THE FOLLOWING EXAMPLES ARE MEANT TO SHOW POTENTIAL FINANCIAL IMPACTS OF PLACING A CONSERVATION EASEMENT ON A LARGE AND A SMALL ACREAGE OF LAND. THE NUMBERS ARE HYPOTHETICAL YET ARE MEANT TO REFLECT REAL WORLD CONDITIONS. YOU SHOULD HAVE A TAX PROFESSIONAL OR LICENSED ATTORNEY EVALUATE THE PARTICULAR DETAILS OF YOUR SITUATION PRIOR TO ENTERING INTO ANY FINANCIAL OR LEGAL AGREEMENT

Larger Land Example:

Mr. and Mrs. Grandin purchased 1000 acres of forestry land forty-five years ago for $300/acre. They manage the land in planted slash pine and long leaf. They lease the acreage to a small hunt club. The property has approximately 350 acres of wetlands surrounding a creek which feeds into an important recreation reservoir and river which are south but not adjacent to the property. The creek bank boasts growth of endangered wetland species. Bald eagles have a nest to which they return annually.

Mr. and Mrs. Grandin hope to retire in the next five years. They currently have an annual income of $200,000 a year from the real estate business, periodic timber harvests, and the hunt club lease. Most of the timber harvest income is reinvested in the timber and wildlife management. The Grandins' total assets including the land equals $8 million. The current fair market value (FMV) of the property is $6 million.

The Grandins' main goal is to insure that their grandchildren's children will be able to know and enjoy the property as it is today. They are considering placing a conservation easement on their property. They want to preserve the wetlands, continue their forest management plan that would include some clear cutting, and reserve the right to build three homes and three barns or work sheds on the property. Currently the property has no built improvements and two artesian wells.

Today's Fair Market Value (FMV) of the land is $6,000 per acre. The FMV after the conservation easement is $2000 per acre when the Grandins voluntarily remove the development rights to the property while reserving the rights to timber, hunting, fishing and personal recreation as well as building three homes for their family on the property.

What are the potential TAX BENEFITS of the Grandin family donating a conservation easement?

1) What is the **value of the Grandin conservation easement**?

The value of a conservation easement is calculated by taking the difference between the Fair Market Value (FMV) before the conservation easement (CE) and the FMV after the CE.

FMV before the CE – FMV after the CE = Value of the CE

FMV before the CE = $6000 x 1000 acres = $6 million and
Minus FMV after the CE = $2000 x 1000 acres = $2 million
The value of the Grandin Conservation Easement = $4 million

2) What **estate tax benefits** would the Grandins receive with a conservation easement (CE) on their property?
   Assume the Grandins' total estate is $8 million

First, consider how much the estate value would be reduced with a conservation easement?
Total estate value = $8 million
Minus CE Value = $4 million
Value of estate w/ CE = $4 million

Next consider the estate tax exclusion amount:
If the $3.5 million exclusion per spouse is reinstated,
WITHOUT A CONSERVATION EASEMENT:
Total estate value = $8 million
Minus 3.5 million x 2 = $7 million
The Grandins will owe taxes on $1 million of their estate.

WITH A CONSERVATON EASEMENT:
Total estate value = $4 million
Minus $3.5 million x 2 = $7 million
The Grandins will owe taxes on $-0 of their estate and avoid estate taxes.

If the $1 million exclusion per spouse is returned to in 2011,
WITHOUT A CONSERVATION EASEMENT:
Total estate value = $8 million
Minus $1 million x 2 = $2 million
The Grandins will owe taxes on $6 million of their estate.

WITH A CONSERVATION EASEMENT:
The Grandins will still owe taxes on $2 million.
Total estate value = $4 million
Minus $1 million x 2 = $2 million
The Grandins will owe taxes on $2 million of their estate

With the 2031 40% exclusion of conserved land value a family can further reduce their estate value by 40% of the value of the land encumbered by a CE.
40% of the $2 million land encumbered by a CE = $800,000

If the 40% exclusion maximum is $500,000,
$2 million
Minus $500,000
The Grandins will owe taxes on $1.5 million

If the 40% exclusion maximum is $5 million
The Grandins will owe taxes on $1.2 million

Federal Income Tax Impacts
What is the full value of the **federal income tax deduction** with a conservation easement?
$4 million, which is the value of the conservation easement.

CURRENT FEDERAL INCOME TAX RULES at a deduction of 30% of Adjusted Gross Income for 6 years. Assume that the Grandins' income is the same every year, and they are filing jointly and with tax brackets applicable for 2010.

What would the Grandins' federal income tax savings be per year?

Without the CE donation:	Income	$200,000
	Tax Due	$44,244
With the CE donation	Income	$200,000
	Deductions	$200,000 * 30% = $60,000
	Tax Due	$22,363

Total tax due over 6 years without the easement donation: $265,464
Total tax due over 6 years with the easement donation: $134,178

INCOME TAX SAVINGS: $ 131,286

FORMER FEDERAL INCOME TAX RULES, at a deduction of 50% of Adjusted Gross Income for 16 years.
What would the Grandins' federal income tax savings be?

Without the CE donation:	Income	$200,000
	Tax Due	$44,244
With the CE donation	Income	$200,000
	Deductions	$200,000 * 50% = $100,000
	Tax Due	$17,363

Total tax due over 16 years without the easement donation: $707,904
Total tax due over 16 years with the easement donation: $277,808
***INCOME TAX SAVINGS:* $430,096**

Note: No matter how much an individual gives to charity, limitations in the tax law may make it impossible to eliminate the total amount of federal income tax due annually.

Property Tax Impacts

After the Grandins record a perpetual conservation easement, they may apply with their county property appraiser for an exemption for a perpetual conservation easement. Depending on the reserved and restricted rights they have included in the perpetual easement, they may receive between 50% to 100% exemption of the assessed value of the land under a conservation easement. The Grandins would still be responsible for ad valorem taxes on any residences when built and potentially other structures.

Capital Gains Impacts

If the Grandins sold their conservation easement, capital gains taxes would be owed on the easement payment.

If the Grandins were paid $2 million for their easement, but the accepted appraised value was $4 million, they would owe 15% on the $2 million or <u>$300,000</u> AND be able to report the difference between the appraised value and the purchase price as a donation. THEREFORE offsetting the $300,000 in capital gains taxes.

Small Land Example:
Mr. and Mrs. Small moved away from the city almost 20 years ago to get away from it all. They were able to purchase 125 acres in rural Marion County, in an area that was still largely undeveloped for a relatively small sum of money. The Smalls love their rolling hills and huge live oaks, small bass pond, and the feeling of seclusion from neighbors and city life. They are still able to go outside and not hear traffic or see lights from nearby houses. They have cattle and horses on their property, and currently receive an agricultural exemption on their property taxes. As subdivisions have popped up in the surrounding area, land values have increased significantly, and the Smalls have heard they could now sell for 1 million due to significant improvements they have made to the property. In addition to their property valued at 1 million dollars, the Smalls have an annual adjusted gross income of $50,000, and additional savings and assets valued at $500,000. They have a daughter and son, neither of whom lives in the area, so they aren't sure what to do with their property. Their daughter has showed interest in coming back to the property at some point, but their son would prefer to not deal with the property. The Smalls are sure of one thing though, they want to see the bulk of their property protected from development. They are considering placing a conservation easement on the property.

What are the potential TAX BENEFITS of the Small family donating a conservation easement?

1. What is the **value of the Small conservation easement**?

The value of a conservation easement is calculated by taking the difference between the Fair Market Value (FMV) before the conservation easement (CE) and the FMV after the CE.

FMV before the CE – FMV after the CE = Value of the CE

FMV before the CE = $ 6,000/acre x 125 acres = $750,000 and
Minus FMV after the CE = $ 2,000 x 125 acres = $ 250,000
The value of the Small Conservation Easement = $ 500,000

2. What **estate tax benefits** would the Smalls receive with a conservation easement (CE) on their property?
   Assume the Smalls' total estate is $ 1.5 million

First, consider how much the estate value would be reduced with a conservation easement?
Total estate value = $ 1.5 million
Minus CE Value = $ 500,000
Value of estate w/ CE = $ 1 million

Next consider the estate tax exclusion amount:
If the $3.5 million exclusion per spouse is reinstated,
WITHOUT A CONSERVATION EASEMENT:
Total estate value = $ 1.5 million
Minus 3.5 million x 2 = $7 million
The Smalls will owe taxes on $ 0 of their estate.

WITH A CONSERVATON EASEMENT:
Total estate value = $ 1.5 million
Minus $3.5 million x 2 = $7 million
The Smalls will owe taxes on $0 of their estate.
If the $1 million exclusion per spouse is returned to in 2011,
WITHOUT A CONSERVATION EASEMENT:
Total estate value = $ 1.5 million
Minus $1 million x 2 = $2 million
The Smalls will owe taxes on $ 0 of their estate.

WITH A CONSERVATION EASEMENT:
The Smalls will still owe taxes on $2 million.
Total estate value = $1.5 million
Minus $1 million x 2 = $2 million
The Smalls will owe taxes on $ 0 of their estate

With the 2031 40% exclusion of conserved land value a family can further reduce their estate value by 40% of the value of the land encumbered by a CE.
40% of the $_________ land encumbered by a CE = $__________

If the 40% exclusion maximum is $500,000,
$_______
Minus $_______
The Smalls will owe taxes on $________

If the 40% exclusion maximum is $5 million
The Smalls will owe taxes on $_________

Federal Income Tax Impacts
What is the full value of the **federal income tax deduction** with a conservation easement?
$500,000, which is the value of the conservation easement.

CURRENT FEDERAL INCOME TAX RULES at a deduction of 30% of Adjusted Gross Income for 6 years. Assume that the Smalls' income is the same every year and they file jointly under 2010 federal tax brackets.

What would the Smalls' federal income tax savings be per year?

Without the CE donation:	Income	$50,000
	Tax Due	$6,663
With the CE donation	Income	$50,000
	Deductions	$50,000 * 30% = $15,000
	Tax Due	$4,413

Total tax due over 6 years without the easement donation: $39,978
Total tax due over 6 years with the easement donation: $ 26,478

INCOME TAX SAVINGS: $13,500

FORMER FEDERAL INCOME TAX RULES, at a deduction of 50% of Adjusted Gross Income for 16 years.
What would the Smalls' federal income tax savings be?

Without the CE donation:	Income	$50,000
	Tax Due	$6,653
With the CE donation	Income	$50,000
	Deductions	$50,000 * 50% = $25,000
	Tax Due	$2,913

Total tax due over 16 years without the easement donation: $106,448
Total tax due over 16 years with the easement donation: $46,608
INCOME TAX SAVINGS: $59,840

Note: No matter how much an individual gives to charity, limitations in the tax law may make it impossible to eliminate the total amount of federal income tax due annually.

Property Tax Impacts

Once the Smalls record a perpetual conservation easement, they may apply with their county property appraiser for an exemption for a perpetual conservation easement. Depending on the reserved and restricted rights they have included in the perpetual easement, they may receive between 50% to 100% exemption of the assessed value of the land. The Smalls would still be responsible for ad valorem taxes on any existing or new residences and potentially other structures.

Transferable Development Rights

The Smalls live in a county that participates in a transferable development rights program, which means that they may be eligible to send their development rights to an area of the county that is a receiving area. Developers can purchase these development credits to increase the number of units allowed on properties in the receiving area. This is a private transaction between the Smalls and the developer, resulting in the Smalls being paid to place a conservation easement on their property. In this case, capital gains taxes will apply, which are covered below.

Capital Gains Impacts

If the Smalls sold their conservation easement, capital gains taxes would be owed on the easement payment.

If the Smalls were paid $250,000 for their easement, but the accepted appraised value was $500,000, they would owe 15% on the $250,000 or <u>$37,500</u> AND be able to report the difference between the appraised value and the purchase price as a donation. THEREFORE offsetting the $37,500 in capital gains taxes.

Life Insurance Wealth Replacement

Life insurance can be used as one of a number of financial planning products and should be considered as an option among the many planning options available. In this situation, if the Smalls were to divide their property between their two children, and their son wasn't interested in being involved, their daughter would have to buy him out. Often times, this is impossible for the other child, and the property will have to be sold. A life insurance policy could be used in this situation to provide the money to give to their son, while giving the daughter the farm. In order to avoid the life insurance policy being included in the Smalls' estate, the policy must be placed in an irrevocable trust, or similar vehicle.

Life insurance can also be used to replace the lost property value in using a conservation easement.