Conservation easements are legal agreements that restrict the type and amount of development that may take place on a particular parcel of land. Landowners may grant conservation easements to keep land in its current use, thus preventing its further development. A landowner may give an easement for charitable and tax motives or sell an easement. Under many circumstances, the donation of a conservation easement or sale of such easement for less than fair market value may give income tax, estate tax, and real property tax benefits to the donor or seller. These benefits will be discussed in greater detail below. This publication will also discuss how the donation of a conservation easement can be a valuable estate-planning tool.

What is a Conservation Easement?
Ownership rights in real property can be viewed as a bundle of sticks. Each stick represents a certain right in the property. For example, one stick represents the right to exclude others. Another stick represents the right to sell the property. The government has retained some of the sticks, like the right to tax the property and restrict some uses of the property.

An easement is a right of use over the property of another. A landowner granting an easement gives up, either temporarily or permanently, certain rights in the bundle of rights that constitutes full ownership of land. For example, a landowner may grant a right-of-way (a common type of easement) over his/her land so a neighbor may access his/her property. Utility companies and government entities acquire easements by negotiation or eminent domain to deliver services essential to the community or public. Examples of these services include pipelines for water or gas, electric power lines, communications cables, and roadways.

A conservation easement is a legal agreement that a landowner makes to limit the type and amount of development on his/her property. The restrictions are written in a deed, which is recorded with the land records. In Virginia, land records are recorded in the clerk’s office of the circuit court where the land is located. Once recorded, everyone is considered as having notice of the deed and its restrictions.

The restrictions are flexible and may be tailored to the needs of individual landowners. However, the restrictions are attached to the land and continue permanent...
except for extremely rare instances. The land may pass from owner to owner, but the conservation restrictions must always be enforced.

“Conservation” easement is really a misnomer. The owner of land subject to a conservation easement is not required to implement conservation measures or institute practices to reduce pollution. Generally the rights that conservation easements affect are the land development rights. The public receives no right to enter the property. The landowner may continue to use the land in any way he/she wishes, except for the restrictions contained in the conservation easement.

**What are the Tax Benefits of Donating a Conservation Easement?**

There are several types of potential tax savings associated with donating a conservation easement: income tax, real property tax, and federal gift and estate tax.

**Income Tax Savings**

Gifts of all or part of a qualified conservation easement provide a charitable income tax deduction to the contributing taxpayer. The donation is based on the fair market value of the easement. The donor usually values the contribution as the difference between the fair market value of the property without the easement and the fair market value of the property with the easement. The annual income tax deduction is limited to 30% of the donor’s adjusted gross income each year. If the donor cannot use the whole deduction in the year of the gift, he/she may deduct a portion of a current gift in each of the next five years, for a total of six years. However, the deduction in each year is subject to the 30% limitation.

Taxpayers may make gifts over several years to overcome the annual charitable deduction limitation. The landowner may also donate a conservation easement on only a portion of the property. For example, a landowner donates a conservation easement on one-half of his/her land. After six years, the landowner donates an easement on the remaining one-half of the property. In this way, the landowner spreads the deductions over a twelve-year period instead of a six-year period. This technique may allow the landowner to derive the full income tax benefits from the two donations, whereas a single donation of a conservation easement may not fully utilize the tax benefit.

**Special Virginia Income Tax Provisions**

Effective January 1, 2000, Virginia law excludes from taxable income the gain derived from the sale or exchange of real property or the sale or exchange of a conservation easement that results in the real property or the easement being used for open space purposes for at least 30 years. For taxable years beginning on or after January 1, 2000, Virginia gives a tax credit in an amount equal to fifty percent of the fair market value of any conservation easement donated in perpetuity by the landowner/taxpayer to a public or private conservation agency. The fair market value must be determined by a qualified appraisal. The amount of the credit that may be claimed by a taxpayer shall not exceed $50,000 for tax year 2000 and $75,000 for tax year 2001, and $100,000 for tax year 2002 and thereafter. In addition, in any one taxable year the credit used may not exceed the amount of income tax otherwise due. Any portion of the credit that is unused may be carried over for a maximum of five consecutive taxable years. For example, if you give a conservation easement in 2000, you may use a portion of the credit in 2000, 2001, 2002, 2003, 2004, and 2005. Any portion that remains unused after 2005 is lost forever. The law places some limitations on combining the use of the tax credit and the exclusion.

**Real Property Tax Savings**

After granting a conservation easement, real property tax savings may result because the market value of the real estate is reduced. Virginia law mandates consideration of the easement in assessing the real property tax. However, the granting of a conservation easement on farmland may not have a noticeable impact on the current real property tax assessment because in many counties in Virginia, farmland assessment is based on an agricultural-use value and not on the fair market value of the property. For example, if the property is worth $1,000 an acre for farming, but $10,000 for housing development, many counties use special use valuation taxation to tax the landowner based on the $1,000 form value. Requirements for this special use valuation vary from county to county. The conservation easement will likely reduce the value of the property to value approximating farm value. Since many
farmers are already taxed based on farm value, no real property tax benefit may accrue at the time of the conservation easement. In the future, counties could opt out of the special use value taxation and the real property savings could be important.

**Federal Gift and Estate Tax Savings**

Conservation easements may be transferred to a qualified charitable or government entity free of federal gift and estate taxes as a charitable transfer. Transfers of easements to individuals would not qualify. In addition, land in a decedent’s estate is reduced in value by the value of a conservation easement and the value of the easement is not subject to the federal estate and gift tax. Conservation easements therefore offer an opportunity to reduce the value of the estate and reduce or eliminate any estate tax.

Actual estate tax savings depend upon the taxable value of the estate and whether the tax law will otherwise allow for exclusion from the estate tax. Because of the features of the estate tax, decedents’ estates of small and modest values will have no federal estate tax liability. The value of property that an individual may gift or pass tax-free is $675,000 per individual in 2001. This exclusion amount will increase, in steps, to $1,000,000 by 2006. (See VCE Publication 448-091 on Estate Tax and VCE Publication 448-085 on Lifetime Gifting).

Farmers may also qualify for special use valuation (section 2032A) of real estate for its use in farming, as opposed to its use for housing, for estate tax purposes. This provision removes up to $770,000 (now indexed for inflation) in value of land from a farmer’s estate (See VCE Publication on Section 2032A—Special Use Valuation 448-092). Finally, the new family-owned business deduction allows an additional deduction of up to $675,000 from a decedent’s estate for federal estate tax purposes for qualifying small business owners, including farmers (See VCE Publication 448-068 on Farm Business Profitability and Succession and VCE Publication 448-093 on Small Family Owned Business Exemption).

By combining the estate tax exclusion, the farm valuation provision and the small family-owned business exemption, an individual can pass up to $2.07 million on to the next generation in 2001 (a husband and wife can pass up to $4.14 million with appropriate estate planning) without paying any estate taxes. In addition, proposals before Congress (which may or may not be enacted) eliminate the estate and gift tax altogether, and thus may eliminate any estate and gift tax benefits of conservation easements.

A conservation easement also allows more efficient use of the $10,000 annual gift tax exclusion. This exclusion allows each individual to give, during life, gifts valued at up to $10,000 per person per calendar year. No gift tax must be paid on these gifts and the gifts do not diminish the amount that the giver may pass on free of estate and gift tax ($675,000 in 2001, gradually increasing to $1,000,000 in 2006). A conservation easement reduces the value of the land and thus allows more land to be given away under the exclusion.

Similarly, a conservation easement increases the amount of land available for the $500,000 per year per person intra-family installment sale qualifying for a reduced interest rate under the Internal Revenue Code (IRC). This provision allows a person to sell land to a family member for payments over a number of years. The individual must charge interest to the family member, but the family member may receive a lower interest rate than a bank would charge (the rate fluctuates and is set by the Internal Revenue Code) without adverse tax consequences.

Finally, donation of a conservation easement may help in reducing or eliminating the gen-
eration skipping tax (GST). The GST is an additional tax, separate from the gift and estate tax, which imposes a tax on gifts or bequests that “skip” a generation. For example, a gift to a child is not subject to the GST. However, a gift to a grandchild is subject to the GST because you “skipped” a generation. Most people do not pay GST because $1 million worth of property may be gifted or devised without paying the GST. However, if someone does have a large amount of property they wish to gift or devise to someone two generations below them, a conservation easement allows more property to be gifted. More property may be gifted since the value of the land is now lower due to the easement.

In summary, use of conservation easements, either alone or in conjunction with other estate planning tools, may significantly reduce or even eliminate estate taxes. However, the landowner must have significant assets prior to these benefits accruing. Whether conservation easements yield estate and gift tax benefits depends on each particular situation.

Estate Tax Exclusion for Qualified Conservation Easements

Recent amendments to the federal gift and estate tax law promise potential further savings with respect to conservation easements. Starting in 1998, a federal estate tax provision allows the exclusion of land value from a decedent’s estate if the land is subject to a qualified conservation easement (QCE). If a QCE meets the requirements of the new law, as much as 40% (or the applicable percentage) of the date-of-death land value may be subtracted from the value of your estate when calculating the estate tax. This exclusion from the value of land applies after the value of the conservation easement is subtracted from the fair market value of the land, essentially allowing the landowner to “double-count” the reduction in value.

However, a location rule limits the use of this new exclusion. Only land located (1) in or within 25 miles of a metropolitan area as defined by the Office of Management and Budget; (2) within 25 miles of a national park or wilderness area; or (3) within 10 miles of an Urban National Forest qualifies for this exclusion. Most land in Virginia lies within one of these areas. In addition, special rules apply to debt-financed property, but these rules are beyond the scope of this publication (See I.R.C. § 2031(c)(4) for more information.)

The maximum amount that can be excluded is the lesser of the “applicable percentage” (a maximum of 40%) or the “exclusion limit” $400,000 in 2001, and $500,000 in 2002 and thereafter). The percentage exclusion may be as high as 40%, but it is reduced by two percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30% of the value of the land. For this purpose, the value of the land is determined without regard to the value of the easement, and it is reduced by the value of any retained development rights.

To illustrate the above rule, consider that a property owner has died and that a qualified conservation easement had been granted on his land. The fair market value of the land on the date of death before considering the conservation easement was $900,000. The value of the QCE is $200,000.

First of all, the $200,000 QCE is fully deducted from the value of the estate. The $200,000 value of the QCE is 22.22% of the total value of the property (before the QCE). The applicable percentage must be reduced by 16% (twice the difference between 30% and 22%). In this example, the applicable percentage equals 24% (40 - 16). That leaves an exclusion amount of $168,000 (24% x $700,000). For estate tax purposes this real estate’s value is $532,000 ($900,000 - $200,000 - $168,000).
An election under this exclusion is irrevocable. The income tax basis for the land that benefits from this new exclusion is reduced by the amount of the allowable exclusion. If the easement is donated after the death of the owner of the land, there is no income tax deduction for the estate or the heirs.

It should be noted that a property owner may also make a charitable gift of a conservation easement upon death, which would also be deducted from the estate. Consequently, this would reduce the value on which estate taxes are levied and result in a lower estate tax, just as a lifetime gift would reduce estate taxes. Such a gift would reduce the income tax basis of the property.

**A Conservation Easement Income Tax Benefit Example**

Assume that the fair market value (FMV) of a piece of land prior to the donation of a conservation easement is $600,000 and the FMV of the land with the conservation easement is $400,000. Therefore, the value of the donated conservation easement is $200,000 ($600,000-$400,000). Assume further that the taxpayer has an adjusted gross income of $80,000. The maximum charitable deduction for the year of the transfer is $24,000 (30% x $80,000). This leaves $176,000 ($200,000 - $24,000) to carryover to future years. Note that in this example, only $144,000 of the $200,000 would be deductible over a six-year period (6 years x $24,000/year = $144,000). The adjusted gross income of the taxpayer relative to the total value of the conservation easement donated determines whether the full tax benefit can be captured.

If this taxpayer is in a 28% income tax bracket, a $24,000 reduction in taxable income provides an income tax savings of $6,720 (.28 x $24,000). Over six years, the tax savings is more than $40,320 (6 years x $6,720 = $40,320) without discounting for the passage of time. Individuals in a higher tax bracket (say 31%) would realize greater savings.

**Practical Considerations**

Once a landowner considers making a donation of a conservation easement, the exact parameters of the restrictions and the exact acreage encompassed by the restrictions must be determined. As in much of life and law, negotiation and compromise determine the final terms and conditions of the easement. The receiving organization always reserves the right to decline any donation offered, but most organizations are eager for donations. The degree of bargaining power held by the landowner depends ultimately on the desirability of the particular tract for preservation. First, one must determine whether the easement will cover all or a portion of the property. The authors know of no state laws that specify a minimum number of acres, but larger tracts tend to be more desirable. Other factors, such as uniqueness of the property, historical significance of the property, development pressure from surrounding areas, and other factors determine whether a particular offer of a conservation easement donation is acceptable to the receiving organization.

In addition, the specific restrictions contained in conservation easements are as variable as the properties they encumber. For example, one landowner may have two children and one farm that they may wish to encumber with a conservation easement. If acceptable to the receiving organization, the landowner may carve out an exception that allows an additional house to be built on the property so that both children may live on the property. If such a “carve out” is attempted, any development is limited in type, scope and geographic area. Again, depending on the desirability of the specific property, the potential receiving organization may accept varying degrees of development restriction. An easement may allow any type of farm or forestry operation, or may limit the scope by imposing limits on, for example, the use of machinery or other inputs by the operation.

**Conclusion**

Conservation easements may provide useful federal and state income tax, estate tax and local real property tax benefits. However, depending upon the extent of the value of the easement, many farmers and landowners may not be able to utilize the full extent of the income tax benefits. Put simply, one must have income before one can take the advantage of the income tax deduction. The law allows a taxpayer to deduct only 30% of his adjusted gross income each year for charitable contributions with a five-year carry forward. Unless a farmer or forester reports significant adjusted gross income, the deduction may prove of little use.

Perhaps more importantly, conservation easements last forever. Property that may be suitable for farming and ranching at the time of the donation may at a later time prove to be inappropriate for those uses. A farm or forest operation that is not profitable must continue into perpetuity.

On the other hand, conservation easements may create income tax, estate and gift tax and real estate tax
savings and protect the land for farming and forestry purposes. Alternatively, the landowner may simply wish to donate the conservation easement regardless of tax benefit or lack thereof.

Each situation is unique and an endless array of possibilities and combinations exist for fashioning the conservation easement transaction. Legal, accounting and financial planning assistance is vital to a conservation easement transaction that satisfies the objectives of all involved.

For additional information on this topic see:
“Conservation Easements in Indiana” by Gerald A. Harrison and Jesse J. Richardson, Jr. Purdue University, February 2000. http://www.agcom.purdue.edu/AgCom/Pubs/ID/ID-231/ID-231.html


“Maximizing Tax Benefits to Farmers and Ranchers Implementing Conservation and Environmental Plans” by Jesse J. Richardson, Jr. 48 Oklahoma Law Review, pages 449-469 (Summer 1995).

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