

A Guide to Preservation and Conservation Easements; *part 2 of 2*

STEFAN NAGEL, ESQ., OF COUNSEL
LAW OFFICE OF STEPHEN J. SMALL, ESQ., P.C.

WHAT ARE SOME OF THE FEDERAL AND STATE INCOME TAX BENEFITS?

When a homeowner donates a preservation easement to a preservation agency such as the Frank Lloyd Wright Building Conservancy, he or she is literally transferring a bundle of rights in that property to the agency. Those rights could include the right to alter significantly the construction or appearance of the facades of the structure, the right to subdivide a larger parcel for additional development, or even the right to demolish the building. Such a relinquishment of rights would be motivated by a desire to preserve and protect a historically or culturally significant property from inappropriate development in perpetuity. But there are also significant tax benefits, which can accrue to the homeowner, which are triggered by such an easement donation.

The bundle of rights transferred can be valued by a qualified appraiser experienced in valuing preservation easements. An appraiser should be contacted early in the process to perform such an appraisal. This appraised value is the amount that can be treated as a charitable donation for income tax purposes. The federal income tax benefits are measured as a deduction against the donor's adjusted gross income.

For example, if an appraiser determines that giving up the right to subdivide a \$2 million parcel of land containing a Frank Lloyd Wright house, is worth \$1 million, the potential tax savings may be computed as follows:

Donation (i.e., appraised value of donation) x tax rate = approximate tax savings

If the donor is in the 38.6% tax bracket, the calculation would be: \$1,000,000 x 38.6% = \$386,000 (approximate tax savings).

Thirty eight and six tenth percent represents the highest federal income tax bracket. Most states allow a similar deduction against state income taxes. In addition, a number of states also provide a credit against state income tax liability, subject to certain limits. Thus, an easement donation with an appraised value of, say \$50,000 may entitle the donor to a dollar for dollar credit against state income tax liability.

There is no rule of thumb for determining what the donation value of a preservation easement will be. Valuations may range from less than 10% to more than 90% of the property's unrestricted fair market value, depending on its location, level of development and other factors.

Certain annual limits apply with respect to the amount of the deduction that can be taken in the year of donation of the easement and in subsequent years.

WHAT ARE SOME OF THE FEDERAL ESTATE TAX BENEFITS?

Estate taxes – levied at rates as high as 55% - may prevent a family from passing a valuable property from one generation to the next. When property owners die and leave the property to their children, the heirs may find that the property has appreciated dramatically since it was purchased, making it difficult to pay state and federal estate taxes. In some instances, the heirs may be forced to sell all or part of the property to pay the estate tax.

Because preservation and conservation easements are measured as a reduction in the appraised fair market value of property, an easement donated by a property owner prior to death, or by will, will reduce the total value of the estate. In addition, the estate of the donor of a conservation easement may be entitled to exclude as much as \$500,000 from the calculation of the donor's taxable estate. See Law Notes in the Bulletin of Summer, 1998 (Volume 7, Issue 3).

ARE THERE REAL ESTATE PROPERTY TAX BENEFITS?

The donation of a preservation or conservation easement may also entitle the property owner to a reduction in his property assessment, reducing the property tax. While the reduction in assessment may not be the same as the valuation ascribed by the appraiser for federal income tax purposes, the appraisal may be used to advocate for a similar reduction in the property assessment.

WHAT ARE THE COSTS OF PREPARING A PRESERVATION OR CONSERVATION EASEMENT?

To assure that easements are properly monitored and enforced, the Frank Lloyd Wright Building Conservancy and other responsible easement holding organizations request the donor of an easement to reimburse the organization for its costs in evaluating an easement donation and administering the easement in the future. In addition, easement donors will have their own legal, appraisal, and in some cases surveying costs to consider. The amount of the contribution for administration of the easement is generally based on the size of the property, the complexity of the easement, and the amount of time which will be required on an annual basis to administer and monitor the easement. A certain amount of each contribution is designated for future legal fees should the need ever arise for the Frank Lloyd Wright Building Conservancy to meet its obligation to defend the terms of the easement. If you wish to discuss these costs or any matter raised in this article, please call the Conservancy's offices.

This article is based in part on materials previously prepared for the Willistown (PA) Conservation Trust and Winchester (MA) Tomorrow.