Tax Scenario of Conservation Easement Tax Incentives (Section 1206) of the Pensions Act (HR4) As Signed by President Bush August 17, 2006

A. Expanded Tax Incentive

1. How does the bill change the current tax incentive for conservation donations?

The new law:

- Raises the deduction a donor can take for donating the value of a conservation easement from 30% of their adjusted gross income in any year to 50%;
- Allows qualifying farmers and ranchers to deduct up to 100% of their income; and
- Increases the number of years over which a donor can take deductions from 6 years to 16 years.

2. Can you give me an example?

Under the previous rules, a landowner earning an adjusted gross income of $100,000 a year who donated a $200,000 conservation easement could take a $30,000 deduction for the year of the donation and for an additional 5 years – a total of $150,000 in tax deductions.

The new rules allow that landowner with the $100,000 income making the $200,000 conservation easement to deduct $50,000 for the year of the donation and then for up to an additional 15 years up to the value of the donation. That's $200,000 in deductions over a four year period. If the gift is smaller (say, $110,000), the landowner would still deduct $50,000 per year for two years, and the remainder in the third year up to the value of the donation.

Qualified Farmer: If the landowner qualifies as a farmer or rancher, they can zero out their taxes. In that case, they could take a maximum of $100,000 in deductions per year for their gift.

Another Example: For a landowner earning $100,000 per year, $1,000,000 conservation easement gift, a landowner previously could take only $30,000 per year in deductions, over a six year period, for a maximum lifetime deduction of only $180,000 for the gift.

The new rules would permit the same donor to deduct $50,000 per year for sixteen year period, for a maximum lifetime donation of $800,000 for the gift.

If one's income is higher, their deduction per year would be greater as well.

3. Can anyone deduct more than the value of their gift?

One can never deduct more than the fair market value of the gift. This change simply allows landowners who previously could not deduct the full value of their gift to deduct more of that value.

4. Who qualifies as a farmer or rancher?

The new law defines a farmer or rancher as someone who receives more than 50% of their income from "the trade or business of farming". The law references an estate tax provision (Internal Revenue Code (IRC) 2032A(e)(5)) to define activities that count as farming. Specifically, those activities include:

- cultivating the soil or raising or harvesting any agricultural or horticultural commodity (including the raising, shearing, feeding, caring for, training, and management of animals) on a farm;
- handling, drying, packing, grading, or storing on a farm any agricultural or horticultural commodity in its unmanufactured state, but only if the owner, tenant, or operator of the farm regularly produces more than one-half of the commodity so treated; and
- the planting, cultivating, caring for, or cutting of trees, or the preparation (other than milling) of trees for market.

The provision apparently does not apply to landowners who only "cash rent" to farmers, but are not actively engaged in farming themselves. However, the provisions apply to those who rent out their land on shares. The qualified farmer or rancher provision also applies to farmers who are organized as C corporations. For an easement to qualify for the special treatment, it must contain a restriction requiring that the land remain "available for agriculture".

5. Do these changes apply to gifts of land?

This expanded incentive applies to the various specific gifts of partial interests in land specified as a "qualified real property interest" under IRC 170(h)(2). A landowner who is considering a gift of their entire interest in a piece of land should consult with an attorney to determine whether he or she may be able to utilize this new incentive.

6. Does this only apply to conservation easements?

The expanded incentive applies to all donations covered in IRC section 170(h)(2), which includes donations of the entire interest of the donor other than a qualified mineral interest; a remainder interest; or a permanent conservation or historic preservation easement.

7. What is the timeline for this expanded incentive?

The new law applies to all easements donated in 2006 and 2007.