# Got Land? Interested in Land Preservation? A Qualified Conservation Easement may be the Solution

**May 2006**

*"Harold's easing into retirement."*

Submitted by Kerri Sullivan-Kreiss, CFP®

Whether it's at the local coffee shop, the little league field, or neighborhood social gathering, real estate development – particularly that occurring in our own backyards - continues to be a hot topic of conversation and debate. "Suburban sprawl" is today's reality, with real estate developers buying up and building on seemingly every square acre of land was once covered by woodlands or farms. Undeveloped land is a hot commodity, especially in towns located within commuting distance from major metropolitan areas, such as Boston here in the Northeast.

Interestingly, while land values have risen dramatically, I have had more and more clients express an interest in protecting their undeveloped land for the preservation of wildlife, the public enjoyment of nature, or the preservation of, as one client recently put it, "some semblance of the town my husband and I fell in love with when we bought our property forty years ago." Protecting undeveloped land can be one of the most meaningful legacies an individual can make. However, few people want to make an outright gift of their property for such purposes for fear of losing control of the asset during their lifetime, or depleting the value of the estate to be passed on to their heirs.

One possible solution to this dilemma involves creating a qualified conservation easement, and then donating the easement to a charitable conservation organization or government agency. The easement effectively restricts future development and use of the land, while allowing a donor to retain ownership and possession. If the easement meets certain requirements, the donor can be eligible for both income and estate tax benefits.

**FEDERAL INCOME AND ESTATE TAX BENEFITS**

The tax(1) benefits of a qualified conservation easement can be substantial:

**Income tax benefits:** If a qualified easement is donated during life, the property owner is eligible for an income tax deduction equal to the value of the easement. The deduction is limited to 30% of the donor's adjusted gross income in the year the donation is made; any excess may be carried forward and deducted for up to five years. No income tax deduction is allowed if an easement is donated upon the owner's death.

**Estate tax benefits:** There are two: 1) The property value for estate tax purposes will be lower; and 2) under IRC Sec. 2031(c), an exclusion from the taxable estate is allowed for up to 40% of the remaining property value (maximum of $500,000) in the estate. Both are available regardless of when the easement is donated, during life or at death.

**TERMS AND REQUIREMENTS**

The terms of a conservation easement are typically determined by the property owner and the organization that is to receive the easement. There are several requirements that must be met in order for the easement to be considered a "qualified" conservation easement:

**Location and Purpose**

Property must be located within the United States

Easement must be permanent and established for at least one of the following:

- Outdoor recreation or education of the general public
- Preservation of a natural ecosystem
- Preservation of open space for scenic enjoyment or pursuant to a governmental conservation policy that will yield a significant public benefit
- Preservation of a historically important land area or certified historic structure(2).

**Charitable Organization**
Donation must be to a qualified charitable or governmental organization with a commitment to protect the easement's purpose.
Easement must contain legally enforceable restrictions that the charitable organization can (and has the resources to) enforce.

**DONOR'S RETAINED USAGE**
The donor can retain the right to occupy and use the property, to conduct farm operations, to construct residences and related buildings, or farm buildings, all without losing tax benefits. However, the tax benefits may be reduced or lost if the donor retains the right to subdivide or develop the property, to use it for commercial purposes other than farming, or to use the land in a way that threatens the conservation purposes of the easement.

**VALUATION OF A CONSERVATION EASEMENT**
A conservation easement is generally valued by appraising the property before and after the donation of the easement. The difference between the two appraisals is the value of the easement. A proportional amount of the donor's income tax basis will be allocated to the easement.

**IMPACT ON A DONOR'S ESTATE**
The donation of a conservation easement can impact a donor's estate in several ways:

Reduction in estate size: The reduction in the value of land means that the size of a donor's estate will be reduced, potentially resulting in a lower estate tax bill.

Estate exclusion: IRC Sec. 2031(c) provides that up to 40% of the post-easement value of the property, up to a maximum of $500,000, may be excluded from the taxable estate. If the easement is worth at least 3% of the original, pre-easement value of the property, the full 40% exclusion is available. If the easement is worth less than 30%, the exclusion will be reduced according to a statutory schedule.

No step-up in basis: Under current law, property received by inheritance generally receives a full step-up n basis to its fair market value on the decedent's date of death. However, property excluded from the estate under IRC Sec. 2013(c) does not receive a step-up in basis. Depending on the situation, there may be circumstances where it would not make sense to use the IRC Sec. 2031(c) exclusion.

**WEALTH REPLACEMENT TRUST**
Some of the income tax savings from a conservation easement created and donated during life can be used to fund a wealth replacement trust to benefit the donor's family. A wealth replacement trust is an irrevocable life insurance trust which owns either a life insurance policy on the life of the donor or a survivorship policy on the donor and his or her spouse. If the trust is properly structured, the life insurance proceeds can be fully excluded from federal estate taxes.

**SEEK PROFESSIONAL GUIDANCE**
Estate planning for certain land owners presents unique estate planning challenges and opportunities. The counsel and guidance of appropriate legal, tax, and financial professionals is strongly recommended.

---

(1) This article concerns federal law; state and local law may differ.
(2) A historically-important land area or certified historic structure is not a qualified conservation purpose for the estate exclusion under IRC Sec. 2031(c).

Questions? Comments? Please let us know what you think.
info@sullivankreissfinancial.com or 508-393-0000
*If you don't want to receive this newsletter, please send an e-mail to info@sullivankreissfinancial.com with the word REMOVE in the subject line and you will be removed promptly.*

If you would like to receive this newsletter, please send an e-mail to info@sullivankreissfinancial.com with the word JOIN in the subject line.
© 2003 The New Yorker Collection from cartoonbank.com. All Rights Reserved.

---

SullivanKreiss Financial * One East Main Street, Ste. 206 * Northborough, MA 01532
t: 508-393-0000 * f: 508-393-0076 * http://www.sullivankreissfinancial.com

Securities and Advisory Services offered through Commonwealth Financial Network, member NASD/SIPC. A Registered Investment Advisor.