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Conservation Easements Conserve Taxes and More

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The recently enacted Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010 (Pub. L. No. 111-312) may have made some Democrats unhappy but it made many in the tax world happy indeed, with tax rate and alternative minimum tax relief, an estate tax answer, extenders, and more.

Although the law gives only a two-year reprieve in many cases, it still provides much to celebrate. It even did some conservation of its own. It retroactively extended the conservation easement deduction all the way back to the beginning of 2010 and continuing through the end of 2011 (not, it should be noted, until the end of 2012). That means there is still time to arrange a conservation easement and secure its unique tax benefits.

The Internal Revenue Service often is not pleased with conservation easements but it is arguably only their misuse IRS dislikes. As so often happens when people get too aggressive, there is a pull-up-the-ladder effect. Conservation easement deductions are a good deal, and they remain available through 2011. Like so much else in the field of charitable contributions, valuation issues—and potential valuation abuses—drive much of the debate.

Just the Basics

You may think an easement is always a right of passage over land. But unlike most easements, conservation easements are not an easement to cross over land. Instead, they are a legal right to enforce the preserva-

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tion of the land. When you put a conservation easement on property, you restrict its future development. You can give this encumbrance to a Section 501(c)(3) charity and claim a tax deduction.

In some cases, giving away a permanent restriction dramatically reduces the value of the land you keep. But in many others, as a practical matter, you might not be able to do much with the property with or without the encumbrance. Put another way, the conservation easement may look more imposing on paper than on the ground. Nevertheless, you may be able to claim a tax deduction for the large value the contribution might be said to have.

Two Birds With One Stone

When you slap an easement across your land and transfer it to a charity you are clearly giving something away. This is a partial interest in property, and transfers of partial interests of property are often suspect. Yet here, it is a partial interest that can qualify for a charitable contribution deduction.

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When it comes to the critical question of what that gift is worth, the charitable organization and professional appraisers will often have the role of telling you the value of what you gave away.

Note that we are not merely talking about natural habitat. The rules also apply to historical facade easements (i.e., an easement to the facade of a historic building). Instead of donating an easement to preserve land, you can donate (usually to a historical preserva-

tion society or similar charity) a permanent right to keep the outside of the building as it is.

Let us say you donate a facade easement to your historic office building (or your historic personal residence) to the local historical society, a tax-exempt charity. You might not be able to do much to alter the historical character of the building even if you wanted to. Nevertheless, you get your tax deduction.

Lest you think this is a bonanza anyone can claim, beware of many technical requirements for the donee organizations and the type of property. The organization must be tax exempt. Moreover, there is a list of permitted purposes, including preserving land for outdoor recreation or the education of the general public, protecting a natural habitat, preserving open space for the scenic enjoyment of the public or pursuant to government (federal, state, or local) policy, or historic preservation.

Indeed, for a restriction on a building exterior to be considered exclusively for historic purposes, the donor and donee must agree in writing that the donee (among other things) has the resources to manage and enforce the restriction, and a commitment to do so. Furthermore, such buildings must be certified as historic, or be in a certified historic district.

The rules are technical enough that you need professional help. And in light of the way some organizations and promoters hawk easements, you will want someone independent who is solely looking out for your interests.

Before and After

One key to all of this is the appraisal process. It involves a before-and-after approach. One figure tells you what your property (land or historic building) is worth pre-contribution. The second figure reveals what it is worth subject to the encumbrance.

Understandably, IRS has targeted inflated appraisals. The service even discussed inflated valuations for building facades as an example of a potential tax scam in its 2005 "Dirty Dozen" list. Nevertheless, many conservation easement assessments seem to hover around 10 percent of the value of the property. Depending on the facts, that often may be reasonable.

A 10 percent valuation would mean that if you have a \$10 million historic building and donate a facade ease-

ment to charity, you could take a \$1 million charitable contribution deduction.

Some claimed deductions have risen to the 40 percent to 50 percent stratosphere. Although IRS has taken on some of such claimed deductions, it has not fared terribly well in court battles with taxpayers. Such disputes can come down to a battle of the appraisers. Taxpayers can usually afford more polished and thorough appraisers than IRS.

Limited Time

Conservation easements have been in the law for decades but the tax deduction was set to sunset on Dec. 31, 2007. Congress then extended the benefit through the end of 2009. Most recently, in the 2010 tax act, Congress extended conservation easement benefits to 2010 and 2011. Beyond that is anyone's guess.

If you make a donation, the limit on the amount of income your deduction can offset is a generous 50 percent of your contribution base (which is adjusted gross income computed without regard to any net operating loss carryback), up from the normal 30 percent limit. Plus, qualifying farmers and ranchers get an even better deal.

For years, the normal rule for conservation easements was that if you could not use all your deduction in one year, you could carry it over for up to five years. If you could not use it up within that ensuing five years, any excess was lost. This five-year period was extended to a liberal 15 years, giving you much more time to claim every penny.

This more extensive reach into the future makes it much more likely that the full amount of your charitable contribution deduction will actually offset income that would otherwise be taxed.

Conclusion

Conservation easements can provide nice societal benefits and attractive tax benefits to the donor. Although there are details to be observed and overly rich appraisals can draw scrutiny, with a properly planned and documented donation, everyone wins.

While it remains possible that they will once again be extended beyond the end of 2011, you should get them while you can.