

Conservation Easements for Tax, Legal, and Real Estate Professionals

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What is an Easement?

- “A right of use over the property of another.”
- For our purposes:
 - A Restriction on the Use of Real Property
 - Granted by a “Grantor”
 - For the benefit of a “Grantee”
 - Memorialized by a Deed or other instrument recorded in the Land Records
 - That “travels with” the property.

Common Types of Easements

- Open Space/Environmental/Rural Preservation/Conservation Easements
 - Maryland Environmental Trust/Private Land Trust
 - Maryland Agricultural Land Preservation Foundation (MALPF)
 - Rural Legacy
 - Historic Easements
- Easements Related to Development Activities
 - Forest Conservation Act/Forest Preservation/Mitigation
 - Stormwater
 - Ingress/egress /access
 - Septic
 - Utility
 - Viewshed

What is a Conservation Easement?

- A deeded transfer of a legal interest in real property to a third party for the purpose of preserving the ***conservation or open space values*** of the property.
- There are potential Tax Benefits/Incentives at the County, State, and Federal levels.
- Donated Easements vs. Purchased Easements vs. Bargain Sale Transactions.

What Conservation Easements Restrict

(and what may still be allowed)

- Real Property Sec. 2-118 – Enumerates eight purposes, under Maryland law (including the catchall “other acts or uses having any relation to the preservation of water or land areas or the improvements or appurtenance thereto) .
- Can be a partial or complete extinguishment of development rights.
- Typically does NOT require any public access – property remains in private ownership.
- All sorts of possible retained rights: Hunting, fishing, agriculture, timber, some development rights.

Purchased Easements

- There are Federal, State, and County Programs to purchase permanent conservation easements.
 - USDA Forest Legacy
 - Program Open Space
 - Rural Legacy
- Usually Part of larger, coordinated preservation efforts in a designated planning area.
- Purchase Price – Carefully vetted through multiple appraisals, and is tied to the development potential of the property.

Donated Conservation Easements

- Threshold Question: Does the Property Owner want to claim a tax benefit for the donation?
- If not, there is considerable flexibility in negotiating terms of the easement (provided someone wants to hold, monitor, and enforce the easement).
- And if the Owner does want to claim a tax benefit. . . .

Types of Tax Benefits

- Federal and State Income Tax Benefits.
- Estate Tax Benefits.
- Property Tax Benefits.

Donated Easements – IRC and Treasury Regulation Requirements to Take a Deduction

(AND HOW TO SURVIVE THE AUDIT)

- IRC Section 170(h) Allows for an Income Tax Deduction for a “Qualified Conservation Contribution.”

Term "qualified conservation contribution" means a ***contribution***:

(A) of a ***qualified real property interest***,

(B) to a ***qualified organization***

(C) ***exclusively for conservation purposes.***

Qualified Conservation Purposes: *Contribution*

- Contribution Requires Donative Intent
 - Includes Bargain Sales of Easements and Property to the government.
- IRS Very Wary of Sham Transactions and “Cute” Appraisals.
- Donation cannot be a “Quid Pro Quo” for Development Approval.
- This DOES NOT mean that donated easement cannot be a part of a larger land planning and development effort.
- It DOES mean that donations that are part of a larger land development plan will be CLOSELY scrutinized.

Qualified Conservation Purposes: *Qualified Real Property Interest*

- The entire interest in property (e.g., the fee interest).
- A remainder interest (e.g., remainderman after termination of a reserved life estate).
- ***“A Perpetual Conservation Restriction,” which means. . .***

“Perpetual Conservation Restriction”

- Treas. Regulation 1.170A-14(b)(2):
 - Restriction
 - In perpetuity
 - On use of real property (including an easement)

Qualified Conservation Purposes: *Qualified Organization*

- A Governmental Entity.
- Certain publicly supported non-profit organizations.
- A Land Trust.
 - Holder of the easement must have the “resources to enforce the restrictions.”

What Is a *Conservation Purpose*?

- Treasury Regulation 1.170A-14(d)(1) – (5)
 - Public Recreation/Education (requires public access).
 - Protection of Significant, Relatively Natural, Habitat for Plants or Animals.
 - Protection of Open Space which yields “significant public benefit.”
 - For scenic purposes and/or
 - Pursuant to a clearly delineated governmental conservation policy (*such as agricultural protection)

What Is a Conservation Purpose (Continued)

- Prohibition on Inconsistent Uses
 - Uses/retained rights cannot interfere with the conservation purposes.
 - For instance, an Open Space Easement that allows development that interferes with scenic values.
 - Retained development rights that are contrary to a governmental conservation policy that is being furthered by the donation.

Perpetuity – what does it mean?

- All prior liens, deeds of trust, and mortgages must be subordinated.
 - Without subordination, easement is not perpetual: it can theoretically be wiped out in a foreclosure action, and thus is not considered perpetual.
- Easement cannot be terminated short of Court order or eminent domain proceeding.
- Easement cannot be modified to reduce protections.
- But ***poorly drafted easements can be and are interpreted by the Courts.***

Problem Areas: Subordination

- Required Ensure Perpetual Nature of Easement
- May be difficult to secure subordination.
- If there is a potential senior lien, start the subordination process **early**, particularly residential mortgages that have been sold into the secondary mortgage market.
- Don't assume a lender will even be willing to subordinate when value of collateral may be negatively impacted.

Problem Areas: Substantiation

- Acknowledgment – Grantee must provide acknowledgment letter to Grantor containing a complete description of goods and services provided.
- Qualified Appraisal – all donations greater than \$5,000 in value must be supported by an appraisal.
- Form 8283 – Grantee must provide Grantor IRS Form 8283 acknowledging that Gift was received.

Problem Areas: Appraisals

- Danger of “Cute” Appraisals
- Make sure to build the case for taking a deduction
- Start with a land use analysis – without the easement, what can you build “by right”?
 - Size of Parcel
 - Potential subdivision density (including septic bill restrictions)
 - Availability of Water and Sewer/septic
 - Critical Area restrictions, other zoning overlays.
- Get a GOOD appraisal (or two or three)

Problem Areas: Retained Development Rights

- Retained Development Rights are Permissible
 - Reduction in Subdivision Potential
 - Redevelopment Rights
 - Relocation Rights
- Retained Development Rights are Difficult to Document
 - Need a thorough understanding of current development potential.
 - Need to anticipate future changes to the law.
- Approval Process – who is the decider?
- All Retained Development Rights need to be Exercised in a Way that is Consistent with the Conservation Purpose.

Problem Areas: Corporate Issues

- Tax benefits are also available to LLCs, LLPs, S-Corps, C-Corps.
- Who has authority to encumber property?
- **DON'T ASSUME – VERIFY.** Bylaws, operating agreements, trust documents, property corporate resolutions executed by the right individuals.
- If in doubt, take a conservative approach.

Scenic Rivers Land Trust, Inc.

Breakfast Briefing
Tax Incentives for Conservation Easements
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Tax Incentives for Conservation Easements

- Federal: income tax (deduction), estate tax (reduction, exclusion)
- State: income tax (credit, deduction), estate tax (ability to grant post-mortem), State property tax
- Local: county property tax

Federal: Income Tax Deduction

- A conservation easement that is voluntarily donated to a land trust or government agency and that benefits the public by perpetually protecting conservation resources can qualify as a charitable tax deduction on the donor's federal income tax return. (Land Trust Alliance)
- The deduction cannot exceed the fair market value of the gift.

Federal: Income Tax Deduction

- A donor can deduct up to **50%** of Adjusted Gross Income in the year of the donation.
- A deduction not fully used in the year of the gift may be carried forward for up to **15 years**.

Federal: Income Tax Deduction

- If taxpayer is “qualified farmer or rancher,” as defined by Internal Revenue Code: maximum deduction increases to up to **100%** of Adjusted Gross Income
- Statute: 26 USC 170h
- Federal Regulations: 26 CFR 1.170h

Federal: Income Tax Deduction

- To claim: must file IRS Form 8283 with federal tax return
- Must include qualified appraisal if value of gift is over \$500,000
- Detailed requirements but achievable with attention to detail
- See examples on Maryland Environmental Trust website

Federal: Estate Tax Benefit

- A conservation easement can be helpful in limiting estate taxes. Two ways:
- (1) For estate tax purposes, land is generally valued at its maximum development potential. A conservation easement limits the amount of development that can occur, thus lowering the appraised value of the land and **reducing the taxable estate**.

Federal: Estate Tax Benefit

- (2) There is estate tax **exclusion** (40% of land value up to \$500,000 per owner), for certain land that is subject to a donated conservation easement. This **allows the land to be partially shielded from estate taxes.**
- Statute: 26 USC 2031(c), cross reference Md. Ann. Code Estates and Trusts 14-111
- Examples on MET website

State: Income Tax Credit

- Who may claim: individuals and (new in 2016!) pass-through entities (LLCs, LPs, LLPs, S corps, business trust, statutory trust)
- Maximum credit per individual or per pass-through entity per year is \$5,000 per year or the amount of State income taxes owed for that year, whichever is less.

State: Income Tax Credit

- Unused credit may be carried forward for up to 15 years, at a rate of \$5,000 per year, for a maximum credit of \$80,000 or value of donation, whichever is less.
- If easement was not entirely donated, the amount paid to taxpayer is not eligible for the credit.

State: Income Tax Credit

- Only for easements conveyed to: Maryland Environmental Trust, Maryland Agricultural Land Preservation Foundation, Department of Natural Resources (latter new in 2016!). Scenic Rivers Land Trust could be coholder!
- Easement must be perpetual and approved by the Maryland Board of Public Works.

State: Income Tax Credit

- Easements donated before July 1, 2001 do not qualify for this credit, but an amendment that materially strengthens the original conservation easement may qualify.
- State agency must be initial grantee, not added in later.

State: Income Tax Credit

To calculate the credit:

- If property owned by multiple people, each one is separately entitled to the tax credit of up to \$5,000 per year.
- To calculate the total credit which an individual may take, multiply the appraised easement value by the individual's percentage ownership of the property.

State: Income Tax Credit

- Spouses, even if filing jointly, may take up to a \$10,000 credit per year, but each spouse must calculate their own state tax liability (ex. if one unemployed).
- For a taxable year the total aggregate amount of credits claimed by members of all pass-through entities cannot exceed \$200,000.

State: Income Tax Credit

- To claim: must file State form 502CR with Maryland tax return
- Need a qualified appraisal
- Statute: Md. Ann. Code Tax-General 10-723

State: Income Tax Deduction

- Who is eligible: Only individuals who itemize deductions on their federal income tax return
- How to calculate: start with total of federal deductions, then subtract any amount claimed for federal tax deduction for which you claimed a state income tax *credit*, then subtract income tax paid to a state or political subdivision of a state.

State: Income Tax Deduction

- Statute: Md. Ann. Code Tax-General 10-218 (for residents) and 10-219 (for non-residents)

State: Estate Tax

- In order to obtain the benefit of the federal estate tax exclusion (26 IRC 2031(c)), trustee and personal representative/executor can grant a post-mortem conservation easement on behalf of the Estate of the deceased person.
- Either the governing instrument (will or trust) must authorize or direct that a conservation easement be donated or each beneficiary who has an interest in the real property must consent in writing.

State: Estate Tax

- Easement must be recorded within time for filing, plus extension(s).
- Statute: Md. Ann. Code Estates and Trusts 14-111 (see also Md. Ann. Code Tax-General 7-309)

State: Tax Credit for State Property Tax

- There is a tax credit for 100% of all State property tax that would otherwise be due on unimproved land not used for commercial purposes that is subject to a conservation easement.
- The credit is for 15 consecutive tax years.
- Easement donors are still responsible for paying property taxes on improved land, i.e. residential structures.

State: Tax Credit for State Property Tax

- Only for easements donated to: Maryland Environmental Trust or Department of Natural Resources. Scenic Rivers Land Trust could be coholder!
- Easement must be perpetual and approved by the Maryland Board of Public Works.

State: Tax Credit for State Property Tax

- To claim: apply to State Department of Assessments and Taxation by October 1 of the taxable year, using its Form 1-012-200-010
- Statute: Md. Ann. Code Tax-Property 9-107

Local: Tax Credit for County Property Tax (Anne Arundel)

- For easements donated to: a land trust (could be Scenic Rivers Land Trust alone or with coholder)
- The value of the tax credit is calculated based on the taxable assessment of the unimproved land
- Easement donors are still responsible for paying property taxes on improved land, i.e. residential structures

Local: Tax Credit for County Property Tax (Anne Arundel)

- Granted for five taxable years, then must file a form to continue for another five years (new in 2016!)
- Must meet definition of “conservation land”
- To claim: use form supplied by Office of Finance, attach copy of recorded easement, file by June 1
- Ordinance: A.A. Co. Code 4-2-307

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Maryland Environmental Trust website:

http://dnr.maryland.gov/met/pages/tax_benefits.aspx

Tax Savings

- Income Tax Deduction
 - Federal and State
 - Easement gift is a charitable deduction
 - Limited to 50% of taxpayer's Adjusted Gross Income
 - 15 year carry forward for a total of 16 years
 - Effect of Change in Law
 - Prior to 2015, a landowner earning \$50,000 per year who donated a \$400,000 conservation easement would generate \$90,000 in tax deductions ($\$15,000 \times 6$)
 - Today - \$400,000 in tax deductions ($\$25,000 \times 16$)
 - Qualified farmers and ranchers - \$800,000 ($\$50,000 \times 16$)

Tax Savings

- State Income Tax Credit - Maryland
 - Alternative to state income tax deduction
 - Credit equal to the amount by which the FMV of the property before the conveyance of the easement exceeds the FMV of the property after conveyance less any payments received
 - Limited to lesser of \$5,000 (\$10,000 if MFJ) or state tax liability - per year for 16 years

Example

Value before easement - \$800,000

Value after easement - \$400,000

Contribution - \$400,000

Federal tax savings of \$132,000 (33% bracket)

State tax savings of \$32,000 (8% bracket if itemizing)

OR

State tax savings of \$160,000 (over 16 years assuming MFJ)

Additional Tax Benefits

- Property Tax Savings
- Federal Estate Tax Savings
- State Estate Tax Savings

IRS Form 8283 Noncash Charitable Contributions

- Documentation is critical
- Be thorough
- Timely appraisal
- Hire a qualified appraiser
- Attach all required statements
- Signatures – appraiser and donee
- Read the instructions

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