

TAX INCENTIVES FOR CONSERVATION EASEMENT DONATIONS

In addition to the knowledge that you have taken an important action in the name of land conservation, there are a number of tax benefits for the donation of a conservation easement on your property. The following is a brief summary of those benefits.

Federal and State Tax Incentives

The donation of a conservation easement is treated as a non-cash charitable donation. The value of the donation is the difference in the fair market value (FMV) of the property before the conservation easement and the FMV of the property after the easement has been recorded. An appraiser qualified to make such valuations prepares an appraisal report that satisfies specific IRS requirements.

The IRS allows easement donors to use the value of their donation as a deduction against up to 50% of their adjusted gross income (AGI). Taxpayers are allowed to use this deduction in the year of the easement donation and may carry forward any remaining balance of the donation amount for up to 15 years. Qualified farmers (those making more than 50% of their income from farming) are allowed to take a deduction of 100% of their AGI in the year of the donation, and are allowed to carry forward the unused balance of the donation amount for up to 15 years.

Virginia offers one of the strongest incentives in the nation for the donation of conservation easements. The Virginia Land Preservation Tax Credit program provides easement donors with tax credits against their Virginia state income tax liability. The amount of the credits issued to a taxpayer is equal to 40% of the value of the easement donation, as determined by a qualified appraisal. Virginia issues only \$75 million in land preservation tax credits each year, and those credits are issued on a first-come, first-served basis.

Taxpayers may use the tax credits in the year in which they are issued and may carry forward any unused tax credits for up to 10 years. There is currently a \$20,000 limit on the credits that a taxpayer may use in any year. You may also transfer (sell) any tax credits that you do not use to another individual or business with a Virginia income tax liability. There are fees associated with the transfer of tax credits. Transferred tax credits may be used for up to 11 years.

As an example of how these tax incentives work, assume that the FMV of a property is \$1,000,000 and that the landowner wishes to restrict development of the property with a conservation easement that lowers its FMV to \$600,000. According to

federal and state tax codes, this reduction of the value of the property, through the voluntary imposition of restrictions on its use, is considered to be a tax-deductible non-cash charitable contribution of \$400,000.

Assuming an adjusted gross income of \$100,000 a year, that landowner can take a tax deduction of \$50,000 a year for eight years (equal to the \$400,000 donation value). Based on a marginal tax rate of 25%, the tax savings over eight years will total \$100,000.

Given the \$400,000 easement valuation, Virginia will issue to the landowner \$160,000 in land preservation tax credits (40% of the appraised value). Assuming the same \$100,000 AGI each year and an approximately \$5,200 state income tax liability, the landowner will not have to pay state income taxes for the full 10 years and will only use up to \$52,000 of the allotted \$160,000 in credits. In this example, the easement donor could transfer or sell the remaining \$108,000 in tax credits. Recent sellers of land preservation tax credits have received a net of about 90 cents on the dollar. Therefore, the proceeds from the sale of the \$108,000 of unused tax credits would net the landowner about \$97,200.

The total of the federal income tax savings (\$100,000), the Virginia state income tax savings (\$52,000) and the net proceeds from the sale of the state income tax credits (\$97,200) is almost \$250,000.

Real Estate Taxes

Once the conservation easement is recorded in the county land records, the easement donor's property is qualified for a permanent reduction in the real estate tax rate. The tax rate varies from county to county, but it is typically a considerable savings from the regular tax rate.

Estate Taxes

For estate tax purposes, the value of the conservation easement property is reduced by the restrictions of the easement. In addition, the executor of the estate is allowed to exclude 40% of the value of the easement property from the estate, up to a maximum exclusion of \$500,000.

Please note that this summary is a simplified example of the tax benefits available for the donation of a conservation easement and does not fully provide the details of the tax codes. LTV does not offer tax advice and recommends that you seek the advice of a tax professional.