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Conservation Options for Heirs to Land

The donation of a conservation easement by a landowner can be an effective means to reduce estate taxes on lands. Section 2055(f) of the Internal Revenue Code (I.R.C.) allows donations of qualifying easements to a public charity such as a land trust to be deducted from the taxable value of an estate.

Section 508 of Public Law 105-34 (the Taxpayer Relief Act of 1997) created another benefit for donations of easements, I.R.C. section 2031(c). This benefit can reduce the taxable value of an estate an additional amount, up to \$500,000. This section of the code can be confusing because of the way it is worded. But it does work, and the Internal Revenue Service (IRS) has confirmed its operation in letter rulings and in practice. Taken together, 2055(f) and 2031(c) create a powerful incentive for conservation which no one who owns land with public value for open space, agricultural preservation, wildlife habitat or recreation should ignore.

Section 6007(g) of the Internal Revenue Service Reform Act (H.R. 2676), signed into law on July 22, 1998, extended these benefits in a new way. **Under this provision, when a landowner dies without having donated a conservation easement, his or her heirs may be allowed to elect to donate a conservation easement on the inherited lands and get these estate tax benefits *post-mortem*.**

Getting this *post-mortem* option requires qualifying for the 2031(c) benefit, and this requires some attention to detail. These provisions have requirements beyond those that qualify conservation easements for income tax deductions under I.R.C. 170(h). Heirs' ability to make a post-mortem donation will also be affected by state law (see below).

I.R.C. 2031(c)

Section 2031(c) of the Internal Revenue Code allows beneficiaries to exclude from the taxable estate up to 40% of the otherwise taxable value of land subject to a qualifying conservation easement. The exclusion is limited to no more than \$500,000.

Under I.R.C. 2031(c), the percentage of land value excluded from an estate is reduced when the easement itself is worth less than 30% of the total value of the land. Retained development rights are fully subject to estate tax, but payment of the tax can be deferred for up to two years.

WHAT LAND QUALIFIES?

As passed in 1997, IRC 2031(c) applied only to certain geographic areas near metropolitan statistical areas, national parks, federally-designated Wilderness Areas, or Urban National Forests (a designation of the U.S. Forest Service). But section 551 of the tax bill enacted in 2001 (H.R. 1835, P.L. 107-16) eliminates those restrictions, **making property anywhere in the United States eligible**. That law also makes it clear that the values to be used to determine what percentage of the property's value is encumbered by the easement are the values at the time of donation.

The land must have been owned by the decedent or a member of his family for three years prior to death. Property subject to a mortgage is eligible for the 1997 exclusion only to the extent of the net equity in the property. The value of structures cannot be counted in any way in applying these provisions -- only the value of the land.

Generally, the value of rights retained to use the land for commercial purposes cannot be excluded from the taxable estate. However, the value of retained rights that are "subordinate to and directly supportive of the use of land as a farm" may be excluded. Such uses include timber cultivation and harvest.

WHAT EASEMENTS QUALIFY?

To qualify for these benefits, easements must first qualify for a deduction under section 170(h) of the I.R.C. They must be perpetual conservation easements, donated to a public charity such as a land trust, or to a governmental entity. The easement must protect outdoor recreation or education resources, wildlife habitat, or open space "for the scenic enjoyment of the general public or in fulfillment of a clearly delineated public conservation policy." Easements solely for the purpose of historic preservation qualify under section 170(h), **but they do not qualify for the benefits of IRC 2031(c)**.

To qualify for IRC 2031(c), **an easement must also prohibit all but "de minimus" commercial recreational activities**. The authors of the provision, however, did specify in the legislative history of the 1997 bill that they did not intend hunting or fishing to be considered "commercial recreational activities."

WHO CLAIMS THE BENEFIT?

IRC 2031(c) can be used for a conservation easement donated in a will or prior to death. But where it is the heirs who are making the donation, the executor must make an irrevocable election to take these benefits. Such an election can be made only if the easement is placed on the land by the executor or beneficiaries before the filing of estate taxes -- generally nine months from the death of the decedent. **Land excluded from estate tax under this provision will receive a carryover basis rather than a stepped-up basis for purposes of calculating any gain on a subsequent sale.**

WHEN WILL THESE PROVISIONS GO INTO EFFECT?

All of these provisions are now in effect and are not subject to expiration.

WHEN WILL WE KNOW MORE?

The Internal Revenue Service will eventually write regulations interpreting these new provisions, and providing further guidance to those seeking to use them. But it will probably be years before such regulations are issued. There have been several private letter rulings confirming the operation of IRC 2031(c). These can be accessed at learningcenter.lta.org, the Alliance's website for member land trusts.

WHAT ELSE SHOULD I KNOW?

The existence of the post-mortem option is no substitute for good estate planning by a landowner. **The power of an executor to make a post-mortem donation of an easement may be limited by state probate law¹**, and a disagreement among heirs could easily frustrate the use of these provisions to preserve family lands from development. In addition, good estate planning by a landowner can yield substantial additional benefits including income tax deductions under I.R.C. section 170(h), which are not allowed in cases where estate tax benefits are taken for easement donations made post-mortem.

Landowners should always consult a qualified attorney in dealing with the particulars of their own situation.

¹ For information on state laws and the ability to make a post-mortem donation, attorneys should see Robert Levin's article in Tax Notes, V. 89, Number 5, October 30, 2000, p. 661 et seq. Available at www.ltanet.org/objects/view.acs?object_id=11140 on LTAnet, LTA's Web site for Sponsor member land trusts.

[TITLE 26](#) > [Subtitle B](#) > [CHAPTER 11](#) > [Subchapter A](#) > [PART III](#) > **Sec. 2031(c) – “The American Farm and Ranch Protection Act “**

Sec. 2031. - Definition of gross estate

(c) Estate tax with respect to land subject to a qualified conservation easement

(1) In general.-- If the executor makes the election described in paragraph (6), then, except as otherwise provided in this subsection, there shall be excluded from the gross estate the lesser of -

(A) the applicable percentage of the value of land subject to a qualified conservation easement, reduced by the amount of any deduction under section 2055(f) with respect to such land, or

(B) the exclusion limitation.

(2) Applicable percentage.-- For purposes of paragraph (1), the term "applicable percentage" means 40 percent reduced (but not below zero) by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land ⁽¹⁾ (determined without regard to the value of such easement and reduced by the value of any retained development right (as defined in paragraph (5)). The values taken into account under the preceding sentence shall be such values as of the date of the contribution referred to in paragraph (8)(B).

(3) Exclusion limitation.-- For purposes of paragraph (1), the exclusion limitation is the limitation determined in accordance with the following table: In the case of estates of The exclusion decedents dying during: limitation is: 1998 \$100,000 1999 \$200,000 2000 \$300,000 2001 \$400,000 2002 or thereafter \$500,000.

(4) Treatment of certain indebtedness.--

(A) In general.-- The exclusion provided in paragraph (1) shall not apply to the extent that the land is debt-financed property.

(B) Definitions.-- For purposes of this paragraph -

(i) Debt-financed property.-- The term "debt-financed property" means any property with respect to which there is an acquisition indebtedness (as defined in clause (ii)) on the date of the decedent's death.

(ii) Acquisition indebtedness.-- The term "acquisition indebtedness" means, with respect to debt-financed property, the unpaid amount of -

(I) the indebtedness incurred by the donor in acquiring such property,

(II) the indebtedness incurred before the acquisition of such property if such indebtedness would not have been incurred but for such acquisition,

(III) the indebtedness incurred after the acquisition of such property if such indebtedness would not have been incurred but for such acquisition and the incurrence of such indebtedness was reasonably foreseeable at the time of such acquisition, and

(IV) the extension, renewal, or refinancing of an acquisition indebtedness.

(5) Treatment of retained development right.--

(A) In general.-- Paragraph (1) shall not apply to the value of any development right retained by the donor in the conveyance of a qualified conservation easement.

(B) Termination of retained development right.-- If every person in being who has an interest (whether or not in possession) in the land executes an agreement to extinguish permanently some or all of any development rights (as defined in subparagraph (D)) retained by the donor on or before the date for filing the return of the tax imposed by section 2001, then any tax imposed by section 2001 shall be reduced accordingly. Such agreement shall be filed with the return of the tax imposed by section 2001. The agreement shall be in such form as the Secretary shall prescribe.

(C) Additional tax.-- Any failure to implement the agreement described in subparagraph (B) not later than the earlier of -

(i) the date which is 2 years after the date of the decedent's death, or

(ii) the date of the sale of such land subject to the qualified conservation easement, shall result in the imposition of an additional tax in the amount of the tax which would have been due on the retained development rights subject to such agreement. Such additional tax shall be due and payable on the last day of the 6th month following such date.

(D) Development right defined.-- For purposes of this paragraph, the term "development right" means any right to use the land subject to the qualified conservation easement in which such right is retained for any commercial purpose which is not subordinate to and directly supportive of the use of such land as a farm for farming purposes (within the meaning of section 2032A(e)(5)).

(6) Election.-- The election under this subsection shall be made on or before the due date (including extensions) for filing the return of tax imposed by section 2001 and shall be made on such return. Such an election, once made, shall be irrevocable.

(7) Calculation of estate tax due.-- An executor making the election described in paragraph (6) shall, for purposes of calculating the amount of tax imposed by section 2001, include the value of any development right (as defined in paragraph (5)) retained by the donor in the conveyance of such qualified conservation easement. The computation of tax on any retained development right prescribed in this paragraph shall be done in such manner and on such forms as the Secretary shall prescribe.

(8) Definitions.-- For purposes of this subsection -

(A) Land subject to a qualified conservation easement.-- The term "land subject to a qualified conservation easement" means land -

(i) which is located in the United States or any possession of the United States,

(ii) which was owned by the decedent or a member of the decedent's family at all times during the 3-year period ending on the date of the decedent's death, and

(iii) with respect to which a qualified conservation easement has been made by an individual described in subparagraph (C), as of the date of the election described in paragraph (6).

(B) Qualified conservation easement.-- The term "qualified conservation easement" means a qualified conservation contribution (as defined in section 170(h)(1)) of a qualified real property interest (as defined in section 170(h)(2)(C)), except that clause (iv) of section 170(h)(4)(A) shall not apply, and the restriction on the use of such interest described in section 170(h)(2)(C) shall include a prohibition on more than a de minimis use for a commercial recreational activity.

(C) Individual described.-- An individual is described in this subparagraph if such individual is -

(i) the decedent,

(ii) a member of the decedent's family,

(iii) the executor of the decedent's estate, or

(iv) the trustee of a trust the corpus of which includes the land to be subject to the qualified conservation easement.

(D) Member of family.-- The term "member of the decedent's family" means any member of the family (as defined in section 2032A(e)(2)) of the decedent.

(9) Treatment of easements granted after death.-- In any case in which the qualified conservation easement is granted after the date of the decedent's death and on or before the due date (including extensions) for filing the return of tax imposed by section 2001, the deduction under section 2055(f) with respect to such easement shall be allowed to the estate but only if no charitable deduction is allowed under chapter 1 to any person with respect to the grant of such easement.

(10) Application of this section to interests in partnerships, corporations, and trusts.-- This section shall apply to an interest in a partnership, corporation, or trust if at least 30 percent of the entity is owned (directly or indirectly) by the decedent, as determined under the rules described in section 2057(e)(3).