Updates to 2015 edition of *Conservation Options: A Landowner’s Guide to Conserving Your Land for Future Generations*

In a great victory for landowners interested in conservation, Congress and the president made the enhanced tax incentive for conservation easement donations permanent on December 18, 2015. The incentive, considered by many to be the most important conservation legislation in 20 years, encourages landowners to place conservation easements on their land to protect important natural, scenic and historic resources. The incentive:

- Raises the deduction a donor can take for donating a conservation easement from 30 percent of his or her income in any year to 50 percent
- Allows qualifying farmers and ranchers to deduct up to 100 percent of their income
- Extends the carry-forward period for a donor to take tax deductions for a voluntary conservation agreement from 5 to 15 years

These changes apply to donations made at any time in 2015 and to all donations made after that. This is a powerful tool for allowing modest-income donors to receive greater credit for donating a very valuable conservation easement on property they own.

While most of the content of *Conservation Options* remains unchanged, the tax incentive has changed some numbers. This document updates critical content to be current as of February 11, 2016 and is organized by page number.
<table>
<thead>
<tr>
<th>Page Number(s)</th>
<th>Updated Content</th>
</tr>
</thead>
<tbody>
<tr>
<td>1, 12, 17</td>
<td>Federal estate tax exclusion for 2016 is $5.45 million for individuals and $10.9 million for married couples (up from $5.43 million and $10.86 million)</td>
</tr>
<tr>
<td>19</td>
<td>Replace the content of the box labeled &quot;Conservation Easements and Estate Taxes&quot; with the following content:</td>
</tr>
</tbody>
</table>

**CONSERVATION EASEMENTS AND ESTATE TAXES**

A landowner purchased property in the 1960s that has appreciated considerably and now has a fair market value of $13,000,000. If he places a conservation easement on the property during his lifetime or in his will, it will reduce the property’s value to $5,500,000. The resulting reduction in estate taxes could be substantial. Assuming that he has $500,000 in taxable assets in addition to the property, that no marital deduction is available and that the unified exclusion (see chapter 8) has not been used, the effect of the easement on estate taxes for someone dying in 2016 would be as follows:

<table>
<thead>
<tr>
<th>Without easement donation</th>
<th>With easement donation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Value of land</td>
<td>$13,000,000</td>
</tr>
<tr>
<td>Other taxable assets</td>
<td>$500,000</td>
</tr>
<tr>
<td>Exclusion allowed from federal gross estate</td>
<td>($5,450,000)</td>
</tr>
<tr>
<td>2031(c) exclusion</td>
<td>0</td>
</tr>
<tr>
<td>Total taxable estate</td>
<td>$8,050,000</td>
</tr>
<tr>
<td>Applicable federal rate</td>
<td>40%</td>
</tr>
<tr>
<td>Total federal and state estate tax*</td>
<td>$3,220,000</td>
</tr>
</tbody>
</table>

*State taxes vary from state to state. In many states, the state estate tax is equal to the maximum federal estate tax credit for state estate inheritance taxes, i.e., the state tax is exactly offset by a federal credit against estate tax. The example above is based on this assumption. However, with the increase in the amount excluded from estate tax, many estates that before could offset the state estate tax with the federal deduction can no longer do so, making the state estate tax a newly important consideration, even for small estates (see chapter 8). |

| 29             | Replace the content of the box labeled “Donation Compared to Sale” with the following content: |

**DONATION COMPARED TO SALE**

A married couple bought a property in the 1960s for $25,000. They are considering whether to sell it (now worth $360,000) to a local developer or to donate it to a land trust. While donating the land would be a very generous thing to do, would it cost them $360,000? No.

Assume that the couple’s adjusted gross income is $200,000 and that, after taking into account various deductions and exemptions, their taxable income is $150,000, that the property is not their principal residence, that they are filing jointly and that these conditions will remain the same for the next five years.

If the couple neither sold nor donated the property, their annual income tax (based on 2016 rates) would be $29,087.50. Over a four-year period, this amounts to $116,350.00 in federal income tax.

If the couple donated the property, they would be entitled to a $360,000 income tax deduction (assuming that a qualified appraisal supports that value), which they can use...
against 50 percent of their “contribution base” (essentially adjusted gross income) annually up to 16 years (or until the deduction is used up, whichever is first). Were they to do so, their annual income tax (calculated using the tax tables) would be $6,581 for three years and $14,094 in the fourth year. Over the total four years in which they can use the deduction, this amounts to $33,837 in income tax. The donation, therefore, saves the couple $82,513 in income taxes.

If the couple sold the property and paid a 10 percent real estate commission, the taxable gain on the sale, taking into consideration the couple’s $25,000 basis in the property, would be $299,000 ($360,000 – [0.10 x $360,000] – $25,000). The current capital gains rate for the couple (because they are in the 25 percent tax bracket) is 15 percent. In the year of the sale, the couple would therefore owe $44,850 in addition to their regular income tax of $29,087.50 for a total of $73,937.50. Assuming after the year of sale the couple’s taxable income reverts to $150,000, their annual tax would revert to $29,087.50. Their total tax for the entire four-year period would be $161,200, which is $127,363 ($161,200 – $33,837 = $127,363) more than had they donated the land.

Thus, the net benefit of selling the land over contributing it would be $196,637 ($360,000 – $36,000 - $127,363 = $196,637). This example does not consider state income tax savings that would result from the contribution, nor does it consider income that the couple might have earned from investing the net proceeds of the land sale or the costs of making the gift (legal and appraisal fees).

50 Percent Limitation/Fifteen-Year Carry-Forward
The tax law places limitations on the maximum annual charitable deduction a donor may take. Generally, for a gift of long-term, capital-gain property—property held by the donor for more than one year—the amount you can deduct in one year is limited to 30 percent of your “contribution base,” which is, essentially, adjusted gross income. If the value of your gift exceeds 30 percent, you can carry forward the excess for up to five additional years, applied each year up to the 30 percent limit. Any remaining portion of the deduction is lost.

However, for "qualified conservation contributions" as defined in Internal Revenue Code section 170(h)(1), including conservation easements, the law allows donors to claim their deductions against 50 percent of their contribution base and carry the unused portion forward for 15 years. This provision of the law was first put in place in 2006 on a temporary basis. However, Congress made the provision permanent beginning in 2016.

The 50 Percent (Step-Down) Election
Prior to permanent enactment of the 50 percent write-off and 15-year carry-forward for qualified conservation contributions, it made sense for some taxpayers to elect to have their contributions treated under a provision of tax law that allowed them the 50 percent write-off (but not the 15-year carry-forward) in exchange for limiting their
deduction to their basis in the conservation easement. With the permanent enactment of the enhanced write-off and carry-forward provisions, this election is no longer necessary for contributions of conservation easements. However, for some contributions of land, this "step-down" election may still make sense. This is because not all contributions of land are "qualified conservation contributions." However, if a donor makes a contribution of land but retains a "qualified mineral interest" and the contribution meets the other requirements to be a "qualified conservation contribution," then the contribution may be considered a "qualified conservation contribution" eligible for the 50 percent, 15-year write-off provisions. For this provision to apply to a gift of land, the land must contain minerals, the extraction of the minerals cannot be by surface-mining, and the extraction may not permanently impair the conservation values of the land. Furthermore, the conveyance must meet the other tax code requirements to be a qualified conservation contribution.

**100 Percent Write-off for Farmers and Ranchers**

In 2016, Congress also made permanent the 100 percent write-off of easement deductions for farmers and ranchers. Under this provision, if more than 50 percent of an easement donor’s income is from the business of farming in the year of the easement contribution, the donor may use the easement deduction against 100 percent of income, rather than the 50 percent write-off allowed to other easement donors. Unused portions of a farmer's or rancher's easement deduction may be carried forward for 15 years.

For purposes of the 100 percent write-off, the term business of farming is defined as cultivating soil, raising or harvesting any agricultural or horticultural commodity (including livestock) on a farm and forestry (the definition found in the tax code is much more detailed and should be consulted directly).

**Treatment of Easement Contributions by S Corporations**

Another important feature of the 2016 tax law is a provision allowing the pass through of the gain portion of “qualified conservation contribution” deductions to S corporation shareholders, regardless of their basis in their shares.

Prior to enactment of this provision, shareholders in S corporations (which pass charitable deductions through to shareholders) could not deduct more for the contribution of a conservation easement than their basis in their shares.

| 50 | Replace box labeled “Effect of 30 Percent Limitation” with this content: |

**EFFECT OF 50 PERCENT LIMITATION**

A landowner donates a conservation easement valued at $300,000 to a land trust. His adjusted gross income in the year of the gift and the next 11 years is $50,000. Assuming that his income remains constant (and that he has no other charitable contributions), he could use the charitable deduction resulting from the easement as follows: 50% of $50,000 = $25,000
Easement deduction
Year 1  $25,000
Year 2  $25,000
Year 3  $25,000
Year 4  $25,000
Year 5  $25,000
Year 6  $25,000
Year 7  $25,000
Year 8  $25,000
Year 9  $25,000
Year 10 $25,000
Year 11 $25,000
Year 12 $25,000

Note that, if the landowner’s easement value had exceeded $400,000, he would never have been able to “use up” the entire deduction.

The content of the box labeled “The 30 Percent Limitation versus the 50 Percent Step-Down Election” with the following content:

The Business of Farming
Kathy and Wint operate a large farm in the Tidewater region of Virginia. The farm has been in Wint's family for five generations. Kathy and Wint are very successful and earn about $1 million annually from their farming operations. In 2013, they contributed a conservation easement over the entire 1,500-acre farm and were able to claim an income tax deduction of $8 million. Under Virginia law, they were entitled to a credit against Virginia income tax in the amount of 40 percent of the value of the easement or $3.2 million. They sold the state tax credits in 2014 and netted $2.7 million from the sale, all of which was subject to income tax at ordinary rates.

However, because more than 50 percent of Kathy and Wint's income in 2013 (in fact, all of their income) was from the "business of farming," they were able to claim their $8 million deduction against 100 percent of their income. Thus, they paid no income tax on their $1 million of income in 2013, no income tax on their $3.7 million income in 2014 (which included the proceeds from the state tax credit sale) and no income tax in 2015, 2016 or 2017. In 2018 there was $300,000 of their deduction remaining which they used against their 2018 income.

Note that if Kathy and Wint had sold their tax credits in 2013 they would not have qualified for the 100 percent write-off because less than 50 percent of their income would have been from the business of farming – income from the sale of tax credits is not income from farming. Furthermore, if Kathy and Wint had bargain-sold their
In addition to noting the change in estate tax exclusions described above, please see the following change:

For estates or gifts in excess of the exclusion amount, the tax rate is 40 percent. Thus, the estate of a single person worth $6.25 million would owe $320,000 in estate taxes ($6,250,000 – $5,450,000 x 0.40 = $320,000).

Replace the content of the box labeled “State Versus Federal Estate Tax Example” with the following content:

| $4,000,000 | Ranch value at date of surviving spouse’s death |
| $5,450,000 | Federal exclusion |
| $0         | Federal taxable estate |
| $0         | Federal estate tax |
| $1,000,000 | State tax exclusion |
| $3,000,000 | State taxable estate ($4,000,000 – $1,000,000) |
| $330,000   | State estate tax ($3,000,000 x approximately 11%) |