



Land Trust Alliance

Conservation Leadership for America's Future



CONSERVATION TAX LAW UPDATE

SEPTEMBER 2006

By Russ Shay & Christen Linke Young



On August 17, 2006, President Bush signed into law H.R. 4, a bill concerned with pension plans that contained provisions that significantly expand the federal tax incentive for conservation easement donations and impose several reasonable reforms to help prevent abuse of that incentive.

This publication summarizes those changes and provides answers to some frequently asked questions. The new law:

- Raises the deduction a donor can take for donating a conservation easement from 30 percent of his or her income in any year to 50 percent;
- Allows qualifying farmers and ranchers to deduct up to 100 percent of their income; and
- Extends the carry-forward period for a donor to take tax deductions for a voluntary conservation agreement from 5 to 15 years.

This is a powerful tool for allowing modest income donors to receive greater credit for donating a very valuable conservation easement on property they own. For land trusts, this translates to the possibility of protecting much more land through conservation easements. The pace of conservation is about to pick up.

The new legislation also includes reforms that affect the appraisal process for all donated property and tighten the rules for easements on historic buildings. All land trusts should make sure the appraisers they and their donors work with know about the new rules.

It is important to note that the new incentive *only applies to easements donated in 2006 and 2007*. LTA will work to make this change permanent, but as it stands it will expire at the end of 2007.

Please check our website frequently for the latest information on this topic. Go to www.lta.org/publicpolicy/tax_incentives_updates.htm.



FREQUENTLY ASKED QUESTIONS

A. EXPANDED TAX INCENTIVE

1. Can you give me an example of the difference the new change makes?

Under the previous rules, a landowner earning \$50,000 a year who donated a \$1 million conservation easement could take a \$15,000 deduction for the year of the donation and for an additional 5 years—a total of \$90,000 in tax deductions.

The new rules allow that landowner to deduct \$25,000 for the year of the donation and then for an additional 15 years. That's \$400,000 in deductions. If the landowner qualifies as a farmer or rancher, he could take a maximum of \$800,000 in deductions for his million dollar gift.

2. Can anyone deduct more than the value of his or her gift?

One can never deduct more than the fair market value of the gift. This change simply allows landowners who previously could not deduct the full value of their gift to deduct more of that value.

3. Who qualifies as a farmer or rancher?

The new law defines a farmer or rancher as someone who receives more than 50 percent of his or her income from “the trade or business of farming.” The law references an estate tax provision (Internal Revenue Code (IRC) 2032A(e)(5)) to define activities that count as farming. Specifically, those activities include:

- cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, 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, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated; and
- the planting, cultivating, caring for, or cutting of trees, or the preparation (other than milling) of trees for market.

The qualified farmer or rancher provision also applies to farmers who are organized as C corporations. For an easement to qualify for the special treatment, it must contain a restriction requiring that the land remain “available for agriculture.”

4. Do these changes apply to gifts of land?

This expanded incentive does not apply to gifts of land in fee; it only applies to gifts that qualify under IRC 170(h)(2), such as conservation easements. A landowner considering donating his land should consult with an attorney to determine whether he should consider changing the structure of his gift to take advantage of this new incentive.

5. Does this only apply to conservation easements?

The expanded incentive applies to all donations covered in IRC section 170(h)(2), which includes donations of the entire interest of the donor other than a qualified mineral interest; a remainder interest; or a permanent conservation or historic preservation easement.

6. What is the timeline for this expanded incentive?

The new law applies to all easements donated in 2006 and 2007. LTA will work hard to make this change permanent, but as it stands it will expire at the end of 2007. If a donor qualifies under this provision, she can continue to apply its formulas to the amount of her contribution that she carries over into years beyond 2007.

7. What other restrictions apply?

Conservation easement donations are subject to the same restrictions as they were before. For example, easements must meet the “conservation purposes” test defined in the existing law; they cannot be donated as part of a “quid pro quo” agreement; and they must be donated to a qualified organization—a governmental unit or a publicly supported charity that has “a commitment to protect the conservation purposes of the donation, and...the resources to enforce the restrictions.”

See www.lta.org/publicpolicy for the Treasury Regulations on conservation easement donations.



8. Will donors who use this provision be audited?

Taking advantage of this new law will not necessarily affect one's likelihood of being audited. All donors should note, however, that the IRS has been increasing the number of tax returns it audits—the number has doubled in the last two years. The IRS has also indicated that high value donations of property—including donations of conservation easements—will receive more attention from the IRS than most tax returns.

That makes it particularly important for a donor to know and follow the law, and utilize a reputable professional appraiser who has experience in the appraisal of conservation easements.

B. REFORMS TO THE RULES FOR EASEMENT DONORS

1. How does the new law prevent abuse?

Under the new law, the definitions of substantial and gross misstatements of value have been changed. Previously, a taxpayer whose donation was finally determined to be worth \$200,000 would have been guilty of a substantial misstatement if he had claimed a value of \$400,000, and guilty of a gross misstatement if he had claimed a value of \$800,000. Now, he would be guilty of a substantial misstatement for claiming a value of \$300,000, and of a gross misstatement if he claimed a value of \$400,000. There are substantial additional tax penalties for such misstatements for the taxpayer, and they make the appraiser subject to penalties of up to 125 percent of his or her fee plus potential disbarment from working on federal tax matters.

The law also redefines who is a “qualified appraiser,” and gives the IRS the power to issue new regulations on appraiser qualifications. This is important: as of August 17, appraisers will need to show donors that they are qualified under the new law and any new Treasury Regulations or guidance that may follow from it. Lastly, the law states that a qualified appraiser must “demonstrate verifiable education and experience in valuing the type of property subject to the appraisal.” These new rules apply not just to conservation easements, but to all charitable donations of property.

2. Will this make appraisals more expensive?

It is possible that appraisals for conservation easements will be more expensive. But these reforms are important steps towards ensuring that appraisals accurately reflect the value of charitable gifts.

3. How does the new law affect easements that protect both conservation and historic preservation values?

The new law tightens the rules for easements on “certified historic structures.” If you are protecting a property that includes such a structure (e.g., a farm with a historic stone barn that is listed in the National Register) these new regulations may apply to you. Donors and donees of easements protecting historic structures need to understand the new rules, which include a filing fee for donors and specific appraisal requirements. Some of the new rules apply to historic structure easements donated as early as July 25, 2006. Any donor who has donated a historic preservation easement since that date should be made aware of the new rules.

4. What about land with historic value, like battlefields and Native American burial grounds?

There is no change in the law for easements covering battlefields or other land with historic value. IRC 170(h)(4)(A)(iv) distinguishes between “historically important land areas” and “certified historic structures.” Only easements protecting the latter should be affected by the new law.

5. What is the timeline for the reforms?

The new law applies to all donations made after August 17. The law makes these reforms permanent. As noted above, sections of the legislation applying to historic preservation easements are retroactive and apply to easements donated since July 25, 2006.

6. Have there been other changes besides this tax bill?

Yes! The IRS has changed the instructions for Form 8283, and now asks for additional information from easement donors. In addition, the IRS has revised Form 990—the tax return all charities complete. See www.ita.org/publicpolicy for more information.

C. WHAT DOES THIS MEAN FOR LAND TRUSTS?

1. Should land trusts that focus on resource conservation avoid historic easements?

The new law’s provisions on easements to protect historic structures do require additional documentation and a small filing fee. But the documentation required should be part of the appraisal report in any case, and the filing fee is relatively small (\$500).

2. Will this new law lead to potential abuses?

Landowners learning of this new law may inquire about donating a conservation easement without knowing what does and does not qualify as a tax-deductible easement. Now as before, a conservation easement donation only qualifies for a tax deduction if it is “exclusively for conservation purposes” as those purposes are specifically defined in IRC 170(h)(4) and the accompanying regulations. Land trusts should carefully explain the law—and their mission—to potential donors, so that landowners understand the requirements, and understand that a land trust may decline to accept a donation that does not, in its best judgment, meet both the legal requirements and the land trust’s specific charitable mission.

3. What can land trusts do to be strategic with this new incentive?

These changes in law should provide a powerful new incentive for conservation donors, and land trusts may be approached by an increasing number of interested landowners. While this increased interest is good for conservation, it places a greater responsibility on land trusts to be strategic and thorough in their conservation projects. We recommend that your land trust staff and board:

- Review the new tax law and the existing Treasury Regulations to be familiar with the conservation purposes test imposed by law (both are posted on www.lta.org/publicpolicy/tax_incentives_resources.htm);
- Adopt *Land Trust Standards and Practices* and review the practices that assist organizations in focusing their conservation including:
 - Practice 1A, Mission. Review your mission and discuss any updates that might clarify the public purpose served by your organization.
 - Practice 8B, Project Selection and Criteria. Review your conservation criteria—the criteria you use to approve easement and other projects. Make sure the criteria accurately reflect your mission, organizational priorities and the tax code. (If your land trust does not have conservation criteria, create and adopt them!)

In addition, several other *Land Trust Standards and Practices* are particularly important at this time. These include:

- **Practice 8D, Public Benefit of Transactions.** The land trust should review its internal procedures for evaluating and documenting the public benefit of every transaction it engages in, and for ensuring that any federal, state and local requirements are met.
- **Practice 9A, Legal Review and Technical Expertise.** Make sure your land trust is adequately represented by an attorney with experience in this area.
- **Practice 10B, Appraisals.** Make sure the appraisers you and your donors work with know about the new appraisal rules. Let donors know that your organization will request to see a copy of the completed appraisal and that your organization

will not knowingly participate in projects where it has significant concerns about the claimed value of the donation.

LTA.net [www.LTAnet.org] includes detailed information, sample documents and relevant links on these and the other *Land Trust Standards and Practices*.

D. OUTREACH TO YOUR COMMUNITY

1. How can I make sure landowners with valuable land know about this?

This is a great opportunity for land trusts to achieve their strategic conservation goals. The land trust, after identifying its focus areas, can use the new tax law as an opportunity to approach landowners in these areas about conservation. LTA's website (see link in text box below) has sample materials that help explain this new incentive, including a template press release, a template op-ed, and a template letter to the editor that you can use to generate press coverage. In addition, the website has instructions for hosting an event to educate landowners, get your work in the news, and thank your U.S. senators and representative.

2. What is your advice for potential easement donors?

Potential easement donors should know that the donation of a permanent conservation easement is a big commitment. They should carefully consider their donation, and should consult with an attorney prior to donating a conservation easement (see *Land Trust Standards and Practices* 9B, Independent Legal Advice).

ACKNOWLEDGEMENTS

There are so many people to thank who were involved in this victory that one grand thank you from LTA goes out to all of you. We could not have done it without you.

LTA has been leading a team effort to achieve this since 2000, when we convened land trust leaders from across the country and a 33-member coalition of national conservation groups to build a consensus on what tax policies would best address the need to expand our conservation work. National land trust organizations, local and regional land trusts, wildlife conservation and sportsmen's groups, and representatives of the ranching and farming community all played important parts in that effort.

This legislation would not have happened without the leadership of Senator Max Baucus (D-MT)—who first introduced a version of it in 1999—and his colleagues Senator Charles Grassley (R-IA) and Senator Rick Santorum (R-PA). Many of their colleagues in the Senate and the House have helped. Land trusts in their states—including the Montana Land Reliance, the Iowa Natural Heritage Foundation and the Pennsylvania Land Trust Association and its members—worked hard to show these leaders that the conservation work of land trusts was important to their communities and broadly supported by their constituents. That work provided the foundation for this new conservation tool.

Remember to visit www.lta.org/publicpolicy/tax_incentives_updates.htm for the latest information.

This information is for informational purposes only and should not be construed as legal advice.



1331 H Street NW, Suite 400
Washington, DC 20005-4734