



Todd Parker

# *The* Conservation Easement

*as a land protection and  
financial planning tool*

*Little Traverse Conservancy*



**The conservation easement** can be an ideal tool for landowners who want to preserve their land's natural and historic heritage for future generations, while maintaining private ownership. Land protected with a conservation easement is not open to the public and continues to carry many of the normal benefits of private land.

In addition to protecting conservation values, landowners may also enjoy financial benefits resulting from their decision to place an easement on their land. Recent tax laws have helped make this decision a bit easier. But of course, the primary motivation behind a conservation easement must be conservation.

Remember...while it is perhaps the most creative tool, the conservation easement is just one of a handful of conservation opportunities available today for your land. We welcome you to contact the Little Traverse Conservancy staff who can share additional information on these and other programs with you.

LITTLE TRAVERSE CONSERVANCY

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**In 1972**, the Little Traverse Conservancy was organized by a handful of citizens who shared the common goal of working with landowners to protect the natural beauty of northern Michigan. Today (2007), the Conservancy has more than 4,200 members and has protected more than 30,000 acres which include nearly 81 miles of shoreline throughout Michigan's northern lower and eastern upper peninsulas. The common thread running through each of these land projects is that they are all designed to protect the natural character of northern Michigan for the present and future generations.

One of the Conservancy's guiding principles is that private land owners have as much right to protect their land as they do to develop it. This goes against the conventional wisdom, developed in the 19th and 20th centuries, that land development is every property's destiny. But as the 21st century dawns, many land owners are recognizing that times have changed and the development pendulum has swung too far. There may have been a day when it was necessary to protect a growing civilization from the ravages of the wild, but in the era of "urban sprawl," "monster homes" and "big-box development," many land owners are using their property rights to protect what's left of the wild from the ravages of civilization.

This brochure is intended to explain the conservation easement as a land protection tool. The first two sections explain what a conservation easement is and provide a list of sample easement provisions. The next section describes the financial considerations of granting a conservation easement. The last section provides five case studies illustrating different ways in which conservation easements can be used to protect land and meet owners' needs.

If you are interested in a conservation easement for your property after reading this brochure, we encourage you to contact our office for additional information.

# The **Whys** and **Hows** of a Conservation Easement

## What is a conservation easement?

A conservation easement is a voluntary agreement that allows a landowner to limit the type or amount of development on their property while retaining private ownership of the land. It is a legal document restricting future uses of the land. The easement is signed by the landowner (the easement donor) and the Conservancy (the party receiving the easement). The Conservancy accepts the easement with the understanding that it must enforce the terms of the easement in perpetuity. After the easement is signed, it is recorded with the County Register of Deeds and applies to all future owners of the land.



Henne Conservation Easement, Charlevoix County

Another way to visualize a conservation easement is to think of owning land as holding a bundle of rights. Each one of those rights represents the landowner's ability to do something with their property. The right to subdivide, build, and to

extract minerals are all rights that the landowner has. A landowner may give up some of these rights through a conservation easement and protect the land's natural values.

Conservation easements offer great flexibility. An easement on property containing rare wildlife habitat might prohibit any development, for example, while one on a farm might allow continued farming and the building of additional agricultural structures. An easement may apply to just a portion of the property and need not require public access.

## Why do People Grant Conservation Easements?

People grant conservation easements because they want to protect their property from future unwanted development but they also wish to retain ownership of their land. A conservation easement ensures that the property will be protected and cared for forever, regardless of who owns the land in the future. An additional benefit of granting a conservation easement is that the donation of an easement may provide significant tax and estate planning advantages to the donor.

### **What activities are allowed on land protected by a Conservation Easement?**

The activities allowed by a conservation easement depend on the landowner's wishes and the characteristics of the property. In some instances, no further development is allowed on the land. In other circumstances, some additional development is allowed, but the amount and type of development is less than would otherwise be allowed.

Conservation easements may be designed to cover all or only a portion of a property. Every easement is unique, tailored to a particular landowner's goals for their land. Agricultural activities and timber management are two activities that are sometimes retained within the easement terms. See page 8 for a list of other commonly reserved rights and restrictions.

### **Can the landowner still sell or give the property away?**

The landowner continues to own the property after executing a conservation easement. Therefore, the owner can sell, give, or lease the property as before. However, all future owners of the land must abide by the terms described in the conservation easement.



Harding Conservation Easement, Mackinac County

**Does the public have a right of access to easement-protected property?** The public does not have access to property protected by an easement unless the original landowner who grants the easement specifically allows it. Most easement donors do not wish for, and therefore do not allow public access to the property.

**How long does an easement last and who upholds it in the future?** To be eligible for a federal income tax deduction, the easement must be perpetual - it must last forever. Generally once a year, the Conservancy monitors the property to assure that the easement is not being violated. If the easement has been breached, the Conservancy will take whatever steps are necessary to uphold the terms of the easement, including legal action.



Seidel Conservation Easement, Charlevoix County (Phil Ohmer)

### Who owns and manages the protected land?

The landowner retains full rights to control and manage their property within the limits of the easement. The landowner continues to bear all costs and liabilities related to ownership and maintenance of the property. The Conservancy monitors the property annually to ensure compliance with the easement's terms, but it has no other management responsibilities and exercises no direct control over other activities on the land.

### Does the easement have to cover all of the landowner's property?

No, some easements only cover a portion of the landowner's property. Again, it depends on the landowner's wishes.

### What kind of land can be protected by a conservation easement?

IRS regulations require that the property have "significant" conservation values. This includes forests, wetlands, endangered species habitat, beaches, scenic areas, and more. The Conservancy also has its own criteria for accepting easements. At the invitation of the landowner, Conservancy staff will evaluate the property to determine whether it meets these criteria. Ultimately, the Conservancy's Board of Trustees decides which easements to accept.

### Why might an easement not be accepted?

Not every property is appropriate for a conservation easement. Some of the reasons why an easement would not be acceptable include: 1) the property is too small or does not meet Conservancy land protection criteria; 2) the complicated nature of the property makes it too difficult to enforce the conservation terms; or 3) The property is part of a permit/mitigation scenario. These issues will be thoroughly discussed with Conservancy staff.



Schaedig Conservation Easement, Chippewa County

## Sample conservation easement terms

Some conservation easements prohibit all future development. In other circumstances, the landowner wishes to retain some development rights. The Conservancy works with each landowner to draft an easement to fit the personal needs of the landowner and the unique characteristics of their land. The following are examples of common easement provisions:

### *Commonly Reserved Rights*

- The right to use the property for all purposes not inconsistent with the easement.
- The right to sell, give, or otherwise convey the property (subject to the easement.)
- The right to replace or add on to the existing buildings or boat docks.
- The right to construct limited additional single-family homes.
- The right to farm.
- The right to manage timber according to an approved plan.

### *Common Restrictions*

- No buildings allowed except those specified above.
- No draining or filling of wetlands.
- No surface mining.
- No industrial or commercial use of the property other than forestry or agriculture.
- No dumping trash or hazardous waste.
- No advertising billboards.
- No further division of the property (except under guidelines set out by the landowner).
- No motorized off-road vehicles (except under guidelines set out by the landowner).
- Timber harvest or vegetation removal may be restricted to some level.



Smith Conservation Easement, Mackinac County

## Tax and Other Financial Considerations

Landowners who place conservation easements on their property may realize tax savings through federal income tax deduction, estate tax savings, reduced inheritance tax, avoidance of gift taxes, and property tax incentives.

When a landowner places a conservation easement on their property, they are making a charitable donation to the Conservancy. The value of this donation is measured by calculating the difference between the fair market value of the property before the easement is in place with the value after the easement is granted. The difference between those “before” and “after” values is the value of the charitable gift.

Donation of a conservation easement may therefore give rise to tax savings, particularly federal income taxes and estate taxes. The amount of the federal income tax deduction depends on the value of the donation and the landowner’s adjusted gross income. As a general rule, IRS regulations allow an easement donor to deduct up to 50% of their adjusted gross income for each year up to 15 years, or until the value of the easement has been deducted, whichever occurs first. If the value of the easement exceeds \$5,000, the landowner must obtain an appraisal by an independent real estate appraiser qualified in accordance with IRS criteria. This appraisal can be made no more than 60 days before the easement is donated, or anytime thereafter. The cost of the appraisal is tax-deductible. As the recipient of the gift, the Conservancy cannot provide the appraisal. However, the Conservancy can provide a list of appraisers experienced in conservation easements.

Estate tax savings result from the fact that the restrictions in the easement reduce the value of the land and, therefore, the taxable estate. This reduction in value may be particularly helpful in situations where the value of the land and therefore the estate taxes are so high that the land itself would otherwise have to be sold to help pay the estate taxes.

In some circumstances, the landowner’s property taxes may also be reduced if the property is being taxed at its development value and the easement will restrict development. **A new (Fall, 2006) Michigan law eliminates the “pop-up tax” on lands protected by a qualified conservation easement.**

Landowners are encouraged to talk with their personal tax advisors and attorneys to learn how they may benefit, financially, by donating a conservation easement.

## Costs to Landowners

The landowner may incur some expenses associated with placing an easement on their property. If the landowner claims a tax deduction and the easement is worth over \$5,000, they will need to hire an appraiser to determine the value of the easement. In addition, the Conservancy invites easement donors to make a financial contribution to the Conservancy’s Easement Endowment Fund. This contribution helps defray the expenses of executing the easement and the long-term costs associated with monitoring and enforcing the easement. Making an endowment contribution is encouraged, but not required by Little Traverse Conservancy.

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## Examples of Financial Benefits from Donating a Conservation Easement

The following example illustrates the potential financial benefits of a conservation easement. Of course, each situation is different, and landowners are encouraged to seek professional advice from their accountants and/or attorneys. (Note: The Alternative Minimum Tax may have an effect upon federal income tax deduction.) To illustrate the potential tax savings from donating a conservation easement, assume that a married couple filing jointly have an adjusted gross income in 2002 and for the three following years of \$100,000 and that they are in the 28% tax bracket. (Keep in mind that the new law now allows the tax savings to be spread over up to 15 years.) In 2002, they donated a conservation easement on their property and the charitable contribution is appraised at \$175,000. Their tax savings are calculated as follows:

Year	Charitable Deduction	Limitation (50% AGI)	Carry Forward	Tax Savings
1	\$175,000	\$50,000	\$125,000	\$14,000 (\$50,000 x 28%)
2	\$125,000	\$50,000	\$75,000	\$14,000 (\$50,000 x 28%)
3	\$75,000	\$50,000	\$25,000	\$14,000 (\$50,000 x 28%)
4	<u>\$25,000</u>	<u>\$50,000</u>	<u>\$0</u>	<u>\$7,000 (\$25,000 x 28%)</u>

Total Federal Income Tax Savings = \$49,000

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Sims-Schulze Conservation Easement, Emmet County

## CASE 1: Protecting the Homesite

Bill and Harriet Dean live on a 120-acre parcel of land. The property is forested with rolling hills and views of a nearby lake. Their home is located on one corner. The Deans have lived on the property for many years and wish to preserve the land as much as possible, both for themselves and their children. Many nearby parcels are being broken up and developed for residential and resort use. Their property has greatly appreciated in value over the years as more and more people desire property with a view of the lake.

The Deans placed a conservation easement on their property and excluded one 5-acre lot near their home which they plan to sell when they retire. The easement also allows them to replace or restore their existing home in its present location. In addition, they can selectively cut trees for timber management and firewood. Clearcutting is prohibited. The Deans will still be able to hike and otherwise enjoy their land, but now they can do so with the knowledge that most of it will remain in its natural state forever.

The Deans qualified for a \$70,000 federal tax deduction as a result of their conservation easement. Because of its proximity to the lake and the encroaching development, the land and their home were appraised at \$280,000 before the easement. The appraiser felt the house was worth \$120,000 and the Deans could have subdivided the remaining portion of the land and received \$160,000. The appraiser judged the property, the house, and the remaining building site after the easement to be worth only \$210,000. The difference between the "before" value of \$280,000 and the "after" value of \$210,000 is \$70,000. The Deans can deduct up to 50% of their adjusted gross income for each of 15 years to use up the value of this easement.

## CASE 2: Protecting the Back Forty

Ruth and Doug Wood have a cottage along Summit Lake. Many years ago, they purchased a 40-acre woodlot locate not far from their cottage. They use this property for firewood, hiking, and hunting. Most of the property nearby is low-density residential, held in 10 to 40-acre parcels. The Woods would like to permanently protect their woodlot to help maintain a natural buffer to oncoming development.

The Woods elected to prohibit all future development on their woodlot. As a result, they received a \$30,000 federal income tax deduction when the appraiser determined that the property was worth \$80,000 before the easement and \$50,000 after.

### CASE 3: Donating a Conservation Easement through a Will or Living Trust.

It is possible to convey a conservation easement to Little Traverse Conservancy through a Will or a Living Trust. Little Traverse Conservancy would always like to have an opportunity to review and approve the easement before the Will or trust is signed, and a copy of the proposed easement should be attached to the Will or trust as an exhibit. If the easement meets the requirements described earlier, the easement value is fully deductible from the donor's taxable estate. In other words, the land will be valued at its restricted value when calculating the federal estate tax.

This could be of great importance to the donor's heirs, because federal estate tax rates go as high as 45% today, and may spring back to 55% in 2011. Suppose, for example, a widow has a total estate valued at \$2 million, of which \$800,000 is the value of a farm that has been in her family for generations, and the balance is made up of life insurance

policies, personal property, and other assets. If the widow died with the land in her estate, her federal estate tax could be as high as \$225,000 (45% of the excess over \$1.5 million). Instead, if the widow placed a conservation easement on the farm during her lifetime or through her Will, which reduced the farm's value to \$300,000, her total taxable estate would be only \$1.5 million, and no estate tax would be due. The 50% limitation application to charitable gifts for income tax purposes does not apply for estate taxes.

At one time, it was essential that the owner conserve the property before she or he died. Otherwise, the farm would be assessed at its full fair market value, and the full estate tax would accrue, even if the heirs were willing to restrict the property. Fortunately, in the late 1990s, Congress amended the law to allow the estate to make two "post-mortem" elections, provided all of the heirs agree.

*(used with permission from the Vermont Land Trust, 12/2006)*



Randy McCune

## CASE 4: Estate Planning

For three generations, the Brown family has owned a 30-acre tract along an inland lake which includes 1,200 feet of frontage. The property has a single summer cottage.

The current owners, Jane and Bill Brown, are both retired. They live comfortably on their retirement income and, excluding the lakefront property, their assets total \$400,000. Their property has escalated in value and if it were split up and sold in 10 small lots, would be worth nearly \$2.3 million dollars.

The Browns have three children who visit the property with their families. The entire family loves the cottage, and the Browns hope to pass the whole parcel along to their children, giving each child an opportunity to have their own cottage on the property.

One of the concerns the Browns have is how to pass this property on to their children without large estate tax consequences. When the children inherit the property, they will be forced to pay estate taxes based on the property's total worth. The Browns are aware of this situation because they have seen what has happened to other families who were forced to sell all or part of their family lands to pay the estate taxes.

The Browns recognized that by placing a conservation easement on their property, they would be able to meet their financial planning objectives as well as permanently protect their property. They elected to draft an easement that excluded two building sites located near the existing cottage, and restricted the rest from development. The easement also incorporated a scenic greenbelt along the lakeshore.

The appraiser concluded that the ten potential lots were worth \$200,000 each and that the original cottage was valued at \$500,000. The remaining value of the house and designated two lots totaled \$900,000. The appraiser also determined that the easement enhanced the value of the property by \$100,000. Therefore, this easement reduced the value of the property from \$2.5 million to \$1,500,000. The value of their donation to the Conservancy, therefore, was \$1,000,000. Although the Browns may not be able to deduct all of this from their federal taxes, their actions will guarantee that they can pass the land on to their children without the children having to divide the property and sell it in small parcels. Also, future increases in property taxes are capped under Michigan law.

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## CASE 5: Wetland Protection

When the Hendersons bought their home along the Pine River, they knew this would be home for a long time. The Hendersons fish, canoe, hunt, and hike, and they spend hours on the river and the 60-acre cedar swamp, which is also part of their property.

The Hendersons have a deep love for their home and land and do not want the property to ever be developed. They are unsure if it could be developed under current wetland laws, but they also know the law could change. To ensure permanent protection, they placed a conservation easement on their property. This easement prohibits any further development except the right to replace the existing home and to place a trail within the marsh. The Hendersons, and their successors, will be able to fish, canoe, hike and otherwise enjoy the property.

The Hendersons elected to not have this conservation easement donation appraised due to the current laws protecting wetlands. They felt they were giving up very little development value, and it appeared that any possible tax deduction would not offset the cost of an appraisal. They simply felt better knowing that if wetland laws are relaxed or not enforced in the future, the Conservancy would be able to protect their land.



Betsie River Conservation Easement, Chippewa County

## Steps in donating a Conservation Easement

Once a landowner has decided to convey a conservation easement to the Little Traverse Conservancy, a number of steps are required by both the landowner and the Conservancy.

Listed below are the basic steps required, while unusual circumstances may require additional steps.



	<i>Responsibility</i>	
	Landowner	Conservancy Staff
<b>Step 1.</b> Tour the property to evaluate the natural resources and determine if an easement is appropriate.	X	X
<b>Step 2.</b> Submit project evaluation form to Conservancy Board for their approval.		X
<b>Step 3.</b> Negotiate the restrictions and draft the document.	X	X
<b>Step 4.</b> Advise the landowner to consult with legal and tax advisors.		X
<b>Step 5.</b> Prepare baseline documentation.	X	X
<b>Step 6.</b> Obtain record of good title and mortgage information.		X
<b>Step 7.</b> Obtain mortgage subordination from lender if lean exists.	X	X
<b>Step 8.</b> Obtain a “qualified appraisal” (if claiming a federal tax deduction of more than \$5,000).	X	
<b>Step 9.</b> Sign and record final version of easement.	X	X



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Paddock Conservation Easement, Emmet County