

Bench & Bar

OF MINNESOTA



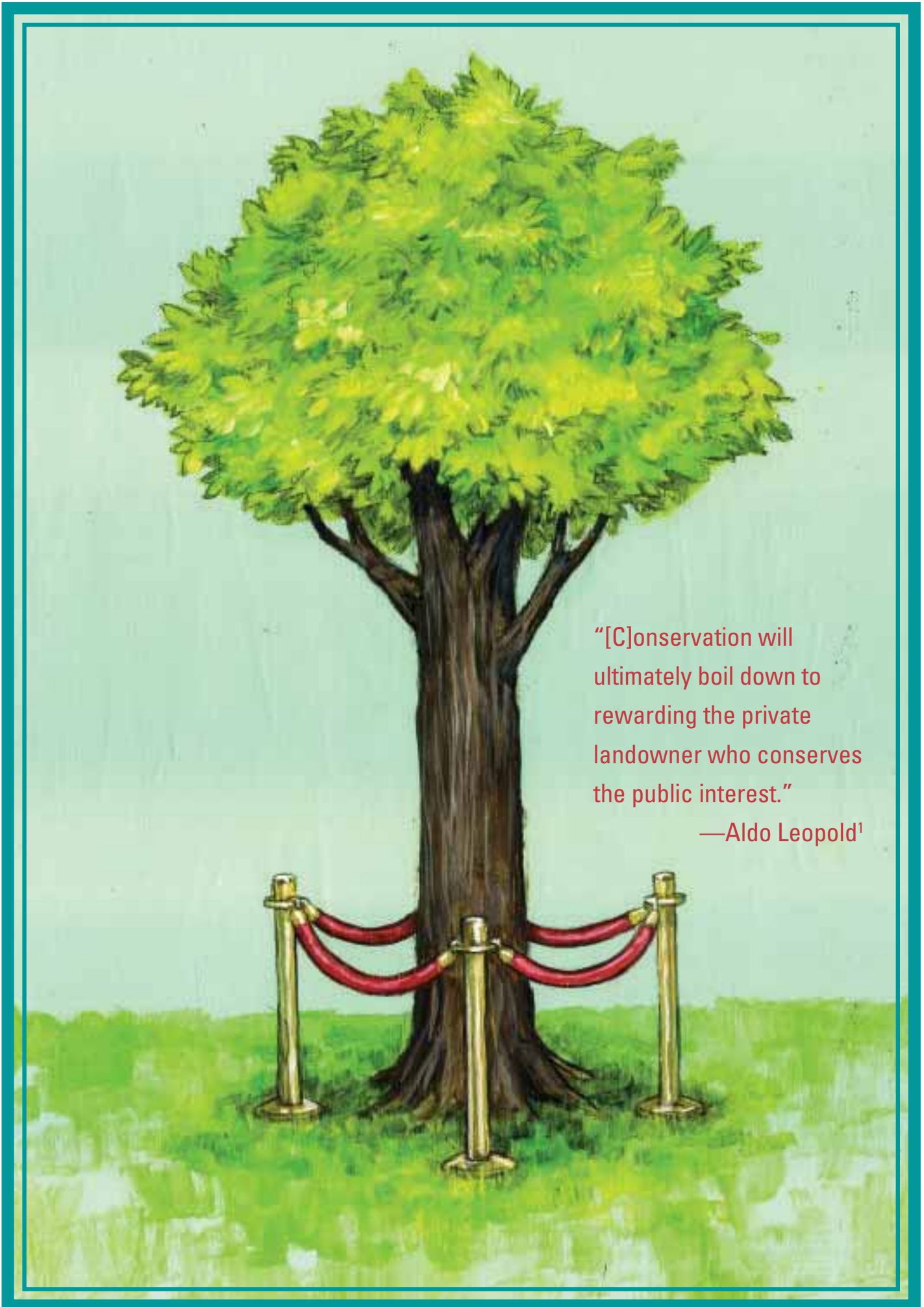
Charitable Contributions Gifts That Will Keep on Giving in 2015

*Tomorrow's
Bar Associations*

*Withdrawing:
Must I? May I?*

Conservation Easements

*Requirements
of Minnesota's
Dangerous Dog Statute*



“[C]onservation will ultimately boil down to rewarding the private landowner who conserves the public interest.”

—Aldo Leopold¹

Conservation Easements

Attractive Opportunity or Risky Endeavor?

By **CARISSA W. BROWN**

Conservation easements present an attractive option for landowners looking to gain a tax advantage while preserving and protecting treasured land, but the process of establishing one can be both costly and onerous and the financial benefits may be limited.

Rewarding private landowners may not be the only way to conserve the public interest, but it is an important tool for government and nonprofit organizations today. At their best, conservation easements allow landowners to benefit the environment and decrease their own taxes, but the donation of a conservation easement is no simple process. Before embarking on it, clients should be advised of the benefits, drawbacks, and risks of this type of charitable gift.

The Conservation Easement

A conservation easement is what's commonly known as a "negative easement," which prevents certain activities and development on the land. A landowner may sell or donate a conservation easement to a government or charitable organization, and while the landowner retains ownership of the land, the use of the land is forever subject to the restrictions delineated in the easement. In exchange for a donation, the landowner may receive a charitable income tax deduction and decrease the value of the landowner's property for estate tax purposes, while protecting the land in perpetuity. The donee is responsible for "protecting" the easement in perpetuity by monitoring the use and care of the property and by taking action to prevent development or uses that violate the easement.

More than 800,000 acres in Minne-

sota are subject to conservation easements, and nearly 80 percent of those easements are on land owned by private landowners.² Easements are frequently granted to government entities, such as the Department of Natural Resources, the U.S. National Park Service, and the U.S. Department of Agriculture, as well as to nongovernmental organizations, such as the Minnesota Land Trust and The Nature Conservancy.

Advantages

Preserving the land for future generations. Landowners committed to the preservation of their treasured land may be looking for a guarantee that future owners of the property will honor the beauty or environmental benefits of the land. Kris Larson, executive director of the Minnesota Land Trust, which has worked with more than 500 families to establish conservation easements in urban and rural areas throughout the state, says that there is no typical donor—income levels vary, and some families have owned the land since it was homesteaded, while others recently purchased their property. But they do have one thing in common: "They have been amazing caretakers of the property, and they don't want their investment wiped out by new owners or development. They know they are temporary owners of the piece of land, and whatever makes them love it, they want to share it with others. They get a lot out of the transaction, because they're getting something beyond themselves."

Conservation easements can provide the guarantee that landowners are looking for by binding future owners of the land to abide by certain use and development restrictions, affording landowners the opportunity to protect what they love about the land, including:

- Watersheds and aquifers that ensure clean water supply;
- Open space near national and state parks, and other public lands;
- Agricultural lands ;
- Scenic beauty and the public's access to it.

Granting a conservation easement does not necessarily open the land to public use. Nearly half of the land subject to easements in Minnesota is not accessible to the public. Such easements frequently benefit the public more indirectly, by decreasing density of development, ensuring a clean water supply, or preserving scenic views.

Larson observes that in Minnesota the landowner population is aging, and there is a sense of urgency on the part of donors and organizations like his to complete conservation easements before ownership interests are fractured among members of the next generation.

Avoiding complicated long-term trusts. During the estate planning process, clients often consider trusts to hold and protect their treasured real estate. A trust is very useful when a landowner wants the property to stay

in the family for as long as possible, or wants to appoint a trustee to manage the property for the benefit of the family. But if the landowner's primary goal is the protection of the land, a conservation easement may be a more effective tool. A trust requires significant start-up costs and ongoing administration, and generally cannot exist in perpetuity. According to Renay Leone, former executive director of the Minnesota Land Trust and a recent donor, conservation easements can give clients "so much flexibility with a minimum of fuss!"

Income tax charitable deduction. Clients looking to minimize income tax may find a conservation easement to be an effective way to attain a meaningful income tax deduction without making a substantial cash gift to charity. In some cases, the grant of an easement may not even alter the landowner's use of the land, because of the landowner's personal choice, or restrictions already in place.

Landowners may receive a charitable income tax deduction for a qualified conservation easement that 1) is a perpetual restriction on the use which may be made of the land; 2) made exclusively for conservation purposes; 3) to a qualified governmental or charitable organization.³ In order to qualify as perpetual, the easement must prohibit the holder from transferring the easement, other than to another qualifying organization and subject to the original conservation purposes.⁴

The IRS considers a number of factors in determining whether an easement was granted exclusively for a conservation purpose, but such purposes generally fall under one or more of the following categories:

- Preservation of land for outdoor recreation by, and education of, the general public;
- Protection of relatively natural habitats of fish, wildlife, plants, etc.;
- Preservation of certain open spaces, including farmland and forest land; or
- The preservation of a historically important land or structure.⁵

The amount of a charitable deduction depends upon the value of the conservation easement. If there is not a substantial record of sales of easements comparable to the donated easement, then the value of the easement is calculated by appraising the value of the real estate before and after the easement is granted; the difference between these two values is the value of the easement.⁶ Deductions for conservation easements are limited to 30 percent of a donor's adjusted

gross income, and excess deductions may be carried forward for five years.⁷

Helping keep property in the family. For families who own a significant amount of real estate (and particularly if it is a large percentage of total assets), a conservation easement can ease the tax burden upon the death of a landowner, preventing the need to sell the real estate to pay resulting estate taxes.

If the Personal Representative of a landowner's estate grants an easement to a qualifying organization within 15 months of a landowner's death, the estate may receive a charitable deduction to the extent an individual is not taking an income tax deduction for the same gift.⁸ The estate tax deduction for an easement granted after death is broader than the income tax deduction during life—it does not require the "conservation purpose" that the income tax deduction requires.⁹

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A decedent may also claim an exclusion for a conservation easement granted by the decedent, a member of the decedent's family, or the decedent's Personal Representative. This exclusion reduces the size of the landowner's estate for the purposes of calculating estate tax. A conservation easement may reduce the value of the real estate for estate tax purposes by up to 40 percent (but not more than \$500,000), depending upon the value of the easement in relation to the land.¹⁰ In order to qualify for this exclusion, the subject real estate must be located in the United States or any possession of the United States, and must have been owned by the decedent or a member of the decedent's family at all times for the three years prior to death.¹¹

Before making the irrevocable election to take a conservation easement exclusion on a decedent's estate tax return, a Personal Representative should

consider that the percentage of property excluded under this provision does not receive the stepped-up basis that inherited properties are otherwise entitled to.¹² Therefore, family members may owe greater capital gains upon a subsequent sale of the real estate.

Disadvantages

Perpetual restrictions on use of the land. Conservation easements impact what an owner can do with the land in perpetuity, and Mary C. Taylor, a partner in the Real Estate practice group at Lindquist & Vennum LLP, who has assisted clients through the process of granting conservation easements, notes that her clients are often surprised by the scope of the potential restrictions, particularly that an easement often covers the whole property that the client owns—not just the portion the client is interested in protecting. In addition, because these restrictions are granted in perpetuity, conservation easements will affect the eventual sale price of the property.

Long process. Donating a conservation easement takes time, as well. The donee organization must do a thorough review of the property and determine whether it has resources to defend the easement before proceeding with negotiations. Negotiations tend to be extensive—the parties must agree on the specific uses of the property. While clients may have a clear idea of the activities and development they wish to prohibit, there may be many other items that don't readily come to mind, including:

- What sort of buildings can be erected on the property, and how many (if any)?
- How must trees and plant life be maintained—can trees be cut down, and for what reason(s)?
- Can the property be subdivided, and if so, into how many lots?
- Where can access to the road be located?

Costly endeavor. While the income and estate tax benefits of donating a conservation easement may be significant, so may the costs:

- Some donors may need to pay for an environmental site assessment and survey before a qualifying organization will accept the conservation easement.
- Some organizations charge a fee to donors to cover the cost of negotiating and documenting the easement.
- Donors must obtain a "qualified appraisal" of the easement if they wish to take a charitable deduction,

■ Donors should consult with their own attorneys and tax advisors to protect their interests during the process.

■ Some donee organizations require the donor to fund an endowment to protect the easement. While this donation may also be tax deductible, it may be a significant cash outlay, depending upon the nature of the easement. However, Minnesota residents are fortunate in that many state programs provide funding for donee organizations, minimizing the need for large cash gifts.

Once the easement is granted, the financial impact on the donor is not complete. The donee organization will monitor the property to ensure it is adequately maintained, but the landowner is still required to maintain the property, and the nature of the easement may require additional maintenance.

Reduced incentive for lower income Minnesotans. On December 31, 2013, a federal tax incentive for conservation easements expired. This incentive allowed donors to deduct up to 50 percent of their income for up to 16 years, providing greater incentives to lower income donors. Proponents of conservation easements are currently working to reinstate this incentive and make it retroactive to January 1, 2014, but if this effort does not succeed, lower income Minnesotans may be unable to deduct the entire value of their gift. However, this doesn't matter to all donors. According to Kris Larson, one-third of the landowners who donate conservation easements to the Minnesota Land Trust do not take an income tax deduction at all.

Limited property tax benefits in Minnesota. States (and counties) have historically differed on their valuation of real estate subject to conservation easements, but Minnesota recently changed its property tax law explicitly to direct that appraisers cannot decrease the value of real estate due to conservation easements, with some narrow exceptions.¹³ As a result of this law, donors of a conservation easement could find their property worth less, but taxed at the "highest and best use."

Risk of denial of deduction, adjustment of value. A client interested in the tax benefits of granting a conservation easement should be aware of the risk that a charitable deduction may be denied or modified as to value. The following are some of the reasons the IRS may deny all or part of a charitable deduction for a conservation easement.

■ **Mortgages on the property.** The IRS will find that a conservation easement is not perpetual, and therefore not a deductible gift, if there is a mortgage on the property and the mortgagee does not subordinate its rights in the property to the right of the donee to enforce the easement.¹⁴

■ **"Floating" easements.** The tax court has ruled that the right to substitute the property subject to an easement disqualifies the easement for a charitable deduction.¹⁵

■ **Overvaluing the easement.** Even if the IRS finds a valid conservation easement, it may dispute the value of the easement (or even argue that the easement does not affect the value of the property at all), and under some circumstances, the client could also be subject to penalties for misstatement of value.¹⁶

■ **Conditional easements.** A conservation easement that is conditional (e.g., returned to the landowner if the IRS denies the deduction for the easement) does not qualify for a charitable deduction.¹⁷

■ **Improper documentation.** The charitable deduction for a conservation easement can be denied if the easement is not properly recorded,¹⁸ or if the gift is not adequately substantiated.¹⁹ Clients should take care to substantiate the gift with a written acknowledgment from the donee organization, and a qualified appraisal, which must be attached to the taxpayer's return.²⁰ Due to the complex nature of the appraisals of conservation easements, clients should consider hiring an appraiser that regularly performs such appraisals.

■ **Invalid under state law.** In order to qualify for a federal charitable deduction, a conservation easement must be valid under state law.²¹

A client that is concerned about the deductibility of a conservation easement may consider requesting a Private Letter Ruling from the IRS prior to making the gift.

The tax benefits that come from granting a conservation easement may not be enough to convince most clients to take on the onerous and risky process. But for many, the financial reward combined with a goal greater than themselves—preserving and protecting treasured land—is well worth it. ▲

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easier for her clients. She helps her clients protect their families and provide legacies for future generations by assisting them in establishing plans and expressing their wishes for their death or disability, and working closely with loved ones and corporate trustees to carry out those wishes.

Notes

¹ Aldo Leopold, "Conservation Economics," 32 *Journal of Forestry* 5 (May 1934), p. 544.

² See, National Conservation Easement Database, <http://www.conservationeasement.us/reports/easements> (2014).

³ I.R.C. §170(h).

⁴ Treas. Reg. §1.170A-14(c)(2).

⁵ Treas. Reg. §1.170A-14(d).

⁶ Treas. Reg. §1.170A-14(h)(3)(i).

⁷ See, Treas. Reg. §§1.170A-8(d) and 1.170A-10(c).

⁸ I.R.C. §2031(c)(9).

⁹ I.R.C. §2055(f).

¹⁰ I.R.C. §2031(c).

¹¹ I.R.C. §2031(c)(8).

¹² I.R.C. §1014(a)(4).

¹³ M.S.A. § 273.117. Exceptions exist for easements impacting water quantify and quality control, easements granted in counties that have adopted by referendum a program to protect farmland and natural areas, and easements granted before May 23, 2013

¹⁴ Treas. Reg. § 1.170A-14(g)(2).

¹⁵ *Belk v. Commissioner*, T.C. Memo 2013-154.

¹⁶ *Gorra v. Commissioner*, T.C. Memo 2013-254.

¹⁷ *Graev v. Commissioner*, 140 T.C. 377 (2013).

¹⁸ Treas. Reg. §1.170A-14(g)(1).

¹⁹ See, Treas. Reg. §1.170A-13(c)

²⁰ I.R.C. §170(f)(8) and Reg. §1.170A-13.

²¹ Treas. Reg. §1.170A-14(g)(1). For Minnesota real estate, see, M.S.A. §84C.02.