

FLATHEAD LAND TRUST

# PURSUING A CONSERVATION EASEMENT

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FACTS ON YOUR OPPORTUNITIES

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# Part I: Introduction

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## WHAT IS A CONSERVATION EASEMENT

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A conservation easement is a voluntary, legal agreement between a landowner and a land trust or government agency that permanently limits a property's uses in order to protect its conservation values. The landowner continues to own and manage the property.

When you own land, you also "own" many rights associated with it, such as the right to harvest timber, build structures, grow crops, or subdivide the land. You also "own" the right to not harvest timber, not grow crops, or not subdivide the land. To donate certain of these rights for the purpose of conservation, while retaining other rights, a landowner grants a conservation easement to the Flathead Land Trust. Rights of landowners may be subject to government control, such as zoning.

The donation of a conservation easement to the Flathead Land Trust **may qualify as a charitable contribution**. As such, it may reduce income, estate and gift taxes.

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## HOW DOES A CONSERVATION EASEMENT WORK?

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The conservation easement document spells out what activities will and what will not be allowed on the property. Each conservation easement is tailored to protect each property's unique conservation values while meeting the financial and personal needs of the landowner. The terms of the easement do not in any way negate or modify local, state or federal law.

The following are general examples of the types of uses that can be allowed with a conservation easement:

- 1) Continued agricultural practices
- 2) Selective timber harvest
- 3) Construction of additional family residences if compatible with conservation objectives
- 4) Wildlife and aquatic restoration efforts
- 5) Any and all uses not specifically prohibited

The following are examples of types of uses that are generally not allowed with a conservation easement:

- Intensive subdivision for residential or commercial development
- Surface mining
- Activities resulting in water pollution or soil erosion
- Non-agricultural commercial activities except home businesses
- Any or all uses which may undermine the conservation aims of the easement

A conservation easement does not require that there be public access to the property, although public access can be allowed if desired by the landowner.

A landowner should plan for the easement process to take a minimum of 3-6 months. The process typically includes: a tour of the land; a baseline inventory and evaluation of habitat value; a title report; an appraisal; a mineral report; negotiation of terms of the easement; approval from the Flathead Land Trust Board of Directors; and recording of the executed, completed easement.

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## WHY GRANT A CONSERVATION EASEMENT?

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Landowners donate conservation easements for a variety of reasons. First and foremost in most donors' minds is their love and appreciation for their land and their desire to see the land remain as they have always known it. Many landowners just wish to give something back to the land that has enriched their lives. Others find conservation easements to be a great way to support a nonprofit conservation group like the Flathead Land Trust. And the future figures into most easement donor's minds. As they think about what will become of the land in the future, some people want to ensure that their property remains intact after they've gone, and that their family can inherit the land and enjoy all the same values that generations before enjoyed. Conservation easements are powerful estate planning tools that can help keep land in family ownership.

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## HOW ARE CONSERVATION EASEMENTS ENFORCED?

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The easement runs with the property regardless of changes in ownership. Legally the easement deeds the easement holder the rights necessary to enforce the terms of the easement. The holder will monitor the easement by inspecting the land regularly (yearly in most cases) and talking to the landowner about future plans in order to avoid conflict with the easement. If a future owner or someone else violates the easement, the easement holder will take action to have the violation corrected, including going to court if necessary. Easement holders typically ask landowners for a financial contribution to a stewardship fund to ensure the ability to monitor and enforce the easement in perpetuity.

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## WHAT ARE THE LEGAL REQUIREMENTS?

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Montana law authorizes the granting of conservation easements to qualified private organizations, such as the Flathead Land Trust. It requires that the county planning authority review the easement and give non-binding advice about the easement's effect upon the county's comprehensive plan. Finally, the law requires that the Deed of Conservation Easement must be recorded at the County Courthouse.

Federal law governs only the tax treatment of a conservation easement as a charitable gift. Although you will need to consult with your own attorney or a person knowledgeable in federal requirements, in general the following major rules apply in order to receive a tax benefit:

- The conservation easement must be granted in perpetuity (mortgage holders must agree to subordinate to the easement).
- The easement must be granted to a qualified organization (such as a land trust or government agency).
- The easement must provide at least one of the following conservation purposes:
  - 1) The preservation of land areas for the education of, or outdoor recreation by, the general public.
  - 2) The protection of relatively natural habitat for fish, wildlife, plants, or similar ecosystems.
  - 3) The preservation of open space (including farmland or forest land) for (a) scenic enjoyment of the general public and/or (b) significant public benefit pursuant to a clearly delineated government policy.

- Baseline data documenting the conservation values of the property must be collected prior to the donation.
- The easement must prohibit all surface mining. If the easement donor does not own all the mineral rights, the possibility of surface mining must be determined "so remote as to be negligible." A geologist's report may be necessary to document this remoteness.

Assuming that the conservation easement is determined to meet federal requirements as a charitable gift, you may be entitled to a reduction in income and/or estate taxes.

*This fact sheet is intended to give only an overview about conservation easements. It is not intended to provide definitive legal or tax advice.*

## Part II: Tax Implications of a Conservation Easement

The desire to protect your land is the primary reason for donating a conservation easement to the Flathead Land Trust. However, it may be the federal income and estate tax incentives that make it possible to give generously and accomplish significant land protection.

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### WHAT IS CONSIDERED A CHARITABLE GIFT?

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The first step in figuring your potential tax deduction is to determine whether your donation is a charitable gift in the eyes of the IRS. The gift must be a true gift motivated by a charitable intent and not granted as a requirement for getting something in return. For example, a conservation easement given to a land trust by a developer in exchange for government approval of a subdivision may not be a gift. In addition, a gift generally must be complete and irrevocable, without strings or contingencies.

To determine whether your gift meets IRS requirements, it is best to review the proposed gift with an experienced attorney or accountant. A deductible, charitable donation is usually given to an IRS-qualified, tax-exempt organization, such as the Flathead Land Trust.

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### HOW IS THE GIFT SUBSTANTIATED?

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For tax deductions on gifts worth more than \$5,000 (other than cash and publicly traded securities), landowners must obtain a *qualified appraisal by a qualified appraiser*. The appraiser estimates the value of the property before and after the easement restrictions are applied. The difference between the two values is the amount of the charitable gift for tax purposes. The Flathead Land Trust can provide you with a list of qualified appraisers in northwestern Montana, but cannot provide the appraisal. The appraisal cost is a necessary expense if you want to pursue a charitable tax deduction.

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### INCOME TAX: AN EXAMPLE

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For illustrative purposes, let's assume you are the owner of a family farm and you desire to donate a conservation easement on your property. Working with the Flathead Land Trust, you negotiate the terms of the easement, which allows for continued agriculture, the construction of one additional residence, protects wetlands and wildlife habitat, and precludes commercial development, subdivision and surface mining.

To determine the value of the conservation easement, you obtain a "qualified appraisal." The appraiser determines the fair market value of the farm with its development and subdivision potential to be \$1,000,000. This is the value of the property before the conservation easement. With the easement in place, the fair market value of the property drops to \$700,000 because you have restricted subdivision on most of the property. In this example, the value of your charitable contribution is \$300,000.

## THE 30 % LIMITATION

The tax law places limitations on the maximum charitable deduction a donor may take. Generally, for the donation of a conservation easement, the amount you can deduct in any given year is limited to 30% of your adjusted gross income. If the value of your gift exceeds 30%, you can carry forward the excess for up to five additional years, applied each year up to the 30% limit. Any remaining portion of the deduction cannot be used. The actual tax reduction is a function of your income tax bracket.

In our example, the value of the charitable contribution generated through the donation of the conservation easement is \$300,000. Let's assume that your adjusted gross income is \$80,000 per year and remains the same for the six-year period. You may deduct 30% of your adjusted gross income each year for the year of the donation and the following five years.

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|------------------|------------------|
| .30 x \$80,000 = | \$24,000         |
| 6 x \$24,000 =   | <b>\$144,000</b> |

## OTHER DEDUCTIONS

Some of the costs incurred in making a charitable contribution are themselves deductible. Legal and appraisal fees and costs associated with compilation of the "Baseline Resource Documentation Report" can generally be deducted as business expenses if, in combination with other miscellaneous deductions, if they exceed 2% of your adjusted gross income. In addition, any cash or securities given to endow stewardship of a conserved property are considered charitable contributions.

### Estate Tax

If you own land of substantial value, you may not be able to pass it on intact to your heirs. State and federal taxes are based on the fair market value of the property at the time of your death, not the original purchase price or current use value. When you die, your children may find that the federal estate tax - which is levied at rates between 37% and 55% - is in the hundreds of thousands or millions of dollars. Selling all or part of the land for development may be the only way to pay the estate tax. Conservation easements can be a useful estate-planning tool to reduce estate tax liability and allow land to remain in the family.

If you place a conservation easement on your land restricting future development, its fair market value will, in most cases, be reduced. This reduction in fair market value also reduces the value of the estate. This can ease the financial burden of passing the property on to your heirs.

Generally, an individual can give up to \$1,000,000 (including land) during his/her lifetime and/or at death that is not subject to federal gift or estate tax. In addition, one can give \$11,000 a year to each of any number of individuals without a gift or estate tax liability. The federal estate or gift tax is levied on amounts over \$1,000,000 and is due within nine months of the date of death.

**An example.** You have a family farm, which you want to pass on to your children, but you are concerned because the value of the land has appreciated significantly over time. You are afraid that your children may not be able to keep the farm intact because of a potentially large estate tax liability.

As described in the income tax example above, the appraised value of your family farm is \$1,500,000 before the conservation easement and is \$1,100,000 after the easement. Without the easement in place, you could pass \$1,000,000 of property to your heirs either by gift or through the estate free of tax. This would leave \$500,000 (\$1,500,000 minus \$1,000,000) subject to estate tax

graduated at rates of 37% to 55% (\$185,000 to \$275,000), depending on marital status, ownership, and the value of other assets owned at the time of death.

With the conservation easement in place, the value of the farm for estate tax purposes would be \$1,100,000. Utilizing the \$1,000,000 exemption, this would leave just \$100,000 subject to estate tax at graduated rates of 37% to 55% (\$37,000 to \$55,000), again depending upon marital status, ownership, etc.

By placing a conservation easement on the property, you have not only saved the family farm and protected open space and wildlife habitat, you have also saved between \$148,000 and \$220,000 in estate taxes. You have made it possible for your children to be able to afford to inherit the family farm.

*Note:* The examples used in this fact sheet are for illustrative purposes only. The Flathead Land Trust does not purport to give legal or tax advice about the consequences of a particular conservation easement. The tax implications of your conservation plan will depend upon the value of your gift, your finances and other factors unique to your situation. The Flathead Land Trust strongly recommends that you consult with your own attorney, CPA or tax advisor to fully understand how current tax law affects your conservation plan.

# Part III: Other Conservation Options

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## LAND DONATION

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Outright donation of the land to a land trust or government agency is another option. An outright donation has several benefits. It releases you from the responsibility of managing the land and can provide substantial income tax deductions and estate tax benefits (while avoiding any capital gains taxes that would result from selling the property). Donating land may be the best conservation strategy for you if you do not wish to pass the land on to heirs; own highly appreciated property; have substantial real estate holdings and wish to reduce estate tax burdens; or would like to be relieved of the responsibility of managing and caring for the land.

Donating land is a very generous act. But especially if the land has appreciated a great deal since you acquired it, it may not be as large a financial sacrifice as one would expect. If you donate your land to a charitable organization or government agency, you can usually claim an income tax deduction equal to the land's current fair market value (within limitations allowed by the tax code). If you sell the land, you will incur capital gains tax on the appreciation. Your profit may be further reduced by a realtor's commission and expenses resulting from the time delay in finding a buyer. Donating the land will also remove its value from your estate, reducing future estate taxes. And, of course, you won't have to pay property taxes on it anymore.

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## DONATING A REMAINDER TRUST

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You can donate land but continue to live on it by donating a remainder interest in the property and retaining a reserved life estate. In this arrangement, you donate the property during your lifetime, but reserve the right for yourself or any other named persons to continue to live on and use the property during their lifetimes (called a "reserved life estate"). You have donated to the land trust a "remainder interest" in the property. When you or those you've specified die or release their life interests, the land trust will have full title and control over the property.

By donating a remainder interest, you can continue to enjoy your land and may be eligible for an income tax deduction when the gift is made. The deduction is based on the fair market value of the donated property less the expected value of the reserved life estate. These transactions have the disadvantage of being relatively complex.

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## DONATING LAND BY WILL

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If you want to continue to own and control your land during your lifetime, you can transfer the land to a land trust or government agency by will at the time of your death. Before writing the devise into your will, you should make sure the chosen recipient is willing and able to receive the gift.

Placing the donation in your will rather than donating the land during your lifetime means that you receive no income tax benefits from your gift and you will continue to be liable for the property taxes. However, removing the value of the property from your estate could significantly reduce the estate taxes.

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## **BARGAIN SALE**

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Land trust and government agencies are sometimes willing, though often not able, to buy conservation land. If you need to realize some immediate income from your land, yet would like the property to go to a land trust or government agency, a bargain sale might be the answer. In a bargain sale, you sell the land for less than its fair market value. A bargain sale combines the income-producing benefit of a sale with the tax-reducing benefit of a donation. The difference between the land's appraised fair market value and its sale price is considered a charitable donation and may be able to be claimed as an income tax deduction.

# Part IV: Easement Procedure

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## PRELIMINARY

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Initial visit with landowner  
Site visit and walk-around  
Draft easement  
Preliminary report to Flathead Land Trust Board

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## INTERMEDIATE

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Easement Baseline Report  
    Independent contractor  
    Start/complete  
    Review by FLT and landowner  
    Revision  
    Acceptance by FLT and landowner

Additional Drafts of Easement  
Final draft  
Landowner - FLT meeting to review easement  
Legal review of easement  
Title report ordered  
Appraisal contracted  
Title report and appraisal completed  
Presentation to FLT Board for approval

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## FINALIZATION OF EASEMENT

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Local government planning board  
Landowner/grantor signs  
FLT signs  
Easement filed  
Stewardship donation made

If you need more information or would like to discuss a conservation easement donation to Flathead Land Trust, please contact us in any of the following ways:

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