

# CONSERVATION EASEMENTS:

## SUMMARY OF BENEFITS FOR LANDOWNERS

A conservation easement is a legal agreement between a landowner and a conservation organization (or government agency) to permanently limit the development of a property to protect the natural habitat, open space, scenic, educational, recreational, historical or cultural values of the land.

### CONSERVATION EASEMENTS:

- Permanently protect family land in its current state.
- Provide multiple, large tax savings to landowners.

### HOW THEY PROTECT LAND:

- Restrict development that can be harmful to the environment.
- Give qualified conservation group the right to enforce restrictions.

### HOW LANDOWNERS ARE PROTECTED:

- All restrictions are negotiated and none are required.
- Landowners continue to enjoy agricultural and recreational use.

### HOW THEY PROVIDE TAX SAVINGS:

- Create charitable deductions when donated to conservation groups.
- Lower estate tax by lowering the appraised value of land in the estate.

### HOW MUCH TAX SAVINGS THEY PROVIDE:

- Near cities, the deduction/reduction can typically be 50-90% of the land's market value.
- For rural land, the deduction/reduction can typically be 30-60% of the land's market value.

### WHO SHOULD CONSIDER CONSERVATION EASEMENTS?

- Landowners committed to leaving their land undeveloped for a long period of time.
- Landowners leaving their children land that they wish to remain undeveloped.

## CONSERVATION EASEMENTS: 2006 CASE STUDY AND FINANCIAL ANALYSIS

Dr. Wien, a 62 year-old, successful surgeon from Houston, is not retiring, but has decided to do some estate planning. His wife, Ann, is 52 years old and they have two children: a boy 28 and a girl 25. The doctor's thriving practice gives them annual ordinary income of around \$550,000. His passion is the 600-acre family ranch that he and Ann bought twenty-five years ago outside of Dripping Springs, Texas.

Ann never enjoyed the ranch much, and in recent years doesn't visit it. However, both the children love the place and want to build second homes there when they have children. Dr. Wien wants to leave the ranch to his children in his will and he hopes that they and their children will love and protect it just as he has done.

The family home and the ranch are the only fixed assets that the Wiens own. Their savings are in mutual funds with a total cash value of \$12MM, on which they make about \$1.2MM annually in capital gains income. They also have about \$50,000 in annual income adjustments. When they bought the ranch they paid \$300,000 and paid off the note in 15 years. Due to Austin's growth, comparable land near Dripping Springs is now selling at \$12,000/acre and the market value of the ranch today is \$7.2MM.

When Dr. Wien and Ann saw an estate-planning attorney, she suggested that they consider donating a conservation easement on the ranch, so the children would pay lower estate taxes when the ranch is left to them. She also said that donation of an easement would qualify them for substantial charitable gift tax deductions over a sixteen year period under a new law. The attorney explained that an easement could be used with other estate planning tools, like family limited partnerships, to add to the effectiveness of their plans. She arranged for the Wiens to meet with an expert on conservation easements to learn more and get their questions answered.

They learned that the type of conservation easement used in estate planning is a permanent, binding agreement between landowners and qualified conservation organizations to preserve environmental values on the land. An easement gives the conservation group an enforceable right to prevent certain types of development set out in the agreement. The terms are negotiable and typically allow the landowner to continue to use and enjoy the land. For example, the Wiens

were able to reserve two new home sites on the ranch for their children.

Legally speaking, the rights to develop the land or to do certain activities on the land are donated to the conservation organization, which cannot by its charter develop the land. Since the right to develop has a value, the donation is a charitable gift and the landowner can take an income tax deduction. Plus, the land that the donor keeps is less valuable, so the children inherit only what they love about the ranch and don't pay estate tax on the right to develop.

Look at the chart on the next page to see the Wien's income tax savings from their use of a conservation easement. After the rights to develop are given away, the ranch is appraised at \$3,500/acre or \$2.1MM. So the Wiens are eligible for a charitable gift deduction of \$5.1MM, which is the difference between the current value of \$7.2MM and the new \$2.1MM value. As a result of changes in the tax code in 2006, they are allowed to deduct 50% percent of their adjusted gross income for each year. With some other technical adjustments, this allows them a \$818,857 deduction. They can carry forward the remainder of the gift and deduct the same percentage each year for up to 15 years or until they use up the entire \$5.1MM. Assuming the doctor's income stays constant, he will be able to deduct \$818,857 per year over the 6 year period necessary to use up the entire \$5.1MM gift. At his maximum tax rate of 35% for ordinary income that amounts to about \$286,600 per year in income tax savings or a total income tax savings of \$1,719,600 over the same six year period. (See note at bottom of chart)

Also look at the estate tax savings that will result from the Wien's donation. Again, the easement reduces the appraised value of the ranch by \$5.1MM. The total size of the Wien's estate is reduced by that amount, plus a 1997 law allows an additional reduction of up to \$500,000 for conservation easements. The total reduction in the estate will potentially result in estate tax savings of \$2,576,000.

This figure is based on the unlikely event that both the Wiens die shortly after donating the easement, and the estate is taxed in the Year 2006. More likely, the ranch will actually pass to the children in Ann's estate many years after the gift of the easement, since estate taxes can be avoided in Dr. Wien's estate if he leaves the ranch to Ann. The actual estate tax savings will depend on the appraised value of the ranch, the tax rates and size of the estate at the time of Ann's death.

## FINANCIAL ANALYSIS OF TAX SAVINGS

	BEFORE EASEMENT	AFTER EASEMENT
Total Appraised Value of the Wien's ranch:	\$7,200,000	\$2,100,000
Total Charitable Deduction/Reduction in value	N/A	\$5,100,000
The Wien's annual ordinary income:	\$550,000	\$550,000
The Wien's annual capital gain income:	\$1,200,000	\$1,200,000
The Wien's annual adjusted gross income (AGI):	\$1,700,000	\$1,700,000
Annual allowable deduction (50% of AGI minus 3% phase-out = \$850,000 - \$31,143):	N/A	\$818,857
The Wien's maximum marginal tax rate for ordinary income:	35%	35%
Annual Income Tax Savings:	N/A	\$286,600
Total Income Tax Savings (over 6 years (see note)):	N/A	\$1,719,600
The Wien's average annual return on investment	10%	10%
Value of Invested Tax Savings After 6 Years (after tax):	N/A	\$2,193,642
Value of Invested Tax Savings After 19 Years (after tax):	N/A	\$5,286,338
Value of Invested Tax Savings After 30 Years (after tax):	N/A	\$11,126,960
Years to Recover \$5.1MM Donated Value	N/A	19 years
Taxable amount of Wien's estate (use \$2,000,000 exemptions):	\$15,200,000	\$10,100,000
The Wien's maximum rate for estate tax (in the Year 2006):	46%	46%
Amount of Estate Tax (in the year 2006):	\$6,992,000	\$4,416,000
Total Estate Tax Savings (in the Year 2006):	N/A	\$2,576,000
<b>TOTAL TAX SAVINGS (after giving ranch to the children):</b>	<b>N/A</b>	<b>\$4,295,600</b>

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**Note:** Although the Wien's can carry forward their annual \$850,000 charitable deduction for up to 16 years total, they will use up all of their \$5.1MM total charitable deduction in about 6 years.

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The Wiens could forgo the charitable gift deduction and leave their children to pay the estate taxes. Unlike many landowners, they will leave enough cash in their estate for the children to pay the taxes without selling the ranch. If they choose not to use a conservation easement, the children will be able to sell the ranch to a developer some time in the future for a profit should the need arise. But, Dr. Wien loves the ranch and likes the idea that it will never be developed. And, from a financial perspective, notice on the chart what could happen if they invest the savings from just the income tax deduction, which they can receive immediately.

With this investment scenario and the current high value of the ranch holding steady, they continue to enjoy the undeveloped ranch indefinitely, while the potential

profits from selling to a developer are made up and surpassed in just over 19 years, when Ann is 71. The conservation easement allows the family to capture the unused, development-value of the ranch in the form of tax savings. When estate taxes are considered, they may actually end up better off financially than if they hold on to the whole value of the ranch to sell later. And most important, they get to keep the ranch.

**Note:** The situations described in this case study are simplified to make specific points. Tax laws are complex and your results will vary depending on your personal situation. Consulting with your attorney and other professionals is the only reliable way to assess the benefits of a conservation easement for you and your family.