

**PRESIDENT SIGNS INTO LAW NEW CONSERVATION TAX INCENTIVES  
UNDER  
THE 2006 TAX ACT!!!**

By

Stephen J. Small, Esq.

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Today the President signed into law significant new tax incentives for land conservation. The changes apply to all **“qualified conservation contributions”** under Section 170(h) of the tax code. **“Qualified conservation contributions”** include (1) the gift of a remainder interest in land for conservation purposes; (2) a gift of the fee interest in real estate for conservation purposes with a reserved right to extract oil, gas, and subsurface minerals; and (3) the gift of a **“qualified real property interest,”** including a conservation easement. **This summary will focus on conservation easement gifts.**

Landowners and land trusts have been given wonderful new incentives to protect land. But remember that every conservation easement must meet the requirements of Section 170(h) of the tax code and every deduction must be based on a thorough, honest, realistic, clear appraisal, based on existing market conditions and a supportable analysis of land use possibilities.

Some landowners need to be reminded that they are not entitled to an income tax deduction for agreeing to build fewer houses on their land than they could under local zoning. They are entitled to an income tax deduction for **protecting important conservation values**. Under Section 170(h) of the tax code, every conservation easement must meet one of these “conservation purposes” tests:

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 for the scenic enjoyment of the general public, or pursuant to a clearly delineated governmental policy, which will yield a significant public benefit; and
4. the preservation of an historically important land area or a certified historic structure.

Stephen J. Small is recognized as the nation's leading authority on private land protection options and strategies. Before authoring the Federal Tax Law of Conservation Easements and Preserving Family Lands: Book I, Book II, and Book III, and he wrote the Federal Income Tax Regulations on Conservation Easements as attorney-advisor in the Office of Chief Counsel of the Internal Revenue Service.

Steve currently represents and advises numerous corporate, individual, and family owners on complex land planning for their properties. He also directs project teams on extensive and complex planning for maximum income tax benefits in connection with conservation easements. Steve advises government agencies and non-profits on leveraging land acquisition dollars.

In addition to representing clients and writing books, Steve Small also tours the United States delivering speeches and leading workshops on the importance of income tax and estate tax planning and land preservation.

Every conservation easement must clearly identify the purposes of the easement and the resources to be protected. Any reserved rights must be consistent with the protection of the conservation values of the property. And the donee land trust must have

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the commitment and the resources to enforce the terms of the restriction. Every donee land trust must adopt and follow LTA's Land Trust Standards and Practices. Every land trust must adhere to the letter and the spirit of the law. And finally, landowners and land trusts (and other donee organizations) need to watch out for promoters and appraisers who are trying to sell bad products, particularly including inflated appraisals. Congress and the IRS have been watching this field intensely for the last three years and the land trust community needs to continue to step up and do the job right.

## **BACKGROUND**

Under the "old" law, an individual could deduct the value of a conservation easement donation generally up [to] 30% of the donor's "contribution base" for the year, with a five-year carryforward of any unused amount. "Contribution base" is a technical tax term that means **adjusted gross income subject to certain adjustments** (which adjustments are not relevant for most landowners). So for shorthand we simply say **the deduction for individuals could be taken up to 30% of "adjusted gross income," or "AGI."**

Also under the old law, a conservation easement donated by a corporation could be deducted **only up to 10% of the corporation's taxable income for the year** (that is, of course, taxable income before taking the deduction), again with a five-year carryforward. **In particular, this very restrictive limitation on charitable contributions by corporate landowners has effectively "killed" countless potential conservation easement donations across the country.**

Gifts by cash or check by individuals are deductible up to 50% of the donor's AGI. This provision has not been changed by the new incentives.

## **THE NEW LAW**

**These new incentives apply to conservation easements donated in 2006 and 2007.** (Technically, the law says "contributions made in taxable years beginning after December 31, 2005, and before January 1, 2008"; this could be important for some corporate taxpayers that do not have a December 31 fiscal year.) To repeat, and this is important, **unless these new incentives are extended, they will only apply to easement gifts made in 2006 and 2007!!**

There are three important changes in the new law.

First, the value of a conservation easement donation can be deducted **up to 50% of an individual's AGI for the year of the gift.**

Second, there is a **15-year carryforward** of any unused deduction amount.

Third, there is an additional incentive in the case of a donation of a conservation easement by a **“qualifying farmer or rancher.”** A “qualifying farmer or rancher” **can be an individual or a corporation.** In certain cases, the deduction can be taken **up to 100%** of the donor's AGI for the year of the gift (that is, 100% of AGI if an individual, or 100% of taxable income in the case of a corporation), again **with a 15-year carryforward.**

At this very early point, there are some things we do not know about the new provisions but there are many things we do know, based on the terms of the statute and the report of the Joint Committee on Taxation. Any “final” word on what the statute means may have to wait until the Internal Revenue Service issues regulations, and that could take years. So here is a further discussion about these provisions, with two caveats.

First, this article is not intended to be tax or legal or financial advice. **Landowners should be advised in no uncertain terms to get advice from an experienced professional on what the new incentives mean in general and what they might mean in any specific case.**

Second, in that regard, landowners should be advised that there is absolutely **no substitute** for having a qualified tax professional “run the numbers” to determine what the tax consequences will be in their own individual cases. I have provided some very simplified spreadsheets to illustrate the potential income tax savings, but these are illustrative only and cannot be relied on in any individual situation.

### **THE 50% OF AGI LIMITATION AND THE 15-YEAR CARRYFORWARD**

One question that is likely to come up is what happens if an individual makes other charitable contributions, say a cash (or check) contribution to the alma mater, or has made other conservation easement donations in the past, and the individual is carrying forward the deductions from those gifts (such carryforward deductions from gifts in prior years are still subject to the 30% of AGI limitation). **When the conservation contribution can be taken up to 50% of an individual's AGI, here is how this provision works, according to the report of the Joint Committee on Taxation:**

“...assume an individual with a contribution base of \$100 makes a qualified conservation contribution of property with a fair market value of \$80 and makes other charitable contributions subject to the 50% limitation of \$60. The individual is allowed a deduction of \$50 in the current year for the non-conservation contributions (50% of the

\$100 contribution base) and is allowed to carryover the excess \$10 for up to 5 years. No current deduction is allowed for the qualified conservation contribution, but the entire \$80 qualified conservation contribution may be carried forward for up to 15 years.”

What this means is that if a donor has made contributions other than these new conservation contributions during the year, those contributions are taken into account first against the existing limitations. After those contributions are “used up” to the maximum allowable extent, then the conservation contributions are taken into account.

Here is another example. Say an individual has AGI of \$100, writes a check to the local land trust for \$40, and donates a conservation easement with a value of \$80. First the \$40 contribution is used up, then \$10 of the \$80 easement contribution is used up, for a total of \$50, that is, 50% of the individual’s AGI. There is a carryforward, for up to 15 years, of \$70 of the conservation easement contribution.

**This tax savings opportunity may be limited!!** Once again, although these incentives might be extended, they now apply only to easement gifts made in 2006 and 2007. A philanthropic donor should understand that even if she has “maxed out” her charitable gifts for this year, and even next year, a conservation easement donation made in this two-year window will carry forward for 15 years!! This opportunity might not be available in the future.

## **THE 100% RULE FOR QUALIFIED FARMERS AND RANCHERS**

Under the new law, there are two requirements for a landowner to be able to take advantage of this additional incentive.

First, the donor, whether an individual or a corporation, must be a “qualified farmer or rancher” (see below).

Second, the property must be used in agriculture or livestock production (or available for such production) and the easement must provide that the property remain available for such production.

If these two conditions are met, **the donor can take the deduction for a conservation easement up to 100% of the landowner’s AGI for the year (if an individual), or up to 100% of taxable income for the year (if a corporation), with a 15-year carryforward.**

A “qualified farmer or rancher” is a defined term: it means a taxpayer whose gross income from the business of farming (as defined under Section 2032A(e)(5) of the tax code) is greater than 50% of the taxpayer’s gross income for the taxable year in which the conservation easement is donated. This definition applies to individuals and to corporations. For purposes of this incentive, farming, ranching, other kinds of

agricultural activities, and forestry use will satisfy the requirements of the statute; I use the term “farming” here as shorthand.

As one example, a landowner (individual or corporate) who has \$50,000 of “gross income,” all of which comes from the business of farming, is a “qualified farmer or rancher.” A landowner with \$200,000 of gross income, \$40,000 of which is from ranching, is not. Again, landowners must check with their own advisors about whether or not they are eligible to take advantage of the 100% incentive.

The second requirement to be eligible for the 100% incentive is that the conservation easement must include a restriction that the property remain available for agricultural purposes.

According to the Joint Committee report, “There is no requirement as to any specific use in agriculture or farming, or necessarily that the property be used for such purposes, merely that the property remain available for such purposes.” (emphasis added) In other words, the conservation easement does not have to require that the property stay forever in agricultural use, but must include such agricultural activity as a reserved right.

Because this particular requirement was added to the statute late in the deliberations, it only applies to conservation easements donated after the date the statute becomes law. In other words, farming easements donated after December 31, 2005, and before August 17, 2006, apparently do not need to include this specific language to be eligible for the 100% deduction (although they almost certainly will include such language if the landowner plans to continue farming activities!!). At this early point, all of the ramifications of this requirement are not clear, but in the vast majority of farming and ranching situations it should be easy to satisfy this requirement with careful drafting in the conservation easement.

Note that apparently if an individual who is a “qualified farmer or rancher” donates a conservation easement that does not include this reserved right for continuing agricultural activities, the easement donation could still be taken up to 50% of AGI with a 15-year carryforward. For corporate donors, the “only” new incentive is the 100% incentive, and apparently both the “qualified farmer and rancher” and the “remain available for agriculture” requirements must be met.

**When the conservation contribution can be taken up to 100% of an individual’s AGI, here is how this provision works, again according to the Joint Committee report:**

Assume that a donor with a contribution base of \$100 makes a qualified conservation contribution with a value of \$80 and has made other cash or check contributions, subject to the existing 50% limitation, of \$60. In this case, the donor may take \$50 of the non-conservation contributions (that is, up to 50% of AGI), plus \$50 of the conservation contribution. The remaining \$10 of non-conservation contributions is

available, subject to the old (and existing) 5-year carryforward rules, and \$30 of the conservation contribution (\$80 minus \$50) is subject to the 15-year carryforward rule.

Or, assume an individual with \$100 of AGI writes a check to the alma mater for \$30, and donates a conservation easement with a value of \$100. The donor first deducts the \$30 contribution, then \$70 of the easement donation (up to a total of 100% of AGI). There is a \$30 carryforward, for up to 15 years, from the conservation easement donation.

Note that in many situations around the country, family farms or ranches have been owned by corporations, and up until the passage of this new law, as noted above, an easement donation by the corporation (or any other charitable contribution by the corporation, for that matter) could only be deducted up to 10% of the corporation's taxable income for the year, with a five-year carryforward of any unused deduction amount. **This is a very important new incentive for landowning corporations that meet the “qualified farmer or rancher” test of 50% of gross income coming from agricultural operations.**

## **OTHER OBSERVATIONS**

With the sole exception of the new rule that to be eligible for the 100% carryforward the property must remain available for agricultural purposes, there are **no changes** to any of the prior (and continuing) rules under Section 170(h) for qualifying easement donations.

Also note that any unused carryforward deduction (in the case of any charitable gift) “expires” with the death of the donor. Married couples that own land and want to take advantage of this extended carryforward should consult with their advisors about structuring their land ownership, and easement donation, to take this issue into consideration.

**Remember, once again, we are operating in an era of heightened scrutiny. This is all about understanding the rules and quality work!!**

## **SPREADSHEETS**

I have included on the following pages some spreadsheets to illustrate potential income tax savings for individuals based on the new tax incentives (the spreadsheets do not cover corporate donations). These spreadsheets may be of great interest to some people and no interest at all to others. All of the cases assume a married couple, filing jointly in 2006, with two exemptions. Please note these are very limited examples, with very limited variations, and are much simpler than most donor's tax situations will be in fact. But they do give us some useful information to start. Once again, any potential

donor should be directed to his or her tax advisor to “run the numbers” for any particular situation.

One of the reasons I wanted to run the spreadsheets is to determine whether the dreaded Alternative Minimum Tax (“AMT”) might somehow reduce the tax savings from these new incentives. (Very simply, you must calculate your regular tax, then you must calculate your alternative minimum tax, and pay whichever is higher.) This is a generalization, and it is always risky to generalize about the AMT or any tax calculations, but as you can see from the spreadsheets the AMT (see the entries under “Tentative Minimum Tax” when they appear at all) is almost never an issue in the limited scenarios covered by the spreadsheets.

The spreadsheets do not address state income tax issues. Also, new software is not yet available for the new conservation donation tax incentives, so I had to improvise a bit here and there to adapt. I believe these calculations are correct, however.

The spreadsheets begin on the next page.

Here is \$50,000 of income, no deductions:

Adjusted Gross Income	50,000
Itemized Deductions	0
Taxable Income	33,100
<b>Net Federal Tax</b>	<b>4,210</b>

Here is \$50,000 of income and a \$500,000 easement donation taken up to 30% of AGI:

Adjusted Gross Income	50,000
Itemized Deductions	15,000 (30% of AGI)
Taxable Income	28,400
<b>Net Federal Tax</b>	<b>3,505</b>

Here is \$50,000 of income, with a \$500,000 easement donation taken up to 50% of AGI:

Adjusted Gross Income	50,000
Itemized Deductions	25,000 (50% of AGI)
Taxable Income	18,400
<b>Net Federal Tax</b>	<b>2,005</b>

Here is \$50,000 of income, with a \$500,000 deduction taken up to 100% of AGI:

Adjusted Gross Income	50,000
Itemized Deductions	50,000 (100% of AGI)
Taxable Income	-6,600
<b>Net Federal Tax</b>	<b>0</b>

Here is \$100,000 of income, no deductions:

Adjusted Gross Income	100,000
Itemized Deductions	0
Taxable Income	83,100
AMTI Net of Exemption	37,450
Schedule or Table Tax	13,890
Tentative Minimum Tax	9,737
<b>Net Federal Tax</b>	<b>13,890</b>

Here is \$100,000 of income, with a \$500,000 easement deduction taken up to 30% of AGI

Adjusted Gross Income	100,000
Itemized Deductions	30,000
Taxable Income	63,400
AMTI Net of Exemption	7,450
Schedule or Table Tax	8,965
Tentative Minimum Tax	1,937
<b>Net Federal Tax</b>	<b>8,965</b>

Here is \$100,000 of income, with a \$500,000 easement deduction taken up to 50% of AGI:

Adjusted Gross Income	100,000
Itemized Deductions	50,000
Taxable Income	43,400
<b>Net Federal Tax</b>	<b>5,755</b>

Here is \$100,000 of income, with a \$500,000 deduction taken up to 100% of AGI:

Adjusted Gross Income	100,000
Itemized Deductions	100,000
Taxable Income	-6,600
<b>Net Federal Tax</b>	<b>0</b>

Here is \$200,000 of income, no deductions:

Adjusted Gross Income	200,000
Itemized Deductions	0
Taxable Income	149,950
AMTI Net of Exemption	167,500
Schedule or Table Tax	40,672
Tentative Minimum Tax	38,987
<b>Net Federal Tax</b>	<b>40,672</b>

Here is \$200,000 of income, with a \$500,000 easement donation taken up to 30% of AGI:

Adjusted Gross Income	200,000
Itemized Deductions	59,010
Taxable Income	134,390
AMTI Net of Exemption	77,450
Schedule or Table Tax	27,033
Tentative Minimum Tax	20,137
<b>Net Federal Tax</b>	<b>27,033</b>

Here is \$200,000 of income, with a \$500,000 easement deduction taken up to 50% of AGI:

Adjusted Gross Income	200,000
Itemized Deductions	99,010
Taxable Income	94,390
AMTI Net of Exemption	37,450
Schedule or Table Tax	16,713
Tentative Minimum Tax	9,737
<b>Net Federal Tax</b>	<b>16,713</b>

Here is \$200,000 of income, with a \$500,000 deduction taken up to 100% of AGI:

Adjusted Gross Income	200,000
Itemized Deductions	199,010
Taxable Income	-5,610
<b>Net Federal Tax</b>	<b>0</b>

Here is \$500,000 of income, no deductions:

Adjusted Gross Income	500,000
Itemized Deductions	0
Taxable Income	487,500
AMTI Net of Exemption	500,000
Schedule or Table Tax	143,876
Tentative Minimum Tax	136,500
<b>Net Federal Tax</b>	<b>143,876</b>

Here is \$500,000 of income, with a \$500,000 easement deduction taken up to 30% of AGI:

Adjusted Gross Income	500,000
Itemized Deductions	143,010
Taxable Income	354,790
AMTI Net of Exemption	337,450
Schedule or Table Tax	97,427
Tentative Minimum Tax	90,986
<b>Net Federal Tax</b>	<b>97,427</b>

Here is \$500,000 of income, with a \$500,000 easement deduction taken up to 50% of AGI:

Adjusted Gross Income	500,000
Itemized Deductions	243,010
Taxable Income	254,790
AMTI Net of Exemption	212,450
Schedule or Table Tax	64,062
Tentative Minimum Tax	55,986
<b>Net Federal Tax</b>	<b>64,062</b>

Here is \$500,000 of income, with a \$500,000 deduction taken up to 100% of AGI:

Adjusted Gross Income	500,000
Itemized Deductions	493,010
Taxable Income	4,790
AMTI Net of Exemption	0
<b>Net Federal Tax</b>	<b>479</b>

Here is \$1,000,000 of income, no deductions:

Adjusted Gross Income	1,000,000
Itemized Deductions	0
Taxable Income	987,500
AMTI Net of Exemption	1,000,000
Schedule or Table Tax	318,876
Tentative Minimum Tax	276,500
<b>Net Federal Tax</b>	<b>318,876</b>

Here is \$1,000,000 of income, with a \$500,000 easement donation taken up to 30% of AGI:

Adjusted Gross Income	1,000,000
Itemized Deductions	283,010
Taxable Income	714,790
AMTI Net of Exemption	700,000
Schedule or Table Tax	223,427
Tentative Minimum Tax	192,500
<b>Net Federal Tax</b>	<b>223,427</b>

Here is \$1,000,000 of income, with a \$500,000 easement donation taken up to 50% of AGI:

Adjusted Gross Income	1,000,000
Itemized Deductions	483,010
Taxable Income	514,790
AMTI Net of Exemption	500,000
Schedule or Table Tax	153,427
Tentative Minimum Tax	136,500
<b>Net Federal Tax</b>	<b>153,427</b>

Here is \$1,000,000 of income, with a \$1,000,000 deduction taken up to 100% of AGI:

Adjusted Gross Income	1,000,000
Itemized Deductions	983,010
Taxable Income	14,790
AMTI Net of Exemption	0
Schedule or Table Tax	1,479
<b>Net Federal Tax</b>	<b>1,479</b>