Conservation Easements: An Essential Tool in the Practitioner's Estate Planning Toolbox

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Comment

CONSERVATION EASEMENTS: An Essential Tool in the Practitioner’s Estate Planning Toolbox

“For the first time in the history of the United States, the family that just wants to leave its land to the children may not be able to do that.”
—Stephen J. Small, Esq. writer of federal income tax regulations on conservation easements.

INTRODUCTION

The West is home to vast expanses of open space; yet, this open space is rapidly disappearing due to increased development. At the same time, many landowners are faced with the economic challenge of using their land for agricultural purposes. Rising income, property, and estate taxes further complicate the landowner’s desire to preserve his land. The Wyoming practitioner should be aware of the dilemma facing the Western landowner and stress the importance of a careful estate plan. The opportunity for estate planning arises at the time the land is acquired. First, it is unwise to wait, as a person’s fate is always uncertain. Second, there are immediate income tax incentives for the living landowner. Third, there are long range estate tax benefits for the landowner’s estate. Consider the following illustration:

John and Jane Doe, a married couple with three children, own Green River Ranch worth $2,000,000.00, located near a rapidly developing area. The ranch has been in John’s family for three generations. It was homesteaded by his great-grandfather. John is concerned about the destiny of the ranch. John and Jane are avid outdoorsmen and advocate preservation of wilderness. Their wish is to keep the Green River Ranch intact for future generations of their family. Their cash assets total $500,000.00

John dies leaving everything to Jane, no taxes are owed due to the marital deduction. In 1998, Jane dies leaving everything to the three children. Here is what happens to the Green River Ranch: Jane’s estate could potentially owe up to $823,750.00 in federal es-

2. I.R.C. § 2056(a) (West Supp. 1999). The Internal Revenue Code contains the statutes governing taxation. Explanations of the statutes are contained in the Treasury Regulations. The authors will be citing both throughout this comment.
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This terrible consequence could have been avoided with proper planning. This comment will discuss the ways a landowner can utilize estate planning opportunities, focusing on conservation easements, to protect and preserve his land in accordance with his wishes.

BACKGROUND

The Development of the New Law

In 1997, "[a]fter seven years, five legislative sessions, three House sponsors, two administrations and one changing of the guard in Congress," President Clinton signed into effect the Taxpayer Relief Act (TRA) of 1997. The TRA was a significant piece of legislation and provided several important tools for the estate planner. Two of these tools are the "family owned business exclusion" and a modified version of the American Farm and Ranch Protection Act (AFRPA). The AFRPA includes an estate tax exclusion for property subject to a "qualified conservation easement." When considering the bill, the Senate reasoned that "a reduction in estate taxes for land subject to a qualified conservation easement will ease existing pressures to develop or sell off open spaces in order to raise funds to pay estate taxes, and will thereby help to preserve environmentally significant land."

Senator John Chafee and Representative Richard Schulze introduced the first version of the AFRPA to Congress in 1990. The proposal originated with the northern Virginia Piedmont Environmental Council (PEC). The PEC supporters saw the need for additional tax code incentives for land protection. The first proposal was simply to exempt land subject to a conservation easement from estate tax under Internal Revenue Code (IRC)

3. This number is calculated for Wyoming using the rate schedule in I.R.C. § 2001(c)(1) (West Supp. 1999). The tax owed on an estate of $2,500,000.00 is $1,025,800.00. Because Jane died in 1998, she is able to utilize the unified credit in the amount of $202,050.00, against the estate tax due. I.R.C. § 2010(c) (West Supp. 1999). This assumes she has not made any prior gifts above the annual exclusion. The amount due may be higher in states which have a state tax on estates. See SMALL, supra note 2, at 88.


7. Small & Lindstrom, supra note 4, at 14.

8. Sawyer, supra note 6, at 68.

9. 1 U.S. TAX REP. EST. & GIFT TAX (RIA) ¶20,311.10, 2522B.

10. Small & Lindstrom, supra note 4, at 14.

11. SMALL, supra note 1, at 102.

12. Id.
§170(h).13 As the legislation progressed, it became more narrow and complex.14 The AFRPA is, however, an important piece of legislation, providing an incentive for private donation of conservation easements.15

History of Easements

Easements were recognized as far back as Roman times.16 An easement approximates what was known as a *praedial servitude* by Roman lawyers.17 "In the case of a *praedial servitude* the burden imposed on one property had to be related to a benefit attached to another property."18 English law echoes this principle.19 Under English law, the distinguishing characteristic of an easement is the right claimed must accommodate the dominant tenement.20 "An easement . . . is a privilege without a profit such as the right to walk over the land of another but not to take anything from it."21

Black’s Law Dictionary defines an easement as a right of use over the property of another.22 A conventional easement involves the conveyance of certain affirmative rights to the easement holder; a conservation easement involves the relinquishment of some of these rights.23 A conservation easement is, essentially, a "negative easement" where the owner of the property is prohibited from doing something otherwise lawful upon his estate.24 Conservation easements protect important conservation qualities of the land, such as habitat, open space, or scenic views.25

Before the Taxpayer Relief Act of 1997 was passed, a landowner could donate a conservation easement and receive the financial benefits of lower estate taxes, a charitable deduction with a five-year carryforward potential on federal income taxes, and possibly lower property taxes.26 In addition to these benefits the new law allows an executor to elect to exclude from the decedent’s estate up to forty percent of the value of the land beyond the reduction in value of the land caused by the conservation easement.27 The

14. Id.
15. Id.
17. Id.
18. Id.
19. Id.
20. Id.
21. Id.
24. Id.
25. SMALL, supra note 1, at 17.
26. David A. Rosen and James E. Morahan, The Tax Benefits of Gifting Land for Conservation, REAL EST. FIN. J., Spring 1991, at 42. The charitable deduction may also be applicable to estate income taxes; however, this is determined on a state-by-state basis. Id.
land must meet certain qualifications to receive this additional benefit. These provisions are included in I.R.C. § 2031, which defines what is included in the value of a gross estate.

The Internal Revenue Service Restructuring and Reform Act of 1998 amended I.R.C. §2031. The Act added a new provision allowing an estate to claim a charitable estate tax deduction under § 2055(f) for the donation of a conservation easement after a decedent’s death. The original version of §2031(c) provided an exclusion for a post mortem easement donation, however the section was silent regarding charitable estate tax deductions under §2055(f). Under current law the estate executor may donate a post mortem qualified conservation easement and by doing so, the decedent’s estate will be entitled to benefits of both §2031(c) exclusion and the §2055(f) charitable estate tax deduction.

**Brief History of Conservation**

The conservation movement was preceded by periods during which the federal government acquired lands from foreign countries and Native American tribes. The government then engineered the transfer of much of the land, “both by granting tracts to states, homesteaders, and railroads . . . and by permitting its resources to be exploited by settlers and other users.” The government transferred the lands with little concern for conservation. Consequently, due to this lack of foresight, many of our nation’s lands and resources were depleted.

America’s concern with the vanishing wilderness led to a “dichotomy between utilitarian and preservationist resource philosophies.” The term “conservation” was coined near the turn of the century by President Theodore Roosevelt and the first chief of the U.S. Forest Service, Gifford Pinchot. According to Pinchot:

> [c]onservation is the application of common sense to the common problems for the common good. Since its objective is the ownership, control, development, processing, distribution, and use of the

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28. I.R.C. § 2031(c)(8) (West Supp. 1999). These qualifications are discussed later within this comment.
30. *Id.* at 263.
31. *Id.* If the charitable estate tax deduction is claimed, no charitable income tax deduction will be available under §170(h). I.R.C. § 170(h) (West Supp. 1999).
33. *Id.* 26.
34. *Id.* 26.
35. *Id.*
36. *Id.* at 6-7.
37. *Id.* at 2.
natural resources for the benefit of the people, it is by its very nature the antithesis of monopoly. . . . The conservation policy then has three great purposes.

First: wisely to use, protect, preserve, and renew the natural resources of the earth. Second: to control the use of the natural resources and their products in the common interest, and to secure their distribution to the people at fair and reasonable charges for goods and services. Third: to see to it that the rights of the people to govern themselves shall not be controlled by great monopolies through their power over natural resources.38

Pinchot, however, did not believe that resources should be preserved for their own sake, as other conservationists of the time did, most notably John Muir.39 In 1965, Time magazine called Muir the real father of conservation.40 Muir founded the Sierra Club and served as president until his death in 1914.41 He saw the value of having healthy forests and watersheds as a value apart from providing resources for man’s use.42 Even today in Washington D.C., the tensions between these two conservation philosophies persist within governmental resource agencies and in the law.43

The federal government slowly responded to the growing concerns regarding conservation. President Roosevelt and Congress created the National Park System beginning with the establishment of Yellowstone National Park in 1872.44 The 1897 Organic Act gave Pinchot authority over the forest reserves.45 Pinchot limited grazing by requiring permits and restricted logging in sensitive watersheds.46

Since that time, awareness of conservation issues has led the federal government to institute numerous legislative actions aimed at protecting the nation’s lands and resources.47 The local face of conservation law has con-

38. Id.
39. Id. at 2-3.
40. Id. at 3.
41. Id.
42. Id.
43. Id.
44. DONAHUE, supra note 32, at 7. It is also important to note that gifts to the Federal Government were made possible by the Migratory Bird Conservation Act of 1929. This Act also established the National Refuge System. Lecture from Fred Lindzey, Adjunct Professor, University of Wyoming, Principles of Wildlife Ecology and Management (Sep. 16, 1999).
45. DONAHUE, supra note 32, at 7. The Organic Act was passed due to pressure from Western interest groups that were concerned by the restrictions placed on timber harvesting, mining, and access by the Forest Reserve Act of 1891. The Organic Act mandated that forest reservations could be established only to protect forests, secure waterflows, or provide a supply of timber. RESEARCH AND MANAGEMENT TECHNIQUES FOR WILDLIFE AND HABITATS (Theodore A. Bookhout ed., 1996).
46. DONAHUE, supra note 32, at 7.
47. Id. at 8.
continued to evolve as well.48 "The American population has become increasingly urban and population growth has resulted in urban and suburban sprawl. High property and estate taxes and the lower profitability of existing land uses has led to the development of vacant lands and the devouring of open space."49 As states become increasingly concerned with protecting wildlife habitat and private landowners seek ways to preserve family lands, the forces have combined to promote conservation objectives.50 Conservation easements, along with the establishment of land trusts, are now being utilized to achieve the goal of preservation.51

ANALYSIS

Congress provides several ways a taxpayer can benefit from granting a conservation easement. These ways include income tax deductions and estate tax exclusions. Congress also allows an income tax deduction for the value of a conservation easement given to a qualified charitable organization.52 The amount of the contribution is not subject to gift tax.53 The landowner will also realize a lower property value for estate tax purposes. In addition to these benefits, the Taxpayer Relief Act of 1997 (TRA) added an important new estate tax exclusion; the executor can elect to exclude from the decedent's estate up to forty percent of the value of the land (not structures) subject to a conservation easement.54 The value of the land is calculated after application of the easement.

This comment will discuss what type of land is subject to qualified conservation easements and how the landowner can utilize such easements for income tax and estate tax planning purposes. The qualifications for the income tax charitable deduction are outlined in IRC § 170. The requirements of § 170 must also be satisfied if the executor of an estate wishes to elect the IRC § 2031 estate tax exclusion for the donation of a qualified conservation easement.55

The Requirements of a Conservation Easement for Income Tax Deduction Allowed by IRC §170(h)

The IRC outlines the elements of a qualified conservation contribution in §170. To qualify, the contribution must consist of a qualified real prop-

48. Id. at 8.
49. Id. at 8-9.
50. Id. at 9.
51. Id. at 7.
55. However, the donation of historically important land or a certified historic structure will not qualify for the estate tax exclusion allowed under I.R.C. § 2031. I.R.C. § 2031 (West Supp. 1999).
ery interest, made to a qualified organization, and donated exclusively for conservation purposes. 56

1. Qualified Real Property Interest

The first requirement of IRC § 170(h) is the donation of a qualified real property interest. The IRC identifies three types of real property interests that may be donated as a qualified conservation contribution. These interests are: (1) the entire interest of the donor, (2) a remainder interest, or (3) a restriction granted in perpetuity on the use of the real property. 57 This last interest is known as a conservation easement.

The §170(h) charitable contribution deduction is not allowed where there is a retention of a qualified mineral interest58 if, at any time, there may be extractions or removal of minerals by any surface mining method.59 In some parts of the country, mineral extraction is not an issue; however, in the Western United States, including Wyoming, land use patterns have developed under which prior owners are reasonably likely to have severed the mineral interests from the rest of the property.60 The IRC states if the mineral rights are not owned by the easement donor, a deduction for a conservation easement will not be allowed unless the property owner establishes that the likelihood of surface mining on the property is “so remote as to be negligible.”61

2. Qualified Organization

The second requirement of IRC § 170(h) is the donation must be made to a qualified organization. The tax regulations specify three criteria an organization must meet in order to be an eligible donee. The organization must be (1) a qualified organization, with (2) a commitment to protect the donation’s conservation purposes and (3) financially able to enforce the restrictions.62 A “qualified organization” generally means a charitable or-

58. A “qualified mineral interest” is the donor’s interest in subsurface oil, gas, or other minerals and the right or access to such minerals. Treas. Reg. §1.170A-14(b)(1)(i) (1999).
60. SMALL, supra note 52, at 111.
62. Treas. Reg. §1.170A-14(c)(1) (1999). Organizations set aside money that is put into monitoring or stewardship funds. The money is used to enforce the easements donated to the organization. JANET DIEHL & THOMAS S. BARRETT, THE CONSERVATION EASEMENT HANDBOOK 102 (1988). The organizations raise money through soliciting cash donations from the easement donor or other fund raising activities. Id.
ganization or a local, state, or federal governmental unit.\textsuperscript{63} Congress does not allow donations to private foundations, which are generally funded by a small group of individuals, a single corporation, a family, or one person.\textsuperscript{64} A conservation group organized for the purposes outlined in IRC §170(h)(4)(A)(i)-(iv) (explained in detail below as the conservation purposes test) will be considered to meet the commitment requirement.\textsuperscript{65}

3. Conservation Purposes

The third requirement of IRC § 170(h) is the donated property must qualify under the "conservation purposes test." The IRC sets out four ways land can meet this test:

1. The preservation of land areas for outdoor recreation by, or the education of, the general public;
2. The protection of a relatively natural habitat of fish, wildlife or plants, or similar ecosystem;
3. The preservation of open space (including farmland and forest land) when such preservation is:

   (i) for the scenic enjoyment of the general public; or
   (ii) pursuant to a clearly delineated federal, state, or local government and conservation policy, and will yield a significant public benefit.

4. The preservation of historically important land or a certified historic structure.\textsuperscript{66}

Once the landowner has established the qualified real property interest, selected the eligible organization, and satisfied the conservation purposes test, she will qualify for the charitable income tax deduction allowed by §170(h).

\textsuperscript{63} I.R.C. §170(c)(2)(B) (West Supp. 1999). The category of eligible donees includes corporations, trusts, community chests, funds, and foundations organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals. \textit{Id.} A list of qualified donees is available on the IRS World Wide Web site at \url{http://www.irs.ustreas.gov/search/eosearch.htm}. 5 U.S. TAX REP. (RIA) ¶ 1704.21, at 22,729.

\textsuperscript{64} SMALL, supra 52, at 38-39. There are beneficial tax consequences in setting up a private foundation, as contributions to a private foundation during lifetime are deductible and subject to charitable deduction rules. Further, testamentary gifts to private foundations are not subject to estate tax. \textit{Id.} at 74.

\textsuperscript{65} Treas. Reg. § 1.170-14(c)(1)(1999).

The Requirements of a Conservation Easement for the Estate Tax Exclusion of IRC § 2031

After the requirements of IRC § 170(h) have been met, the landowner then must satisfy the additional requirements of IRC § 2031. This section allows an estate tax exclusion for land subject to a "qualified conservation easement."67 Land subject to a "qualified conservation easement" is defined as land, which on the date of the decedent’s death is:

1. located in or within 25 miles of an area which is a metropolitan area68;
2. in or within 25 miles of an area which is a national park, or wilderness area designated as a part of the National Wilderness Preservation System; or;
3. in or within 10 miles of an area which is an Urban National Forest.69

The decedent, or a member of the decedent’s family, must have owned the land for at least three years prior to the decedent’s death. Additionally, the decedent, a member of the decedent’s family, trustee of a trust, or the executor of the decedent’s estate must have donated the easement.70 The ability to donate a conservation easement is an important tool for Wyoming landowners because of the hundreds of acres of wilderness land in Wyoming.71

68. The Office of Management and Budget defines the term “metropolitan area” to mean large cities, surrounding suburbs, and other areas. McLaughlin, supra note 29, at 267. A list of metropolitan areas can be obtained from the U.S. Department of Commerce, Technology Administration, National Technical Information Service, 5285 Port Royal Road, Springfield, Virginia 22161 or on-line at http://www.whitehouse.gov/OMB/bulletins/95-04.html. Id.
71. The wilderness areas are listed in 16 U.S.C.A. § 1132 (West 1985 & Supp. 1999). The wilderness areas in Wyoming are:
Bridger Wilderness, Bridger National Forest
Cloud Peak Wilderness, Bighorn National Forest
Encampment River Wilderness, Medicine Bow National Forest
Fitzpatrick Wilderness, Shoshone National Forest
Gros Ventre Wilderness, Bridger-Teton National Forest
Huston Park Wilderness, Medicine Bow National Forest
Jedediah Smith Wilderness, Targhee National Forest
North Absaroka Wilderness, Shoshone National Forest
Platt River Wilderness, Medicine Bow and Routt National Forests, Wyoming and Colorado
Popo Agie Wilderness, Shoshone National Forest
Savage Run Wilderness, Medicine Bow National Forest
South Absaroka Wilderness, Shoshone National Forest
Teton Wilderness, Teton National Forest
Rights Kept vs. Rights Given Away

When donating a conservation easement, the landowner will necessarily be concerned about what rights he has kept and what rights he has given away. The conservation easement represents a conveyance of development rights from the landowner to a qualified organization. Therefore, the landowner retains "reserved rights," which can include farming, ranching, and other agricultural activities.

Congress subjects any development rights kept by the landowner to estate tax. A development right is defined as any right that, "is retained for any commercial purpose which is not subordinate to and directly supportive of the use of such land as a farm and for farming purposes. . . ." If development rights are retained in the easement, they are not subject to estate tax if the decedent’s heirs agree to permanently extinguish those rights within nine months of the decedent’s death. The heirs can agree to extinguish only a portion of the development rights, but any rights they keep will be subject to estate tax.

The terms of the easement must prohibit "all but 'de minimis' commercial recreational activities." Activities such as granting hunting and fishing licenses have generally been considered "de minimis" commercial recreational activities, which are consistent with the conservation purpose. Although the IRC contains no current definition regarding what constitutes a "de minimis" activity; it is anticipated that the Secretary of the Treasury may provide guidance in the near future.

When a landowner is considering alternatives, she may not want to give away all development rights when she donates the easement. Depending on the size of the property, it may be prudent to set aside parcels for future development. For example, assume John and Jane’s property consists of 500 acres. If they set aside three, five-acre parcels for development, they will still realize substantial tax savings (estate and income) with

Washakie Wilderness, Shoshone National Forest
Winegar Hole Wilderness, Bridger-Teton National Forest
72. SMALL, supra note 52, at 23–24.
74. I.R.C. § 2031(c) (West Supp. 1999).
76. I.R.C. § 2031(c)(5)(D) (West Supp. 1999). The estate tax is due nine months after the decedent’s death. The rights do not have to be extinguished within nine months, "the heirs have nine months to agree to extinguish them, and then have up to two years after the decedent’s death to extinguish those rights." Id.
79. See Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in 1997 (JCS-23-97) (12/17/97).
80. 1 FED. EST. & GIFT TAX REP. (CCH) ¶ 3185.10, 15,082.

https://scholarship.law.uwyo.edu/land_water/vol35/iss1/6
the donation of a conservation easement on the remaining parcels. Furthermore, the reserved lots could be used in the future by John and Jane’s children for home sites or sold to help pay the estate taxes. By utilizing prudent planning, this could be a viable alternative for the landowner.

Why the Donation of A Conservation Easement Can Help the Landowner

The use of conservation easements is an important tool for the Wyoming landowner for several reasons. As agricultural land continues to be developed, the need to preserve and protect vanishing open spaces increases. Also, the value of land has risen dramatically in the last decade. Often, the increased value of the land is not recognized by the family and its advisor until the estate tax is due. The rate of estate taxes remains high and many landowners are in the position of being “land rich and cash poor.” Emphasis on early planning by the landowner will enable him to “preserve the land and to have a manageable estate tax bill.” Utilizing conservation easements is an important planning strategy for the Wyoming practitioner in helping the client to reach his goals.

1. Income Tax Savings

The landowner is able to take an income tax deduction “for the value of a conservation easement that is given to a qualified charitable organization.” “If the requirements of §170(h) are met, a landowner who donates a conservation easement will be deemed to have made a charitable gift and will be entitled to a charitable income tax deduction.” The charitable deduction, allowed by Congress, is equal to the fair market value of the easement at the time of the donation. The fair market value of the easement is based on the sales price of comparable easements, if there is a substantial record of such easements. If there is no substantial record of comparable easements, the fair market value of the easement will be equal to the fair market value of the property before the easement, less the fair market value

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81. SMALL, supra note 1, at 51-54.
82. Id. at 7-8.
83. SMALL, supra note 1, at 7-8.
84. Id.
85. SMALL, supra note 52, at 27.
86. The qualified conservation contribution tests of §170(h) is explained at supra, Section (III(A)(3).
88. Treas. Reg. § 1.170A-14(h)(3)(i) (1999). The treasury regulation further states that the determination of the fair market value of the property before contribution must take into account the current use of the property and an “objective assessment of how immediate or remote the likelihood is . . . that the property would in fact be developed.” Id. The practitioner must also consider the “effect from zoning, conservation, or historic preservation laws that already restrict the properties potential highest and best use.” Id. Further, a grant may have no material effect on the value of the property or may serve to enhance rather than reduce the value of the property. In such instance, no deduction would be allowed. Id.
of the property after the easement.\textsuperscript{90} The fair market value of the property usually is decreased after the donation of a conservation easement due to the restrictions on development and other uses of the property.\textsuperscript{91}

The value of the gift is allowed as a charitable deduction. The amount of the deduction cannot exceed thirty percent of the donor's adjusted gross income for the year of the donation.\textsuperscript{92} \textquotedblright The donor may carry forward any unused deduction for up to five years after the year of the donation until the deduction is fully used.\textquotedblright \textsuperscript{93} The following example will help to illustrate the tax savings:\textsuperscript{94}

John and Jane Doe have donated an easement, which reduced the value of the Green River Ranch from $2,000,000 to $700,000. Their adjusted gross income is $180,000 a year. The Doe's have $40,000 in other itemized deductions.

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\textbf{WITHOUT THE DONATION} \\
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\textbf{Year 1} & \\
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Adjusted Gross Income: & $180,000.00 \\
Deductions: & $40,000.00 \\
Taxable Income: & $140,000.00 \\
\hline
Tax Due: & $35,928.50\textsuperscript{95} \\
Total Tax Due Over Six Years: & $215,571.00 \\
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\textsuperscript{90} Id.
\textsuperscript{91} McLaughlin, supra note 29, at 253.
\textsuperscript{93} McLaughlin, supra note 29, at 256.
\textsuperscript{94} SMALL, supra note 52, at 28-29.
\textsuperscript{95} This number is calculated using I.R.C. § 1(a)(2). This is a simplified example to show tax consequences. In reality, the taxpayers may have other deductions.
WITH THE DONATION

<table>
<thead>
<tr>
<th>Year 1</th>
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<tbody>
<tr>
<td>Adjusted Gross Income:</td>
<td>$180,000.00</td>
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<tr>
<td>Deduction:</td>
<td>$94,000.00*</td>
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<tr>
<td>Taxable Income:</td>
<td>$86,000.00</td>
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<tr>
<td>Tax Due:</td>
<td>$19,283.00</td>
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<tr>
<td>Total Tax Due Over Six Years:</td>
<td>$115,698.00</td>
</tr>
<tr>
<td>Income Tax Savings (over six years):</td>
<td>$99,873.00</td>
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Obviously, John and Jane will realize a substantial tax savings by utilizing their charitable deduction.

The donor also must reduce his basis in the retained property interest by the amount of the total adjusted basis allocable to the contributed conservation easement. The landowner’s basis in the property must be changed to reflect the donation of the conservation easement. The percent of the landowner’s basis to the fair market value of the land is multiplied by the fair market value of the easement, with the resulting figure being the amount of basis allocable to the easement.

The following example illustrates this calculation:

John and Jane have a basis in the Green River Ranch of $40,000. The fair market value of the ranch is $2,000,000. They donated a conservation easement to a qualified organization. The easement’s fair market value equals $1,300,000. The amount of basis allocable to the easement is $26,000 ($40,000/$2,000,000 = 0.02%, 0.02% x $1,300,000 = $26,000). Accordingly, the basis of the property is reduced to $14,000 ($40,000 - $26,000).

The calculation results in the reduction of the landowner’s basis in the property. A reduction in basis will mean added gain upon sale of the property.

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96 The charitable income tax deduction is limited to 30 percent of the adjusted gross income (AGI). I.R.C. § 170(b)(1)(B)(i)(West Supp. 1999). We will assume John and Jane’s other deductions are not charitable. Therefore the total deduction allowed is $40,000 (their regular deductions) + $54,000 (30% of $180,000) = $94,000 (total deductions allowed).


99 McLaughlin, supra note 29, at 255.
erty. However, the proceeds from the sale will be much less due to the reduction in value of the property. If the landowner holds the property until death, the basis in the property will be the date-of-death value which will reflect the easement donation.

2. Estate Tax Savings

In this decade, pressures have increased on owners of undeveloped real estate to sell their land to commercial developers. Prior to the Taxpayer Relief Act of 1997, the landowner’s options were limited for keeping the land preserved for future generations. A donation of a conservation easement would reduce the value of the land in the gross estate, thereby reducing taxes. The estate tax exclusion for a donation of conservation easement, added by the Act, is an additional valuable tool for the landowner. "The law makes the exclusion available for an easement donated by a decedent’s executor or trustee, even though the decedent failed to donate the easement before his or her death." Indirectly, this Act also helps to preserve environmentally and aesthetically significant lands.

a. Calculating the Exclusion Amount

When calculating the estate tax, the property itself is included in the gross estate. In general, the value included in the gross estate is fair market value of the property reduced by the amount of the conservation easement. The estate then is entitled to an exclusion, which “is a tax benefit which reduces the estate tax liability in the same manner as a deduction.” The amount of the exclusion is determined in accordance with I.R.C. § 2031(c). According to the statute, the portion of the value of the land subject to a qualified conservation easement that may be excluded from the decedent’s taxable estate is the lesser of:

the Applicable Percentage of the value of the land subject to a qualified conservation easement, reduced by the amount of any §
2055 deduction\textsuperscript{108} with respect to the land; or the exclusion limitation.\textsuperscript{109}

b. The Applicable Percentage

The Applicable Percentage is defined as "40% reduced, (but not below zero) by two percentage points for each percentage point (or fraction of a percentage point) by which the value of the qualified conservation easement is less than 30% of the value of the land."\textsuperscript{110} The land is valued without regard to the value of the easement (the Without-Easement Value) and by subtracting the value of any retained "development right."\textsuperscript{111} The following example will help illustrate this concept:

The landowner grants a conservation easement and retains the right to use the land for a commercial purpose. This retained development right has a value of $25,000. The conservation easement is also valued at $25,000. The land is valued at $125,000 before the easement donation. Thirty percent (30%) of the value of the land would be excluded from the value of the gross estate. The percent is calculated as follows:

1. Subtract the value of the development rights from the land value. $125,000 - $25,000 = $100,000.
2. Calculate the value of the land after the value of the retained development interest is subtracted. Then divide the value of the conservation easement by the land value just determined. $25,000/$100,000 = 25%.
3. Calculate the exclusion percentage. 40% - (2 x (30% - 25% [see #2]) = 30%.\textsuperscript{112}

The Applicable Percentage rule is complicated and intended to discourage "marginal" easements that do not reduce the land value significantly,\textsuperscript{113} which would occur if, for example:

Landowner had property valued at $1,000,000.00 The easement reduced the value of the land to $900,000.00 Because this 10% reduction in value is twenty percentage points less than 30%, the ex-

\textsuperscript{108} Section 2055 provides for a charitable estate tax reduction. An estate is entitled to the benefit of both the § 2055 reduction and the § 2031 exclusion.

\textsuperscript{109} I.R.C. §2031(c) (West Supp. 1999). The exclusion limitation is defined by I.R.C. §2031(c)(3) (West Supp. 1999).

\textsuperscript{110} I.R.C. §2031(c)(2) (West Supp. 1999).

\textsuperscript{111} Id.

\textsuperscript{112} 1 U.S. TAX REP. EST. & GIFT TAX (RIA) ¶20,314.13, 2588B-1.

\textsuperscript{113} SMALL, supra note 1, at 110. This result should not discourage the landowner whose goal is conservation and not tax savings.
clusion is reduced from 40% to 0 (two percentage points for each point the easement fails to reduce the land value by 30%).


c. The Exclusion Limitation

Congress caps the amount a decedent’s estate can claim as an estate tax exclusion for a donation of a conservation easement. The exclusion limitation is determined using the following table as set in IRC § 2031(c)(3).

<table>
<thead>
<tr>
<th>If decedents die during:</th>
<th>The exclusion limitation is:</th>
</tr>
</thead>
<tbody>
<tr>
<td>1998</td>
<td>$100,000</td>
</tr>
<tr>
<td>1999</td>
<td>$200,000</td>
</tr>
<tr>
<td>2000</td>
<td>$300,000</td>
</tr>
<tr>
<td>2001</td>
<td>$400,000</td>
</tr>
<tr>
<td>2002 or thereafter</td>
<td>$500,000</td>
</tr>
</tbody>
</table>

EXAMPLE: A landowner has property with a value of $1,000,000. She donates a qualified conservation easement, reducing the value to $700,000 and retains no development rights. Landowner dies in 1999. At the time of death the land is still valued at $700,000 and the conservation easement is still valued at $300,000. Because the value of the easement is equal to 30% of the Without-Easement Value of the land, the easement satisfies the 30% threshold test and the Applicable Percentage is not reduced from 40%. Accordingly, the exclusion amount is equal to $200,000 (which is the lesser of (1) 40% x $700,000 = $280,000 and (2) the 1999 exclusion limitation of $200,000).

d. Treatment of Debt Financed Property

Additional consideration must be given to property encumbered by a mortgage. The estate tax exclusion for qualified conservation easements does not apply to the extent that the land is debt-financed property. The IRC defines “debt-financed property” to mean there is acquisition indebtedness on the property on the date of the decedent’s death. “Acquisition indebtedness” is defined as the unpaid amount of:
(1) the indebtedness incurred by donor in acquiring the property;
(2) the indebtedness incurred before acquisition of the property if the indebtedness would not have been incurred but for the acquisition;
(3) the indebtedness incurred after acquisition of the property if the indebtedness would not have been incurred but for the acquisition and the incurrence of the indebtedness was reasonably foreseeable at time of such acquisition; and
(4) the extension, renewal or refinancing of any acquisition indebtedness. 118

EXAMPLE: A dies owning a property valued at $1,000,000 on which he placed a conservation easement. The property is subject to an outstanding debt balance of $100,000. To determine the exclusion for a qualified conservation easement the property is treated as a $900,000 property that is not debt financed ($1,000,000 - $100,000 = $900,000). 119

e. Basis

Congress generally allows a “step-up” in basis to the fair market value of the property, when the property is acquired from a decedent. 120 The “step-up” in basis is not allowed where the decedent has benefited from a qualified conservation easement. 121 Congress’ intent was to prevent the “beneficiaries of land subject to a qualified conservation easement from benefiting from both the exclusion and the basis step-up rule.” 122 The beneficiaries’ basis in the property will be the same as the basis of the property in the hands of the decedent. 123

f. Property Tax Savings

As illustrated throughout this comment, the gift of a conservation easement generally will lower the property valuation. This, in turn, should result in a lower property tax assessment by a similar percentage. However, the assessment is determined by the local assessor. 124 In Wyoming, local assessors have been responsive to the conservation easement and assess property with a value reflecting the easement. 125 However, the land may already be subject to a lower property tax assessment due to an agricultural

119. 1 U.S. Tax Reporter Estate & Gift Tax, supra note 9, at ¶20,314.13, 2588B-1.
122. McLaughlin, supra note 29, at 259.
124. SMALL, supra note 52, at 31.
125. Telephone interview with Suzanne Olmstead, Teton County Assessor (July 26, 1999).
valuation. In this case, the property tax would not be further reduced by the donation of a conservation easement.

How to Set Up a Conservation Easement

Once a landowner decides a conservation easement is the proper tool to accomplish his goals, the next step is establishment. The landowner first should seek out a competent advisor, usually an attorney, who can answer questions and oversee the process. Several steps are involved in donating a conservation easement. First, the landowner must decide which organization will receive the donation. Second, the property must be appraised and surveyed. Third, the title to the land must be checked, as well as the title to any mineral or water rights. Finally, the landowner must make the tax election in order to take advantage of the tax savings.

1. Qualified Charitable Organizations

"A conservation easement no matter how expertly crafted, cannot alone protect important land or historical resources—only the easement holder’s excellent stewardship can." Thus, the landowner must carefully choose the recipient of the easement. The landowner also must remember that in order for the gift to be tax deductible, the easement must be donated to a unit of government or a qualified charitable organization.

A qualified charitable organization can be either local or national. Most national organizations have regional offices. Some of the national organizations include The Nature Conservancy, the Trust for Public Lands, the Audubon Society, Ducks Unlimited, the Rocky Mountain Elk Foundation, and the American Farmland Trust. These organizations perform services associated with land trusts. "Most land trusts around the country have as their primary purposes the protection of locally important open space, wildlife habitat, scenic property, farmland, forestland or ranchland.” Over one thousand land trusts nationwide have helped to protect more than four million acres. When a land trust accepts a dona-

126. WYO. STAT. ANN. § 39-13-103(b)(x) (Lexis 1999). "Agricultural land" is land which has been used for the previous two years and is still being used " for the primary purpose of obtaining a monetary profit as agricultural or horticultural use." WYO. STAT. ANN. § 39-13-101(a)(iii) (Lexis 1999).
128. SMALL, supra note 1, at 61.
129. Id. at 62.
130. Id.
131. Id. The Jackson Hole Land Trust, located in Jackson, WY, is an example of a local land trust.
132. LAND TRUST ALLIANCE, CONSERVATION OPTIONS A LANDOWNERS GUIDE 5 (1999). A land trust is private, non-profit organization that protects land directly by accepting donations of easements or in some instances purchasing the land outright. Id. at 50.
133. SMALL, supra note 52, at 37.
134. LAND TRUST ALLIANCE, supra note 132.
tion of a conservation easement, the trust assumes the "legal responsibility of permanently protecting the property's conservation resources."135

A conservation easement also may be contributed to a government agency.136 Government agencies that accept donations of conservation easements include recreation, park or wildlife agencies, conservation commissions, and open space districts.137 A landowner can either work directly with these agencies or ask a land trust for help in working with them.138

When choosing an organization to be the recipient of the conservation easement, the landowner should remember he is giving the organization the "job of monitoring and enforcing the terms of the conservation easement in perpetuity."139 The organization will monitor the easement by inspecting the land on a regular basis and will take action in the event of any violation.140 The landowner should ensure the donee organization has the resources and the knowledge to protect the easement.141 Furthermore, the landowner should investigate whether the land trust has adopted the Land Trust Standards and Practices.142 "The Standards and Practices guides land trusts in operating legally and ethically and in conducting sound land trans-
action and stewardship programs."143

2. Land Planner or Consultant

The landowner should consult a land planner or consultant if he plans to reserve part of the land for development.144 The land planner can provide assistance in determining which parcels of the property should be reserved for future development. The landowner should choose a planner who is "sensitive both to environmental and open space concerns and to the tax law's requirements for the deductibility of an easement donation."145 The land planner will help provide ideas for conservation minded development

135. Id. at 51.
136. An example of a local government agency, which accepts donations of conservation easements is the Wyoming Game and Fish Commission. The department considers "acquiring only those rights needed to protect or enhance defined wildlife or resource values." Dave Hunt, Conservation Easements and Donations for Tax Deductions, HABITAT EXTENSION BULLETIN, JANUARY 1994, at 2.
137. Id. at 37.
138. Id.
139. SMALL, supra note 52, at 37.
140. LAND TRUST ALLIANCE, supra note 132, at 11. Land trusts generally inspect the property on a yearly basis. They also protect the easement in court. Because these permanent responsibilities result in a monetary expense, the easement donee may request a monetary donation to help offset the costs of defending the easement. Id.
141. Id. at 36-37.
142. Id. at 52.
143. Id. The Land Trust Standards and Practices were developed by the Land Trust Alliance in 1989. A copy of the Standards and Practices can be found at the Land Trust Alliance's web site at http://www.lta.org/standard.htm.
144. SMALL, supra note 1, at 66.
145. Id. at 67.
with minimum intrusion on the property. Land trusts and other charitable organizations can provide recommendations if the landowner requires the services of a land planner.

3. Appraiser

Hiring an appraiser is mandatory if the landowner expects a charitable deduction for his contribution of the qualified conservation easement. Congress requires a “qualified appraisal” of any charitable contribution of property with value over five thousand dollars, or the gift may be disallowed. The “qualified appraisal” must be made no earlier than sixty days before the date of contribution and no later than the due date of the return in which the deduction is first claimed. “The appraisal must be prepared, signed and dated by a qualified appraiser.” A qualified appraiser cannot be; (1) the donor; (2) a party to the transaction in which the donor acquired the property; or (3) the donee or any person employed by, related to or married to, any of the aforementioned people. A good appraisal is vital as “in an audit with the IRS, the qualifications of the appraiser and the thoroughness of the appraisal can be very important factors.”

4. Survey

The donee organization likely will require a recent survey of the property. A survey is done to clarify the boundaries of the donated property

146. Id.
147. Id.
148. Id. at 65.

1. A description of the property in enough detail so that a person not generally familiar with the type of property can tell that the property appraised is the property contributed;
2. The physical condition of any tangible property;
3. The contribution date;
4. The terms of any understanding between the donor and donee relating to the use, sale, or other disposition of the contributed property;
5. The qualified appraiser’s name, address, and if otherwise required by I.R.C. § 6109, taxpayer identification number;
6. The qualified appraiser’s qualifications, including background, experience, education and membership in professional associations;
7. A statement that the appraisal was prepared for income tax purposes;
8. The date when the property was appraised;
9. The appraised fair market value of the property on the contribution date;
10. The valuation method used; and
11. The specific basis for the valuation.
151. 5 U.S. TAX REP. (RIA) ¶ 1704.51, 22,746A.
153. SMALL, supra note 1, at 66.
154. Id. at 68.
property.\textsuperscript{155} The boundaries should be identified at the time the easement is acquired,\textsuperscript{156} as the donee will use this information to monitor encroachments.\textsuperscript{157} However, the survey may be performed at a later date.\textsuperscript{158}

5. Clear Title and Mineral Rights

In general, a landowner must have clear title to the property in order to donate a conservation easement.\textsuperscript{159} If the land is encumbered by a mortgage, the mortgagee must agree that foreclosure on the mortgage will not extinguish the easement.\textsuperscript{160} Also, as discussed previously,\textsuperscript{161} the landowner either must own the mineral rights for the property or satisfy certain conditions. The landowner should research the ownership of the mineral rights. Even where the landowner has held the property for many years, it would be prudent to check the title for any encumbrances.\textsuperscript{162} The landowner may be unaware of liens or prior conveyances of mineral rights affecting the title.\textsuperscript{163} Many problems with the title may be solved after the fact; however, early detection of the problem is preferable.\textsuperscript{164}

6. Election

The election for the income tax deduction allowed under I.R.C. § 170(h), must be made on the income tax return for the year the donation was given. A donor must comply with three substantiation requirements when claiming an income tax deduction for a charitable contribution.\textsuperscript{165} These requirements are 1) to obtain a qualified appraisal (as previously defined), 2) to include a fully completed appraisal summary with the tax return, and 3) to maintain records containing donation information.\textsuperscript{166}

The executor must elect to take the estate tax exclusion allowed by IRC § 2031(c) on the estate tax return.\textsuperscript{167} The election must be made by the due date for filing the estate tax return.\textsuperscript{168} The estate tax return is due nine months from the date of the decedent’s death.\textsuperscript{169} The estate tax exclusion is available for an “easement donated by a decedent’s executor or trustee even

\textsuperscript{155} Id.
\textsuperscript{156} Id.
\textsuperscript{157} LAND TRUST ALLIANCE, supra note 132, at 12.
\textsuperscript{158} Id.
\textsuperscript{159} I.R.C. § 1.170A-14(a) (West Supp. 1999).
\textsuperscript{160} Treas. Reg. §1.170A-14(g)(2) (1999).
\textsuperscript{161} See notes 58-62 and accompanying text.
\textsuperscript{162} SMALL, supra note 52, at 110-11.
\textsuperscript{163} SMALL, supra note 52, at 110-11.
\textsuperscript{164} Id.
\textsuperscript{165} Id.
\textsuperscript{167} Treas. Reg. § 1.170A-13(c)(2)(i)(A-C) (1999). The required contents of the appraisal summary are provided on IRS Form 8283 (1/92) and at 5 U.S. TAX REP. (RIA) ¶ 1704.51, 22,747.
\textsuperscript{168} I.R.C. § 2031(c)(1) (West Supp. 1999).
\textsuperscript{169} I.R.C. § 2031(c)(6) (West Supp. 1999).
though the decedent failed to donate the easement before . . . death.\textsuperscript{170} This exclusion can be elected "in addition to the [IRC] § 2032A special use valuation and [IRC] § 2057 qualified family owned business deduction."\textsuperscript{171} Using these provisions together can result in substantial tax savings for the estate.

7. Extinguishing the Easement

In general, easements may be extinguished by private mutual agreement between the parties to the easement.\textsuperscript{172} However, Congress provided in the Treasury Regulations that conservation easements are extinguishable only by a judicial proceeding.\textsuperscript{173} The circumstances that might justify extinguishment include a "change in conditions surrounding the property" that makes the conservation purpose "impossible or impractical."\textsuperscript{174} The terminology of the regulation is confusing at best.\textsuperscript{175} The traditional rule under property law is that easements can be terminated only if their purposes become "impossible" to accomplish.\textsuperscript{176} The regulations refer to the "changed conditions" doctrine, which sets a lower threshold for extinguishment.\textsuperscript{177} This doctrine foreseeably could be used to terminate a conservation easement on the grounds of economic hardship.\textsuperscript{178} Increased economic development and rising property values surrounding the property could result in extinguishment of the easement.\textsuperscript{179} This result would be contrary to the landowner's original goal of preservation. To correct the ambiguity of the regulations, the Land Trust Alliance has provided a Model Conservation Easement that "assumes the impossibility standard is the correct one to apply to conservation easements."\textsuperscript{180}

The courts have yet to interpret the regulation language regarding extinguishment.\textsuperscript{181} Thus, the drafter of the easement needs to be aware of the

\begin{footnotesize}
\begin{enumerate}
\item [170.] Dietrich, supra note 59, at 48.
\item [171.] Id.
\item [172.] THOMAS S. BARRETT & STEFAN NAGEL, MODEL CONSERVATION EASEMENT AND HISTORIC PRESERVATION EASEMENT, 1996 71 (1996).
\item [174.] BARRETT & NAGEL, supra note 172, at 71. If there is a subsequent unexpected change in the conditions surrounding property that is subject to a conservation easement, which makes it impossible or impractical to continue using the property for conservation purposes, the conservation purpose can be treated as continuing in perpetuity if the restrictions are extinguished by judicial proceeding and all of the donee's proceeds from subsequent sale or exchange of the property are used by the donee organization in a manner consistent with the conservation purposes of the original contribution. Treas. Reg. § 1.170A-14(g)(6)(i). "Proceeds" are defined by Treas. Reg. §1.170A-14(g)(6)(ii) (1999).
\item [175.] BARRETT & NAGEL, supra note 172, at 71.
\item [176.] Id.
\item [177.] Id. Presumably the Regulations could not control the state courts regarding extinguishment of an easement, as this is a property law issue.
\item [178.] Id.
\item [179.] Id. at 71-72.
\item [180.] Id. at 72.
\item [181.] BARRETT & NAGEL, supra note 172, at 71.
\end{enumerate}
\end{footnotesize}
ambiguities in the regulation and, therefore, choose his words wisely.\textsuperscript{182} The courts generally give added weight to the intent of the original parties to the easement.\textsuperscript{183} Hence, some drafters have added language “to indicate that economic hardship has been considered and rejected as a potential ground for termination.”\textsuperscript{184}

\textit{Alternatives to the Conservation Easement}

There are several alternatives to the donation of a conservation easement. These alternatives include the life gift, the cash sale, the like-kind exchange, the § 2057 family owned business deduction and § 2032A special use valuation. These alternatives are important, as the practitioner may be faced with a client who is resistant to the idea of donating a conservation easement. The practitioner should note that some alternatives would save estate tax, but not protect the land; whereas, others would protect the land, but not reduce estate tax. The client should be aware of the available alternatives in order to make an informed decision regarding his estate plan.

1. The Life Gift

A landowner simply cannot sign his property over to his children in hopes of avoiding estate tax, particularly if the landowner continues to reside on the property.\textsuperscript{185} Congress took the position that if the owner gives away the property, “but retain[s] the right to use or enjoy that property, the value of the property will be included in [the] estate at . . . death.”\textsuperscript{186} Congress based its reasoning on the proposition that the property owner truly has not given the property away if he retains the rights of continued use and enjoyment.\textsuperscript{187} The landowner will also incur gift tax liability on the transfer to the children.\textsuperscript{188}

If the landowner gives away the property and does not continue to reside on the property, the value of the property is no longer in the landowner’s estate.\textsuperscript{189} As a result, the landowner may incur substantial gift tax liabilities.\textsuperscript{190} However, Congress did provide for tax-free life gifts.\textsuperscript{191} Generally, a person can give away ten thousand dollars a year, per donee, before

\textsuperscript{182} Id. at 71-72.
\textsuperscript{183} Id. at 72.
\textsuperscript{184} Id.
\textsuperscript{185} SMALL, supra note 1, at 45-46.
\textsuperscript{186} Id. Remember that the marital deduction would allow a spouse to transfer the property to the other spouse without any tax consequences. See generally I.R.C. § 2523 (West Supp. 1999); I.R.C. § 2056 (West Supp. 1999).
\textsuperscript{187} SMALL, supra note 1, at 46.
\textsuperscript{189} I.R.C. § 2503 (West Supp. 1999).
\textsuperscript{190} Id.
\textsuperscript{191} I.R.C. § 2503(b)(1) (West Supp. 1999).
incurring any tax liability.\textsuperscript{192} If spouses join in the gift, up to twenty thousand dollars a year, per-donee, may be given tax-free.\textsuperscript{193} Consequently, if the landowner gifts property valued in excess of the ten thousand dollars per donee limit in one year, the landowner is subject to a gift tax liability.\textsuperscript{194} In addition to allowing the ten thousand dollars per-donee annual exclusion, Congress permits individuals to claim an applicable exclusion.\textsuperscript{195} The applicable exclusion allows a taxpayer to transfer up to six hundred fifty thousand dollars\textsuperscript{196} of property during his lifetime or at death, without tax liability.\textsuperscript{197}

The landowner can utilize the annual exclusion and the applicable exclusion as an estate planning tool to keep rapidly appreciating property out of their estate. As an example, our landowners, John and Jane Doe, could give each of their children twenty thousand dollars worth of property each year, totaling sixty thousand dollars. In five years, John and Jane will have given away three hundred thousand dollars of the value of the property. If the land is worth five hundred thousand dollars now and increases in value at a rate of seven percent per year, in ten years the value of the property will have almost doubled.\textsuperscript{198} This plan result will keep a substantial part of the appreciated land out of John and Jane’s estates.\textsuperscript{199} However, if the property continues to appreciate, it may take longer to give it away in this manner. Another consideration is the life-gift will not prevent the children from selling or developing the property in the future.\textsuperscript{200}

The life-gift and conservation easement may be used in conjunction with one another. The landowner could donate a conservation easement on the property, which reduces the property value, generates an income tax deduction, and permanently protects the land.\textsuperscript{201} The landowner could then “begin a program of annual family gifts, in the end giving away [the property] in a shorter period of time.”\textsuperscript{202} This program would assist the landowner in meeting his goal of conserving the present condition and use of the property, while also utilizing tax exclusions to eliminate the land from his estate.

\textsuperscript{192} \textit{Id.}
\textsuperscript{193} SMALL, supra note 1, at 47.
\textsuperscript{194} I.R.C. §2503(b)(1) (West Supp. 1999).
\textsuperscript{195} I.R.C. § 2010 (West Supp. 1999); I.R.C. § 2505 (West Supp. 1999). The applicable exclusion was formally known as the Unified Credit.
\textsuperscript{196} The applicable exclusion is determined by the table in I.R.C. § 2010(c). The applicable exclusion amount will increase each year, until 2006 when it will reach $1,000,000. I.R.C. § 2010(c) (West Supp. 1999).
\textsuperscript{198} SMALL, supra note 1, at 48.
\textsuperscript{199} \textit{Id.} at 48-49.
\textsuperscript{200} \textit{Id.}
\textsuperscript{201} \textit{Id.} at 49.
\textsuperscript{202} \textit{Id.}
2. Cash Sale

Some landowners may feel the best alternative is to sell the land outright, which results in removing the property from his estate, thus avoiding estate tax. The landowner also may want the cash immediately. While the cash sale may appear a viable alternative, the landowner must realize that if the proceeds from the sale remain in his estate, estate tax has not been avoided.\textsuperscript{203} In addition, depending on his basis in the property, he may owe income tax on any gain that was recognized.\textsuperscript{204} The cash sale may not be a viable alternative if the landowner desires to keep the property in the family, as the family members may not have the funds to purchase the property.

3. § 2032A Special Use Valuation

The Taxpayer Relief Act of 1997 added additional protection for family-owned farms and businesses.\textsuperscript{205} The Act provides, "under certain circumstances, real property owned by a decedent as a farm or in a trade or business can be valued for estate tax purposes at its actual use, rather than its highest and best use."\textsuperscript{206} For the provision to apply, the "deceased owner and/or a member of the owner's family must materially participate in the operation of the farm or other business."\textsuperscript{207} The provisions of this statute are fairly complex and technical; however, utilization of this provision can result in substantial tax savings.

The tax benefits of the special use valuation provision may be combined with the conservation easement, resulting in additional tax savings.\textsuperscript{208} However, if the value of the land is severely diminished by the conservation easement, the estate might not meet the percentage test under § 2032A(b)(1).\textsuperscript{209} This section requires that the real property in the family-owned business must constitute twenty-five percent or more of the adjusted gross estate in order to use the deduction.\textsuperscript{210} With proper planning, the taxpayer has the potential to realize a large tax benefit. Also, if the heirs do not comply with the requirements of § 2032A, the estate tax savings will be recaptured.\textsuperscript{211} The recapture should serve to provide a disincentive for the heirs to change the use of the land.

\textsuperscript{203} I.R.C. § 2033 (West Supp. 1999).
\textsuperscript{204} I.R.C. § 1001(a) (West Supp. 1999); I.R.C. § 1011 (West Supp. 1999).
\textsuperscript{205} I.R.C. § 2032A (West Supp. 1999).
\textsuperscript{206} Sawyer, supra note 6, at 75.
\textsuperscript{207} Treas. Reg. §20.2032A-3(a) (1999). Determination of material participation "is a factual determination, and the types of activities and financial risks which will support such a finding will vary with the mode of ownership of the property itself and of any business in which it is used." \textit{Id}
\textsuperscript{208} SMALL, supra note 1, at 114-115.
\textsuperscript{209} Sawyer, supra note 6, at 75.
\textsuperscript{210} \textit{Id}
\textsuperscript{211} I.R.C. § 2032A(c) (West Supp. 1999).
4. § 2057 Qualified Family Owned Business Deduction

In an effort to protect small family owned businesses, Congress provided a deduction from estate tax for interests in qualified family owned businesses.212 The maximum allowable deduction under § 2057 is six hundred seventy-five thousand dollars.213 The § 2057 deduction must be used in conjunction with the unified credit, giving the taxpayer a maximum deduction of one million three hundred thousand dollars.214 A family owned business interest would qualify under this section if it is an active trade or business and one family owns at least fifty percent of the entity.215 The decedent or members of the decedent’s family must have owned the business interest and materially participated in the business for five of the eight years preceding the decedent’s death.216 The estate tax savings will be re-captured if, during the ten (10) years following the decedent’s death, any of the following events occur: (1) the heirs cease to materially participate in the business,217 (2) the heirs cease to be United States citizens or residents, (3) the heirs dispose of any portion of the business,218 or (4) the place of business ceases to be located in the United States.219

The new deduction in § 2057 provides a way for the small business owner to preserve family farms and other family-owned enterprises.220 The heirs will not be forced to liquidate the business to pay the estate taxes.221 The taxpayer electing to use the § 2057 deduction may also elect the § 2032A exclusion, thereby realizing substantial tax savings.222

5. Like-Kind Exchange

The Wyoming practitioner may encounter certain situations where the landowner is approached by a qualified charitable organization that wants to acquire a conservation easement on the landowner’s property.223 The landowner may think that the conservation easement is a good idea in general, but has no personal incentive to give an easement where he receives nothing

215. I.R.C. § 2057(c)(1) (West Supp. 1999). The Code also allows a deduction if at least 70% of the entity is owned by two families or at least 90% is owned by three families. Id. In both the 70% and 90% tests, the decedent and members of the decedent’s family must own at least 30% of the qualified family owned business interest. Id.
218. The heirs may dispose of the interest without penalty to a member of the qualified heir’s family or through a qualified conservation contribution under I.R.C. § 170(h) (West Supp. 1999).
221. Id.
222. Id.
in return. Indeed, he may even be asked to donate additional funds to the organization to defend the easement in later years. The Like-Kind Exchange under IRC § 1031 is an alternative from which all parties will benefit. The following illustration helps explain this concept:

Landowner has property, which includes an entire mountainside. A qualified charitable organization approaches landowner and asks him to donate a conservation easement. Their goal is acquiring property in an effort to preserve land for the scenic enjoyment of the public. Landowner does not plan to develop his mountainside and is certain that his children will use the land just as he has, for farming and ranching activities. However, landowner has no interest in reducing the value of his ranch by making a charitable contribution. The organization must now offer an incentive to the landowner, a Like-Kind Exchange. The organization offers landowner another property in exchange for the conservation easement on his current property. The result is that landowner continues to use his land just as he has always done, for farming, ranching, etc., with only minimal restrictions on the development rights of the property. In addition, landowner receives, from the organization, the property exchanged for the conservation easement and increases the size of his ranching operation. The organization gets the conservation easement it sought which satisfies the organization’s goals of scenic preservation.

The IRS has ruled that this type of exchange will qualify as a §1031(a), Like-Kind Exchange. Therefore, no gain or loss will be recognized on the exchange of property by the landowner.

CONCLUSION

The landowner can achieve several goals by utilizing the qualified conservation easement. The incentives for donation of a conservation easement include the realization of substantial income and estate tax savings and the preservation of land for the use and enjoyment of future generations. The landowner must give away a large portion of the value of his estate; however, by giving away some value now, the landowner avoids the consequence of selling the land to pay the estate tax and a large portion of the land’s value is kept out of his estate.

224. Id.
225. Id. However, there is no estate tax benefit for the use of the like-kind exchange.
226. Id.
Planning for the future is important for any landowner. The implementation of the conservation easement for tax saving purposes is complicated. The practitioner who wishes to utilize the conservation easement in this manner should further research this subject and the IRC, as being thoroughly prepared helps to avoid any problems with the IRS. When used wisely, the conservation easement is a valuable asset to the landowner. The conservation easement is just one of many tools that the practitioner can utilize in assisting his clients to achieve their estate planning goals.

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229. The are many resources available to the practitioner interested in conservation easements. One good place to start is the Land Trust Alliance. Their national office is located at 1319 F. Street, N.W., Suite 501, Washington D.C. 20004-1106 (phone: 202-638-4725; fax: 202-638-4730). The Land Trust Alliance can provide background literature and also help identify local land trusts and other conservation organizations. SMALL, supra note 1, at 62.