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Timber and Taxes

William C. Siegel, J.D.

Tax Aspects Of Conservation Easements

A woodland owner may wish to guarantee that his or her forest land always remains as forest. Persons in this situation sometimes consider placing a conservation easement on the property to achieve that goal. A qualified conservation easement is defined as a transfer of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest means a restriction, granted in perpetuity, on the use that may be made of the property. A conservation easement on woodland can be created by either selling or donating the interest.

For example, a restriction on the use of the property for purposes other than forest land—such as housing or commercial development—can be transferred. The restriction can be structured to permit the transferor and the transferor's heirs to continue to live on the property and manage it for commercial timber production. This type of transfer permits a woodland owner to control the use of the land both during and after his or her lifetime. Selling such a restriction, although not providing an income tax deduction, will produce income from the development rights. On the other hand, donating the restriction to a qualified organization will provide an income tax charitable deduction, as well as remove the value of the donated interest from the donor's estate where it would perhaps be subject to the federal estate tax and possibly also state death taxes. Additionally, there is no gift tax on a conservation easement charitable contribution.

Income Tax Benefits

The criteria necessary to qualify for a conservation easement charitable deduction need to be carefully evaluated. These are discussed in IRS Publication 526, Charitable Contributions. Two basic criteria must be considered.

Qualified Organization

The contribution must be made to one of the following types of qualified organizations:

- A unit of local, state or federal government.
- A publicly supported charitable, religious, scientific, educational or similarly qualified organization.
- An organization that is controlled by, and operated for, the exclusive benefit of a government unit or a publicly supported charity.

Conservation Purpose

The contribution must be made only for one of the following purposes:

- Preservation of land areas for outdoor recreation by, or for the education of, the general public.
- Protection of a relatively natural habitat for fish, wildlife, plants or a similar ecosystem.
- Preservation of open space, including farmland and forest land. The preservation must yield a significant public benefit. Additionally, it must either be for the scenic enjoyment of the general public or under a clearly defined federal, state or local government conservation policy.
- Preservation of an historically important land area or structure.

Valuation of the Donation

The value of a donation of a conservation easement generally is equal to the value of the entire property before the donation minus its value after the donation. The best evidence of this difference in value is found by examining sales of similar properties in the area, some without restrictions and some with restrictions similar to those associated with the easement in question. The basic principle is demonstrated in the following example.

Example: Mr. Smith owns 300 acres of woodland. Similar property in the area has a bare land fair market value of $1,600 an acre. However, comparable woodland in the vicinity that is restricted solely to forestry uses under the state's special use forest property tax law has a fair market value of $600 per acre. The county is interested in preserving 200 of Mr. Smith's acres as part of its green space program. Mr. Smith grants the county a conservation easement in perpetuity on the 200 acres which restricts the use of this acreage to sustainable timber management and harvesting. The fair market value of the property before the easement was $480,000 (300 X $1,600). The fair market value of the property after the easement is $280,000 (100 X $1,600 plus 200 X $600). The value of the easement is therefore $200,000 ($480,000 minus $280,000).

Because of the need for accuracy, a professional appraisal should be used to determine the value of the donation. In fact, if the deduction is more than $5,000, a written appraisal by a qualified appraiser is required.

A federal income tax charitable contri-

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bution deduction may be taken in the year of a real property donation in an amount up to 30 percent of the donor's adjusted gross income for that year. Deductions unable to be taken because of this limitation may be carried forward for five additional years.

Estate Tax Provisions

The executor of an estate may elect to exclude from the gross estate up to 40 percent (called the "applicable percentage") of the value of land that is subject to a qualified conservation easement. If the easement was not in place prior to the decedent's death, a post-mortem conservation easement may be executed with the concurrence of all heirs and legatees. The amount of the exclusion is limited to $500,000.

Family Ownership

In order to qualify for the exclusion, the land must have been owned by the decedent or a member of the decedent's family during the three-year period ending on the date of the decedent's death. Family members are (1) an ancestor of the decedent, (2) the spouse of the decedent, (3) a lineal descendant of the decedent, of the decedent's spouse, or of a parent of the decedent, or (4) the spouse of any individual described in (3). An interest in a partnership, corporation or trust will qualify for the exclusion provided that at least 30 percent of the entity is owned—directly or indirectly—by the decedent.

Special Use Valuation Property

The granting of a post-mortem conservation easement does not affect property valued for estate tax purposes under the special use valuation provisions. The granting of the easement is not treated as a disposition of the property so as to trigger a recapture tax. Additionally, the existence of a qualified conservation easement at the decedent's death does not prevent the property from subsequently qualifying for special use valuation.

Debt-financed Property

The exclusion does not apply to the extent that the land is debt-financed property. Thus, debt-financed property is eligible for the exclusion only to the extent of the net equity in the property. Debt-financed property means property with respect to which there is an acquisition indebtedness on the date of the decedent's death.

Retained Development Rights

The exclusion amount is calculated based on the value of the property after the conservation easement has been executed. However, the exclusion amount does not extend to the value of any development rights retained by the decedent or the donor. Development rights are defined as any rights retained to use the land for any commercial purpose that are not subordinate to and directly supportive of the land as used for farming or forestry purposes.

Applicable Percentage

If the executor makes the election, the amount of the exclusion is the lesser of the applicable percentage of the land subject to the conservation easement or the exclusion limitation of $500,000. The applicable percentage means 40 percent reduced, but not below zero, by two percentage points for each percentage point (or fraction thereof) by which the value of the conservation easement is less than 30 percent of the value of the land. For this purpose, the value of the land is determined without regard to the value of the easement and is reduced by the value of any retained development rights. As a result, if the value of the easement is 10 percent or less of the value of the land before the easement, less the value of any retained development rights, the applicable percentage will be zero. The calculations are demonstrated in the following example.

Example: Mrs. Jones dies owning woodland subject to a qualified conservation easement. She has not retained any development rights in the property. The fair market value of the property on the date of her death is $500,000 without the easement and $400,000 with the ease-

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FLTC Tax Report

by **Frank Stewart, RF**

Death Tax: On April 19, Senate Majority Leader Bill Frist wrote, "The death tax is simply unfair. It tells every American that no matter how hard you work or how wisely you manage your affairs, in the end the federal government is going to take it away. The death tax is double and, in some cases triple, taxation. It punishes hard work and savings, and it fails to raise the kind of revenues that might conceivably justify some of the damage it causes. It has been destroying businesses and ruining lives for four generations. Let us not make this mistake with our children. I am proud to declare that the days of the death tax are numbered. I am committed to a FULL REPEAL. Next month, I'll bring it to the Senate floor and I'll do everything in our power to bury the death tax once and for all!"

Research: The Forest Landowners Tax Council is seeking funding, through Congressional appropriation, for research into the tax structures for non-industrial private forest landowners in other countries, for clarification on the actuarial data used in calculation of forest casualty losses, and how other nations have chosen to regulate woody biomass as an alternative energy feedstock.

Mississippi Legislature Passes Fed Tax Resolution: A concurrent resolution of the state of Mississippi legislature urges the United States Congress to enact federal income tax relief to tree farmers who have suffered loss as a result of the hurricane Katrina disaster. The Resolution: NOW, THEREFORE, BE IT RESOLVED BY THE SENATE OF THE STATE OF MISSISSIPPI, THE HOUSE OF REPRESENTATIVES CONCURRING THEREIN, That we do hereby urge the United States Congress to enact one-time federal Income Tax relief to Mississippi tree farmers who have suffered loss as a direct result of the Hurricane Katrina disaster by authorizing a generous casualty write-off. BE IT FURTHER RESOLVED, That this resolution be forwarded to the President of the United States, the Commissioner of the Internal Revenue Service and members of Mississippi's Congressional delegation, and be made available to the Capitol Press Corps.

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ment. Thus the value of the easement is $100,000, or 20 percent of the value of the property without the easement. The applicable percentage for the estate is 20 percent (40 percent reduced by twice the difference between 30 percent and 20 percent). Therefore the exclusion amount is $80,000 (20 percent of $400,000).

Conclusion

A conservation easement on woodland can insure that the woodland will always remain as such and not be commercially developed. At the same time, if the easement is donated rather than sold, it can provide significant tax benefits. However, careful thought should be given to the granting of an easement. The transfer must be in perpetuity and is not reversible. With a donated easement, unless the donor's estate is large enough to be subject to the federal estate tax, there will be no estate tax benefit. Legal fees and appraisal costs will reduce the income tax deduction. In summary, a conservation easement may be ideal for certain woodland owners but something that others will want to avoid.

William C. Siegel is an attorney and consultant in private practice specializing in timber tax law and forestry estate planning. He is retired from the US Forest Service where he served as Project Leader for Forest Resource Law and Economics Research with the Southern Forest Experiment Station, where he still serves as a volunteer. He provides this column as a regular service to National Woodlands readers. Mr. Siegel welcomes comments and questions. They may be directed to him at: 9110 Hermitage Place, River Ridge, LA 70123; tel. (504) 737-0583.

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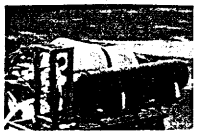

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On the Cover: In the face of dramatically higher energy prices, emerging markets for wood-based fuels like biomass and methanol should make timber stand improvement operations more profitable. This woodlot, which was thinned in 2005 for firewood, is an example of how private, non-industrial timberland can produce energy today and quality sawtimber in the future.