



**The Benefits of
Conservation Planning:
A Toolkit for the
Tax Professional**

American Rivers, along with its partners, the Waccamaw RIVERKEEPER® Program of the Winyah Rivers Foundation and the Pee Dee Land Trust, are working to improve recreation and protect critical land along the Waccamaw River in South Carolina.

These groups are collaborating with the communities in Horry and Georgetown Counties to establish the Waccamaw River Blue Trail. Blue trails, the water equivalent to hiking trails, help facilitate recreation in and along rivers.

The Waccamaw River Blue Trail will not only improve recreational opportunities, it will also help to educate citizens, local governments, and elected officials about the importance of the river as a community asset, increase community involvement, and support conservation.

As part of our effort to educate local communities on the vast benefits and opportunities associated with private land conservation, project partners are hosting a series of workshops. The first of these workshops, “The Benefits of Conservation Planning: A Workshop for the Tax Professional” provided accountants, estate planners, and tax attorneys with information on conservation easements and planning. Presentations were made by the Pee Dee Land Trust, United States Department of Agriculture’s (USDA) Natural Resources Conservation Service (NRCS), and Turner Padgett, LLP a local law firm whose staff specializes in conservation planning. This toolkit was created as an outline of the discussion so that all may have access to the information offered.

Divided into three major parts, the toolkit details the basics of conservation easements, USDA’s NRCS easement programs as well as more detailed information that may be of benefit to tax professionals. With this user-friendly guide, readers are provided with a primer; focusing on topics such as how to qualify for an easement, the process of constructing an easement, and the tax benefits associated with conservation planning.

This document is not meant to be legal advice. Please contact your attorney or accountant regarding tax and financial information specific to your situation.

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Section I: Conservation Easements

1a. Defining a Conservation Easement

A conservation easement is a legal agreement between a landowner (grantor) and a designated nonprofit that protects natural and historical areas, farms, and forestland (aka qualified conservation organization, grantee).

The owner voluntarily restricts the land uses and development potential on his/her property in order to protect its conservation values. Easements can only be given by the owner of the property and can only be accepted by qualified conservation organizations such as local/regional land trusts and national conservation organizations).

Conservation easements are a “negative” covenant. They grant no rights (as a “positive” covenant would), but rather restrict certain damaging uses. The landowner works with the land trust to decide the restrictions of use on land, commonly being residential or commercial activity, mining (prohibited), impervious surfaces, and subdivision or partition of property.

1b. Conditions of a Conservation Easement

Conservation easements are most akin to covenants, in that they are binding agreements between two parties. While the landowner retains ownership of the property, the land trust is the true “keeper” of the portion under easement. The landowner retains all the customary rights and responsibilities of land ownership that are not specifically prohibited or restricted by the conservation easement. Typically, these rights include engaging in agricultural activities, some forestry activities, hunting, fishing, managing ponds, and other low-impact recreational activities. These reserved rights are meant to protect the conservation values while allowing a landowner to generate some revenue from the land.

Other conditions include:

- ◆ Permanency: Conservation easements are typically permanent, though the specifics of the agreement can be flexible and tailored to the individual property at the onset. Landowners are understood to abide by these restrictions and honor their permanence. Restrictions run with the land, regardless of the owner, so sale or transfer of the property takes the easement restrictions with it.
- ◆ Responsibility: Landowners retain all responsibilities for paying taxes on their land and for the liabilities associated with land ownership. Organizations that accept easements must be fiscally able to enforce them over time and must monitor the easements each year.

1c. Constructing a Conservation Easement

Conservation Easement Process:

- ◆ Site visit
- ◆ Identification of Conservation Values
- ◆ Preparation of Present Condition Report
- ◆ Preparation of conservation easement agreement

- ◆ Signing and recording of documents
- ◆ Stewardship Contribution or fee (based on complexity of transaction)
- ◆ Appraisal
- ◆ Tax forms 8283
- ◆ Monitoring

In creating a conservation easement, the landowner and land trust have separate legal counsels. To fully understand the long-term ramifications, landowners are encouraged to seek the advice of their financial and legal advisors.

Questions often arise regarding such items as:

- Subordination of existing mortgages
- Effects on minor interests such as rights of way

1d. Benefits of a Conservation Easement

I. Conservation Purposes

Conservation easements provide a way for an individual landowner to protect natural habitats, maintain open space or forest land, and preserve historic areas and structures on his or her own property in circumstances where land is threatened by development, fragmentation, or lack of land use regulation. Conservation easements can lower the value of a property by restricting its uses, in some cases reducing the burden of estate taxes.

II. Tax Benefits

There are two primary kinds of federal tax benefits available to conservation donors: federal income tax benefits and federal estate tax benefits. There can occasionally be a reduction in property taxes as well.

Receiving full tax benefits happens only as a result of voluntary conservation easement gifts – charitable intent is not evident when there is quid pro quo such as payment, a regulatory requirement, or if associated with permitting or penalties, or if the landowner's nearby property is enhanced in value

Federal Income Tax Benefits- Donors of land and conservation easements may claim an income tax deduction under § 170 of the Internal Revenue Code.

In determining the exact amount of tax savings, the following are considered:

- ◆ How long the donor has owned the property (benefits are generally greater if owned for more than one year)
- ◆ How the donor has used the property (residence, investment, agricultural)
- ◆ The income of the donor (the higher one's income, the more one will save on taxes)
- ◆ The value of the donated property (the more valuable the property, the bigger the deduction)

Under most circumstances, the value of the easement may be considered a charitable gift and may be claimed as a deduction from federal income tax, subject to any other limitations that may exist.

Reduction of Federal Estate Taxes-The value of the estate tax is reduced because of the easement in place. The landowner's heirs may also be entitled to significant Estate Tax relief.

South Carolina Income Tax Credit-South Carolina taxpayers may claim a state income tax credit for a donation of land or donation of a conservation easement to a qualified organization. The tax credit can also be sold to any other SC taxpayer. This could be of value to someone whose taxable income would not allow them to fully utilize the credit.

1e. Overview: The Pros & Cons of Conservation Easements

Pros

- ◆ Landowner retains title, use of land
- ◆ Document is drafted to fit property
- ◆ Property is permanently protected
- ◆ Tax benefits
- ◆ Land remains in economy/tax base
- ◆ Cost-effective way for taxpayers to protect natural resources

Cons

- ◆ Perpetual restriction on property
- ◆ Up front costs
- ◆ Income level affects ability to fully realize tax effects

Section 2: USDA NRCS Easement Programs

2a. Wetland Reserve Program (WRP)

I. Overview

The Wetlands Reserve Program is a voluntary program offering landowners the opportunity to protect, restore, and enhance wetlands on their property. The USDA Natural Resources Conservation Service (NRCS) provides technical and financial support to help landowners with their wetland restoration efforts. The goal of the NRCS is to achieve the greatest wetland functions and values, along with optimum wildlife habitat, on every acre enrolled in the program. This program offers landowners an opportunity to establish long-term conservation and wildlife practices and protection.

II. Qualifications

The Wetland Reserve Program is one of the most restrictive easements that the NRCS offers. Eligible acres are limited to private and Tribal lands. A “compatible use agreement” (specific to each property) outlines management activities, and no structures or timber harvesting are allowed. The easement must consist of a minimum of 20 contiguous acres. No easement shall be created on land that has changed ownership in the last 7 years.

III. Enrollment Options & Payment

- ◆ **Permanent Easement:** A conservation easement that protects a tract of land in perpetuity. USDA pays 100 percent of the easement value and up to 100 percent of the restoration costs.
- ◆ **30-Year Easement:** An easement that expires after 30 years. USDA pays up to 75 percent of the easement value and up to 75 percent of the restoration costs.
- ◆ **Restoration Cost-Share Agreement:** An agreement to restore or enhance the wetland functions and values without placing an easement on the enrolled acres. USDA pays up to 75 percent of the restoration costs.

On both permanent and 30-year easements, USDA pays all costs associated with recording the easement in the local land records office, including recording fees, charges for abstracts, survey and appraisal fees, and title insurance.

Payment rates can vary by state. If you would like specific information for your area, contact your local [NRCS](#) office.

2b. Farm and Ranchland Protection Program (FRPP)

I. Overview

The Farm and Ranch Lands Protection Program (FRPP) is a voluntary Farm Bill program that helps farmers and ranchers keep their land in agricultural uses. Eligible entities are State, Tribal, local governments, and non-governmental organizations. They acquire conservation easements from landowners who agree to NOT convert their land to non-agricultural uses and to develop and implement a conservation plan for any highly erodible areas.

II. Qualifications

To be eligible for FRPP, land must:

- ◆ contain prime, unique, or otherwise productive soil or have archaeological resources;
- ◆ be large enough to sustain agricultural production (greater than 50% managed cropland);
- ◆ be surrounded by parcels of land that can support long term agricultural production;
- ◆ be owned by an individual or entity that does not exceed the Adjusted Gross Income (AGI) limitation.

Current AGI is \$1,000,000 for landowners. For parcels that have more than one owner, each owner must make less than the specified amount to qualify. If one property owner qualifies and others don't, the qualifying landowner receives only their percentage of the incentive.

Farm related structures are allowed in this easement. The landowner reserves the right to farm or to lease the farming rights in this program.

III. FRPP Payment

Easements are purchased based on the fair market value determined by a licensed appraiser. Appraisals are the responsibility of the landowner. NRCS provides up to 50 percent of the appraised fair market value of the conservation easement in this voluntary program. State, tribal and local entities can match that amount and can include landowner donations in their match.

Landowners may accept less than the appraised fair market value of the easement. The difference between the appraised value and the purchase price the landowners are willing to accept is considered a landowner donation.

The eligible entity must provide at least 50 percent of the easement purchase price, including a maximum 25 percent landowner donation.

Parcels selected for funding must also include:

- ◆ an appraisal
- ◆ survey
- ◆ title search
- ◆ preparation of conservation easement deed
- ◆ payment for the closing

2c. Grassland Reserve Program (GRP)

I. Overview

The Grassland Reserve Program (GRP) is a voluntary program that helps landowners and operators protect eligible grazing lands, including rangeland, pastureland, shrubland and certain other lands using rental contracts or conservation easements. Restoration agreements on either rental contracts or conservation easements may be required for some properties.

The program emphasizes support for working grazing operations, enhancement of plant and animal biodiversity, and protection of grasslands under threat of conversion to cropping, urban development and other activities.

GRP is implemented jointly by the USDA Natural Resources Conservation Service (NRCS) and the USDA Farm Service Agency (FSA). Program funding comes through the Commodity Credit Corporation.

II. Qualifications & Conditions

Eligible land includes privately owned grasslands; land that contains forbs (including improved rangeland and pastureland or shrubland) for which grazing is the predominant use; or land that is located in an area that historically has been dominated by grassland, forbs or shrubland that has the potential to serve as wildlife habitat of significant ecological value.

There is no minimum acreage for enrollment. Land is not eligible if it is currently enrolled in another conservation program or is already protected by an existing easement, contract or deed restriction or is owned by a conservation organization.

III. Options

The following protection options are available:

- ◆ Permanent Easements: Payments are based on the appraised value minus the grazing value.
- ◆ Rental Agreements: 10, 15, or 20 year options are available. Seventy-five percent of the grazing value will be paid in annual payments for the length of the agreement. Rental rates for your county are available; please contact your local field office.
- ◆ Restoration Agreements: NRCS pays up to 90 percent of the restoration cost on grassland or shrubland that has never been cultivated and not more than 75 percent on restored grassland or shrubland that has been cultivated.

Section 3: Conservation Planning for the Tax Professional

3a. Background on State and Federal Tax Incentives

I. Background

- ◆ “Old Law”:: Section 170(b) provides that the percentage limitation applicable to gifts of conservation easements (see Section 170(h)) to **30%** of adjusted gross income and limits the carry-forward to **5 years**
- ◆ South Carolina: No state tax incentives for gifts of conservation easements in South Carolina until 2001

Example of Old Law:

Landowner with adjusted gross income of \$100,000 donates a conversation easement on his 500 acres (\$2,500 /acre) and is entitled to a \$375,000 charitable contribution deduction (\$1,250,000 - \$875,000); landowner would ordinarily be in the 25% federal income tax bracket:

II. American Jobs Creation Act of 2004

Created enhanced benefits:

- ◆ Deduction increased from 30% of AGI to **50% of AGI** (100% for “qualified farmers and ranchers”)
- ◆ Carry-forward increased from 5 yrs to **15 yrs**

Enhanced benefits extended by 2008 Farm Bill and again for 2010 (tentatively) by H.R. 4213

Example with enhanced benefits:

Landowner with adjusted gross income of \$100,000 donates a conversation easement on his 500 acres (\$2,500 /acre) and is entitled to a \$375,000 charitable contribution deduction (\$1,250,000 - \$875,000); landowner would ordinarily be in the 25% federal income tax bracket:

AGI:	\$100,000
Tax Before:	\$ 17,350
Tax After:	\$ 6,665
Tax Savings:	\$ 10,685 [\$80,138]

NOTE: Increase in AGI and carry-forward allows \$375,000 deduction to be fully used in 7.5 years

III. South Carolina Conservation Incentives Act of 2001

- ◆ South Carolina income tax credit of up to 25% of federal income tax deduction
- ◆ Credit is capped at \$250 per acre
- ◆ Maximum credit is \$52,500 per year
- ◆ Carry forward indefinitely
- ◆ Credit can be sold or transferred

2005 Amendments: Quid Pro Quo, Golf Courses, Agricultural Use Classification, New Valuation Penalty

Examples under South Carolina Act:

- ◆ (Same facts as prior examples) \$375,000 charitable contribution deduction produces a South Carolina income tax credit of \$93,750 (\$250 per acre cap not applicable).
- ◆ Assuming state income tax liability of \$3,500 per year, credit can be carried forward 27 years;
- ◆ or landowner can sell \$58,750 (keeps 10 yrs worth of credits) to 3rd party for \$47,000

Organizations such as South Carolina Conservation Credit Exchange facilitate the transfer of state tax credits between landowners and buyers (70% - 80% on the dollar).

For the sale to be effective the transaction must be approved by the SC DOR. —SC Rev. Proc. #01-11 provides guidance as to how approval should be sought.

Sale of credits will produce ordinary income under Section 1001.

3b. Technical Rules

I. Section 170(h)-“Qualified Conservation Contribution”

A “qualified conservation contribution” is a contribution:

- ◆ of a qualified real property interest (such as a “restriction (granted in perpetuity) on the use which may be made of the real property”);
- ◆ to a qualified organization [such as a 501(c)(3) exempt org];
- ◆ exclusively for conservation purposes

“Qualified conservation contributions” are an exception to the general rule that there is no charitable income tax deduction for gifts of partial interests (*see* I.R.C. Section 170(f)(3)(B)(iii)).

According to Section 170(h), a “qualified conservation contribution” is a contribution:

- ◆ of a qualified real property interest (such as a “restriction (granted in perpetuity) on the use which may be made of the real property”);
- ◆ to a qualified organization [such as a 501(c)(3) exempt org]; and
- ◆ exclusively for conservation purposes.

“Conservation Purposes” include:

- ◆ protection of relatively natural habitat of fish, wildlife, or plants;
- ◆ preservation of land for outdoor recreation and education of the general public;
- ◆ preserving open space for the scenic enjoyment of the public; and
- ◆ preservation of an historically important area or structure.

Fundamental Requirement of Section 170 – “donative intent”:

- ◆ Intent to make a charitable contribution
- ◆ Can not be required by regulation or contract
 - ◆ Cluster Development Projects: A growing number of localities allow a landowner to increase residential density, or simply to cluster permitted residential density, in exchange for the grant of a conservation easement on that portion of the property from which the clustered density has been derived. Because the grant of the easement is a requirement of local regulation, there is no donative intent and, therefore, no deduction.
 - ◆ Reciprocal easements: When one landowner agrees to grant a conservation easement over his land in exchange for his neighbor’s grant of an easement,

the two neighbors will not be considered to have the requisite donative intent **IF** the agreement between them is considered legally enforceable.

- **Conservation Buyer and Notice 2004-41**: Specifically criticizes a type of two-step conservation buyer transaction. In the transactions at issue, the land trust would sell previously purchased property and retain a conservation easement. In order to recover what it paid for the property the land trust would require the buyer to make 2 payments, one for the property—equal to its appraised value as restricted by the easement and a second cash contribution equal to the value of the easement.

Substantiation Requirement:

- ◆ Treas. Reg. Section 1.170A-16(d) denies a deduction for all noncash charitable contributions in excess of \$5,000 unless the donor obtains a “*qualified appraisal prepared by a qualified appraiser*” and completes Form 8283 and files it with the return
- ◆ “Qualified appraiser” standard requires the appraiser to have a “recognized appraisal designation” (MAI, SREA, SRPA)

II. Significance of Substantiation-Penalties:

- ◆ Taxpayer – Valuation Misstatements
 - “Substantial Valuation Misstatement”
 - 150% or more of the correct value
 - 20% penalty
 - Gross Valuation Misstatement”
 - 200% or more of the correct value
 - 40% Penalty
 - Reasonable Cause Exception
- ◆ Appraiser Penalty
- ◆ If appraisal results in a substantial or gross misstatement, penalty is the greater of:
 - 10% of tax attributable to error; OR
 - \$1,000 (capped at 125% of income received)

There is a reasonable cause exception for a substantial valuation misstatement (TP acted in good faith and had a reasonable basis to use the value). Pension Protection Act of 2006 did away with the exception for gross valuation misstatements.

III. Effect of Conservation Easements on Basis

- ◆ **Donated Easement**: Reduce retained basis by proportionate value of donated easement
- ◆ **Sale of Easement**: Return of basis before gain on sale of easement (Rev. Rul. 77-414)
- ◆ **Bargain Sale**: A combination of the 2 rules:
- ◆ Determine retained basis
- ◆ Recover basis against proceeds, excess is gain

Basis Examples: Facts – FMV of prop = \$900K; Basis = \$300K; and Easement = \$300K

- ◆ Donated Easement
- ◆ $\$300K \times (\$600K/\$900K) = \$200K$ basis in fee
- ◆ Sale of Easement
- ◆ $\$300K - \$300K$ orig basis = no gain and no basis remaining in \$600K fee
- ◆ Bargain Sale of Easement for \$150K
- ◆ Balance of easement donated for \$150K
- ◆ $\$300K \times (\$750K/\$900K) = \$250K$ basis in fee
- ◆ Sale results in no gain ($\$150K - \$250K$) and \$100K basis left

Contiguous Property: If an easement conveys a portion of the contiguous property owned by the donor and the donor's family, the value of the easement is equal to the value of the entire property (including unencumbered portion) before the easement minus the value of the entire property afterward (see Treas. Reg. Sec. 1.170A-14(h)(3))

"Enhancement Rule": requires the value of a deduction to be reduced by the amount of any increase in value the easement causes to other property owned by the donor or a related person (see Treas. Reg. Sec. 1.170A-14(h)(3))

IV. Granted in Perpetuity

Six Requirements of Perpetuity:

- ◆ Donor's retained interest must be subject to legally enforceable restrictions
- ◆ All pre-existing mortgages must be subordinated
- ◆ Negligible possibility of easement being defeated
- ◆ No retention of rights for surface mining
- ◆ Grantee must be provided with documentation, notice and access rights sufficient to enforce terms of easement - written "natural resource inventory" / baseline
- ◆ Unexpected termination

Is perpetual really perpetual?

- ◆ Conservation easement will not be deemed non-perpetual in nature if an "unexpected termination" arises:
 - ◆ as a result of a court order;
 - ◆ is due to "changed circumstances"; and
 - ◆ the easement holder uses the proceeds in a manner that furthers the conservation purposes of the easement.

"Changed Circumstances" relate to issues making the continued use of the property for conservation purposes impossible or impractical.

Due to the charitable aspect of a conservation easement and the quasi-fiduciary nature that the grantee of the easement serves in, it is likely that the body of case law that applies to charitable trusts will apply to conservation easements (amendments for administrative purposes or which further restrict the property are OK; questionable requests guided by case law and possibly State Attorney General).

3c. Role of Conservation Easements in Estate Planning

I. Estate Planning Considerations

Inter-vivos is:

- ◆ an effective strategy to reduce the size of taxable estate,
- ◆ but family objectives & dynamics must be considered.

Estate tax exclusion - I.R.C Section 2031(c):

- ◆ Provides an exclusion of up to 40% of the value of land subject to a conservation easement from the decedent's estate—exclusion is in addition to the easement reduction

- ◆ Only applies to “qualified conservation *easements*” not just “qualified conservation *contributions*”

Reduction in size of estate can be critical in an illiquid estate—a client with 1,700 acres would likely be forced to sell the land if there were no conservation easement.

“Qualified Conservation Easements” additional requirements:

- ◆ Three year holding period prior to death
- ◆ The easement contribution must have been made by the decedent or a member of his family
- ◆ Conservation purpose must go beyond historic preservation
- ◆ The easement can allow no more than a “*de minimis*” amount of commercial recreational use

Limitations on Section 2031(c):

- ◆ Easement must reduce the value of the land by at least 30%
- ◆ Exclusion reduced by 2% for every 1% below 30%
- ◆ Capped at \$500,000

Post Mortem:

- ◆ Exclusion provided by Sec. 2031(c) can apply to conservation easements created after decedent’s death
- ◆ Personal representative must enter in to the easement and make election on or before due date of estate tax return

3d. Practical Issues and Concerns

I. Developer Easements

- ◆ Quid Pro Quo issues
- ◆ Appraisal rules
- ◆ Dealer/Inventory vs. Investor/Capital Asset

II. Audits Regarding Valuations

- ◆ IRS and SC DOR

III. Applicability of state transfer fee statute

- ◆ SC Code Ann. Sec. 12-24-10 – imposes fee of \$1.85 for every \$500

Deed recording fee is “imposed for the privilege of recording a deed in which land and improvements on the land, tenements or other realty is transferred to another person”.

Section 4: Resources

- ◆ ***Conservation Options: A Landowner's Guide, How to Protect your Land for Future Generations***, by the Land Trust Alliance. This book explains in simple terms the importance of planning when considering future use of private lands, whether you retain or transfer title.
- ◆ ***Land Conservation Financing***, by McQueen and McMahon. This resource is beneficial for both local officials and the general public. It gives an overview of successful land conservation easements and includes model programs at the state and local level.
- ◆ ***Local, State and Federal Tax Incentives for Conservation Easements 3rd Edition***, from the SC Department of Revenue. This publication is designed to assist private landowners, land trusts, attorneys, appraisers, real estate agents and other conservation professionals regarding the specific requirements and implications associated with tax incentives for conservation easements in our state.
- ◆ ***Preserving Family Lands, Books 1-3***, by Small. These books include tax strategies for landowners. Each book is more detailed and in-depth than the one before, enabling the reader to develop a sophisticated understanding of tax planning strategies in order to hold onto land that they love and do something good for the community, too.
- ◆ ***Protecting Water Quality through Conservation Easements***, by Lind. This brief book describes whether, when, and how to use easements for water quality. It includes a section on funding sources.
- ◆ ***Saving American Farmland: What Works***, from the American Farmland Trust. This book includes case studies of successful programs from around the country. The final chapter offers lessons and outlines the steps involved in creating a farmland protection program. Though it is an older book, the information is still relevant.
- ◆ ***South Carolina Agricultural Landowners Guide***, by the American Farmland Trust. This booklet compiles and describes the various state, federal and private farmland protection programs available specifically in South Carolina. It also highlights success stories from around the state.
- ◆ ***Your Land is Your Legacy***, by Cosgrove and Freedgood. This was written especially for farmers to share with their advisors. This book explains estate planning options and pitfalls. It includes examples, worksheets and also addresses the various strategies to keep land available for the next generation of farmers.