

Conservation Easements as a Creative Tool for Farm Transfer

Benefits of an Agricultural Conservation Easement

1. Perpetual restriction on the development of the land for non-agricultural uses that runs with the land;
2. Landowner retains ownership of parcel until ready to sell;
3. Landowner can negotiate terms of the easement (note: if landowner is seeking tax benefits, landowner must be consider IRS requirements for a deductible easement);
4. Potential tax deduction to landowner;
5. Funding opportunities available to sell the easement to a qualified conservation entity. Typically these entities are offering 70% of the value of the easement as a purchase price. This type of transaction is known as a bargain sale.

Drawbacks of an Agricultural Conservation Easement

1. Perpetual restriction on the development of the land for non-agricultural uses that runs with the land;
2. Tax Liability- capital gains tax;
3. Transactional costs – legal fees, potentially appraisal fees or baseline documentation report fees;
4. Time – depending on the entity who will be the holder of the easement, these transactions can be lengthy;
5. Complicated legal jargon;
6. Reduced value of property post easement and reduced pool of buyers; and
7. Older generation farmers are wary of the limitations posed by conservation easements.

Tax Benefits and Liabilities:

1. Potential for tax deduction
 - a. Easement language must meet IRS requirements for deduction, i.e., grantee must be an eligible conservation organization, easement must be perpetual, must serve a conservation purpose (for agriculture-open space includes farmland), any other liens/encumbrances must be subordinated and many other details we won't go into here.
 - b. Must have baseline documentation report;
 - c. Must have appraisal that meets IRS standards;
 - d. Land trust must issue a contemporaneous written acknowledgement of receiving the donation.
 - e. Must file all necessary tax paperwork- challenge of finding a qualified accountant.
 - f. 15 year carry forward! (compared to the usual 5 year carry forward)
 - g. Areas to exercise extreme caution
 - i. Amendment clauses – The IRS has been challenging the deductibility of easements with amendment clauses on the grounds that such provisions violate the “granted in perpetuity” and “protected in perpetuity” requirements. The IRS has issued a “safe harbor” amendment clause (attached with materials). The safe harbor provision includes problematic language, specifically that the amendment cannot permit development, improvements, or uses prohibited by the Easement on

its effective date. Query the purpose of an amendment clause if this language is included.

- ii. Reserved building areas – Case law in the tax courts and on appeal has left significant risk of disqualification of tax deduction for easements which allow for floating homesites, boundary adjustments, building area relocation or land substitution. This case law is still in flux, so you should do your legal research before moving forward with any reserved building areas in an easement if you are seeking a tax-deductible easement.

2. Potential Capital Gain

With the sale of a conservation easement, there is the potential for a capital gain. The gain (or loss) is calculated based on the price the easement is being sold for in relation to the landowner's basis in the property. Basis is essentially the original purchase price or original value of the easement. If the landowner bought the property outright, basis in the easement is calculated based on that purchase price. If the landowner inherited the property, and the property was probated, the basis in the easement is calculated based on the value of the property in the probate inventory. If the property was passed on from family member to family member by way of a quit claim deed for \$1.00, the current landowner essentially takes the basis of his or her predecessor in interest.

Important Legal Considerations:

1. **Public Access.** Some agricultural easement holders will require a public access provision. Exercise extreme caution when considering whether this is appropriate from the perspective of landowner liability.
2. **Farmstead Home.** Many agricultural easement holders will require that the farmstead home be part of the easement, cannot be subdivided from the farm property and will require a square footage limitation for the home. From the easement holder's perspective, this helps keep the farm viable because there is an affordable home attached to the farm property. The legal practitioner should try to minimize restrictions on use within the farmstead home area to give the landowner more flexibility. The legal practitioner is also advised to seek out a square footage limitation that is satisfactory to the landowner. Lastly, be sure your client understands any prohibition on subdivision.
3. **Monitoring/Enforcement.** The easement holder will need to monitor the easement in order to enforce the provisions thereof. Be wary of any provisions that impose monitoring costs or excessive enforcement costs on landowners.
4. **Balancing Conservation with Agriculture.** Agriculture and conservation are not always in harmony. Agricultural uses can have detrimental impacts on the environment and it is important to review an agricultural conservation easement with this in mind. Conflicts between conservation and agriculture can arise in the context of the purposes of the easement, farm waste storage, mowing timeline limitations, fencing requirements, etc. Be sure to discuss any provisions that may limit the farm activities with the landowner and negotiate revisions accordingly.