. Some states allow non-perpetual (or "term") conservation agreements. Though landowners will often be compensated for such agreements, these generally do not qualify for tax deductions or credits.

To qualify as a charitable contribution for federal tax and state tax purposes, a transfer of a conservation easement deed must be made to a qualified grantee

(generally a nonprofit organization or a public body). The deed must restrict the property to the point of meeting one or more of the following conservation purposes:

1. Protection of relatively natural habitats of fish, wildlife, or plants;
2. Preservation of open space including farm and forest land;
3. Preservation of land for public outdoor recreation or education;
4. Preservation of historically important land or buildings.

These conservation values must be documented through a resource inventory that may include aerial and topographic maps, photographs of improvements and attributes, descriptions or surveys of specific resources and land features such as prime soils, historic buildings, wildlife habitats, or wetlands.. The inventory is known as the "baseline," and will be the reference point of the condition of the property at the time the easement is granted and the values that will be protected by the conservation easement. The owner can decide with the agency or organization receiving the easement which conservation purpose is met by which part of the property, and can distinguish ecologically sensitive areas from other areas that might be appropriate for other uses.

Rights, Restrictions and Allowable Uses

A conservation easement's restrictions should be tailored to the particular conservation values of the land and interests of the landowner and grantee. Examples of activities that may be prohibited or restricted in a conservation easement include industrial use, mineral exploration or soil excavation, subdivision into smaller tracts, residential development, road and infrastructure expansion, and extensive timbering.

Depending on the size and character of the land, conservation easements may allow limited subdivision of the land into parcels, and typically allow timbering, forest management and agricultural use. The conservation easement also usually allows wildlife management, hunting and fishing, or the construction and maintenance of a limited number of new homes or other infrastructure necessary to produce income from the property. Such improvements will often be limited

to construction within certain delineated areas called “envelopes,” or conversely may be prohibited from being constructed in identified “no-build” areas.

The grantor retains ownership along with the right to manage, care for, and derive income from the property. Conservation easements are not generally effective in imposing affirmative duties or obligations on the landowner. In special cases, as in the case of sensitive wildlife habitat, a conservation easement holder with a particular expertise may have the right to undertake certain management activities on the land. A conservation easement qualifies the property for Use Value (or Land Use) Taxation if the locality has such a program. Production standards may still be required for certain categories of land use assessment.

As noted, a core function of a conservation easement is to limit subdivision or otherwise prescribe how land can be subdivided into smaller tracts. Even so, the owner can still sell, encumber (mortgage) or otherwise convey the rights in the land through lease, will, trust, or to a management entity such as a limited liability company. However, despite the type of transaction, the land remains subject to the conservation easement. The rights the landowner retains pass to any heirs or assigns (by gift or sale).

With regard to using the land for security on a loan, the value of the land as collateral will be its restricted value subject to the easement. Normally the fair-market value of the land is lowered due to the easement and its restrictions. The lower value primarily reflects its subdivision restriction, since smaller parcels are more marketable and can sell at higher prices. If there is an existing deed of trust securing a loan on the land, the lender will be required to consent to, and join in the grant of the easement. The loan will be subordinated to the conservation easement.

In order for the grantor to realize tax benefits for the easement, the holder of the conservation easement is required by the Internal Revenue Service to monitor and enforce the obligations contained in the conservation easement. Therefore, the conservation easement must provide, or allow, for monitoring visits by the conservation easement holder; these visits typically occur every one to three years. The grantor and the grantee can agree on more visits, particularly if the conservation easement has provisions for activities such as habitat research.

Where the grantor reserves rights, such as the right to timber or to subdivide, the conservation easement may require review and approval prior to the exercise of such rights by the grantee of the easement.

In most cases, a conservation easement does not require or allow entry by the public. The landowner retains the right to control or prevent public access. However, sometimes scenic and open-space easements require visual access from public roads, trails, or waterways to qualify for deductions under the Internal Revenue Code. These conservation easements are designed to protect the scenic character of the land, and thus the requirement that the land can be viewed by the public is critical to its conservation value.

Conservation Easement Tax Advantages

As noted above, there are tax advantages for the donor of a conservation easement. The tax implication is generally related to the value of what the donor is giving up: usually the right to subdivide and further develop the property.

Federal Income Tax

If the conservation agreement gift is made during the donor's lifetime and the land is considered long-term capital gain property, the donor may claim a federal income tax deduction for the full fair market value of the gift of the conservation easement. The value of the easement is the difference between the “before” value of the land (unrestricted) and the “after” value of the land (restricted). The diminution or difference in the land value due to the easement is the gift value eligible for use as a deduction.

However, to prevent a donor from using the deduction to avoid paying taxes completely, the Internal Revenue Service (IRS) places a cap on the amount of the deduction that can be claimed in any given year. For tax year 2011, the cap is set at 50% of the adjusted gross income for individuals. Individuals may carry over any unused portion of the donation for the next fifteen years subject to the 50% AGI cap each year.

For individuals who qualify as farmers by earning more than 50 percent of his or her income from “the trade or business of farming,” the tax deduction is raised to 100% of adjusted gross income, and any unused deduction can be carried forward the next fifteen years.

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For donations made after 2011 (unless there is a change in the legislation) the deduction reverts to 30% of AGI with a carryover period of five years.

Activities that count as farming for purposes of the deduction of up to 100% of AGI include:

- Cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including raising, training, and management of animals) on a farm;
- Handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner or operator regularly produces more than one-half of the commodity so treated; and
- Planting, cultivating, caring for, or cutting of trees, or the preparation (other than milling) of trees for market.

The easement in these circumstances must require the land remain “available for agriculture.”

State Income Tax

In Virginia, taxpayers can claim a land preservation tax credit (offsetting state income taxes) of 40% of the value of the easement for donation of qualifying open-space easements. The amount of credit claimed by any one taxpayer may not exceed \$50,000 for tax year 2011 or \$100,000 for tax year 2012 and tax years thereafter, but any unused amount may be carried over for a maximum of 13 consecutive years if the credit originates in tax year 2011 or for a maximum of 10 consecutive years if the credit originates in tax year 2012 or thereafter. In the event that a landowner has more credits than he or she can use against state tax liability, the credits may be sold or otherwise transferred to other persons or entities. The Department of Taxation charges a fee of 2% of the value of the donated interest (5% of value of credits) for transfer of credits. For donors claiming a Virginia tax credit of \$1 million or more (gift of an easement in which the easement value is \$2.5 million or more), the deed of easement must meet Virginia Department of Conservation and Recreation criteria, which may require conservation restrictions additional to those required by the easement holder.

Federal Estate Tax

Conservation easements offer estate tax benefits, in that a conservation easement will generally decrease the land’s fair market value due to development and

subdivision restrictions. The restrictions will stall the rapid appreciation of the property tied to residential or commercial development potential for that property. The lower land value may serve to decrease the overall estate value that might otherwise be exposed to an estate tax.

Under the Internal Revenue Code, if certain requirements are satisfied, an executor can elect to exclude up to an additional 40% of the after-easement value of the land from a landowner’s estate for estate tax purposes (subject to a \$500,000 maximum).

However, be aware that, even with a conservation easement, land can still appreciate, and given the location and desirability, can appreciate higher than originally anticipated when the conservation easement is donated during one’s lifetime as part of a comprehensive estate planning strategy.

If the conservation easement is granted by will, the donor’s estate may claim an unlimited charitable deduction for the value of the easement, which has the same effect of reducing the estate tax. In this case, the testator can have directed that an easement be donated upon his or her death, or can give the executor the power (option) to do so if it appears such donation will serve to retain wealth (ie. lower or eliminate estate tax burden). Up to \$500,000 of the land’s residual value may also be deducted from the value donor’s estate in some special situations.

Local Property Taxes

In Virginia, counties that have adopted Land Use Taxation or agricultural tax value programs must qualify and assess conservation easement properties at use value. If the county does not have a use value property tax program, the assessed value is limited to the lands restricted value under conservation easement and therefore should result in a reduction in the fair market assessment and attendant real estate taxes.

Valuation of Conservation Easements for Tax Purposes

An appraiser uses a before-and-after test to determine the value of a conservation easement. Simply, the value of the property whose uses are restricted by the conservation easement is subtracted from the value of the property as if there were no conservation easement restrictions. The difference between the two appraisals is the value of the conservation easement.

Sometimes, the presence of a park or other conservation property can soften the reduction in value as it

is an amenity to adjacent land, and actually results in added value to the adjoining land. This also may happen when the donor or donor's family owns property adjacent to the easement property. The adjacent property may increase in value due to the now-protected easement property. The appraiser must reduce the value of the donated conservation easement by the amount which the other property increases in value. This is known as an "enhancement" value and must be accounted for when appraising the easement property.

An appraiser who understands the local real estate market and conservation easements should do the appraisal. When the motivation for donation is an income tax deduction, one would think there is an opportunity to substantially increase the deduction by dramatically lowering the value of the land under the conservation easement restrictions. However, there are substantial penalties imposed on both donors and appraisers for such overvaluations. Furthermore, the donor, appraiser, and the grantee organization must all sign a special tax form (Form 8283) in order for the donor to claim a federal income tax deduction.

The Conservation Easement Transaction

Conservation easements may be granted to public agencies, such as federal and state agencies, counties and towns, or to a nonprofit tax-exempt conservation organization. A non-profit entity will normally be called a "land trust" or "conservancy". The largest holder of conservation easements in Virginia is the Virginia Outdoors Foundation (VOF), a public entity holding approximately 80 percent of all conservation easements in Virginia.

Conservation easement transactions are complex. To ensure the conveyance of a conservation easement will qualify for a federal tax deduction or a state tax credit, certain documents must be prepared, including:

1. *Deed of conservation easement.* This is the document that outlines the agreement and whose language supports the public purposes that qualify for tax benefits. The agreement should be drafted by an attorney.

The easement holder/land trust will normally have a deed that they commonly use that will reflect the land trust's "protection" concept and expectations. The deed then is tailored to address the particular conservation values of the property and the present owner's needs. Landowners are advised to seek the advice of an attorney of their choosing who will ensure that

the conservation easement allows for the continued use of that land (i.e. for farming) by the grantor, with enough flexibility that will not otherwise endanger tax benefits. This deed will be recorded in the county court house with the county register of deeds.

2. *Inventory of the property.* This document is known as the baseline report, and can be prepared by the agency or organization that will hold the easement. This document supports any declaration of conservation purposes, and will also serve to illustrate the conditions of the property at the time of the donation and the particular attributes of the property that the easement holder will not want significantly changed.

3. *Appraisal.* The appraisal is prepared by an independent appraiser, who is hired by the landowner/grantor. The appraiser should be competent in conservation easement transactions. The appraiser will conduct essentially two appraisals: one for the land's highest and best use, and the second for its value under the conservation easement restrictions. The difference represents the value of your donation or sale if you are to receive payment, partial payment, or tax benefits for the granting of the conservation easement.

4. *Title work.* There must be title work completed on the property to determine true ownership and whether any encumbrances (such as deeds of trust or easements) exist. Title work helps insure that all owners or parties with an interest in the property are party to the deed, and sign in the appropriate capacity. This work should be performed by an attorney.

5. *Survey and legal description.* As with any real estate transaction, there needs to be adequate and accurate legal description of the property encumbered by the easement. In some cases a survey may be necessary to properly delineate the property to be subjected to the easement.

6. *Form 8283.* This is an attachment to the federal tax return of all individuals claiming charitable contributions of more than \$5,000, prepared by the Grantor or his accountant, and signed by the Grantor, Grantee and appraiser. If the deduction claimed is greater than \$500,000, then the full appraisal must also be attached.

Note federal tax law requires the grantee organization to maintain sufficient assets to carry out its monitoring and enforcement obligations in the future. Therefore, organizations that agree to hold conservation

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agreements will have a stewardship fund or endowment set aside to pay for staff costs associated with monitoring. Therefore, they generally need to raise money to add to this fund whenever they add a conservation easement to their monitoring requirements. While it is not a requirement, the grantee organization (particularly private non-profit organizations) will usually ask the grantor to contribute to the fund.

Modification and Extinguishment of Conservation Easements

Grantors of conservation easements should never make their decision based on the possibility that the conservation easement will be revoked or able to be modified. Conservation easements are designed to be permanent, so amendment can be difficult and extinguishment is almost impossible. In rare circumstances, extinguishment may be accomplished through a court proceeding. Successful extinguishment requires a convincing demonstration that, due to a change in circumstances (normally regarding the surrounding land use) use of the property for the original conservation purposes of the conservation easement are no longer practical or possible. If the conservation easement is extinguished, the interest in the land (or the proceeds from any sale) is allocated to Grantee and Grantor, respectively, in proportion to the value of the agreement and the value of the land. In addition, Virginia law provides a special process for “converting or diverting” land from its open-space use. This process is different from the extinguishment process; one of the most notable differences is that when an easement is extinguished the holder of the easement is only compensated with the cash value of the easement, whereas the process for conversion or diversion requires replacement land to be substituted for the land that is converted or diverted. This process is only available for easements and other protected lands held by public bodies, such as the Virginia Outdoors Foundation.

It is possible that a conservation easement can be amended by agreement of the owner and the holder of the easement. Such agreements can clarify an ambiguity in the easement, but cannot in any way diminish the conservation value upon which any tax deductions were calculated. Amendments also can add acreage to an easement or add further to the protection of the property. For instance, an increase in the conservation value of the easement, such as adding acres or relinquishing a parcel right that was

retained in the original easement could generate an additional gift value for tax purposes.

Remember that while a conservation easement can be a valuable tool, it is not a matter of right. Landowners must understand that holding and monitoring a conservation easement is a responsibility that a land trust or county must choose to undertake. Accepting an easement will depend on a number of factors, including a) the potential holder’s organizational capacity, b) their conservation priorities, and c) the conservation qualities of your land or whether its use (in farming or forestry) aligns with the priorities of the organization.

For more information:

Virginia

Virginia Outdoors Foundation

<http://www.virginiaoutdoorsfoundation.org/>

Office of Land Conservation

Virginia Department of Conservation and Recreation

http://www.dcr.virginia.gov/land_conservation

Office of Farmland Preservation

Virginia Department of Agriculture and Consumer Services

<http://www.vdacs.virginia.gov/preservation/>

National or Regional

Land Trust Alliance

<http://www.landtrustalliance.org>

North Carolina

Conservation Trust for North Carolina

www.ctnc.org

South Carolina

South Carolina Land Trust Network

<http://www.lolt.org/lolt>

Georgia

Georgia Agricultural Land Trust

www.georgiafarmland.org/

You can also inquire with your county’s Soil and Water Conservation District to see if they hold conservation easements.