

Maryland Agricultural Land Preservation Program

TAX CONSIDERATIONS IN SELLING OR DONATING YOUR EASEMENT

This Fact Sheet describes some of the tax issues surrounding the sale or donation of an agricultural preservation easement to the Maryland Agricultural Land Preservation Foundation (MALPF) program, including potential tax implications, the range of potential benefits, and the requirements for establishing a charitable contribution.

The information in this fact sheet is for guidance and general planning purposes only. It should not be used to make decisions on specific matters. The tax advantages of easement donations and sales will vary with individual financial situations. Consult a tax advisor or attorney for how an easement donation or sale would affect your taxes.

Sale of an Easement

Estate Planning. By removing the development rights from your land, you will likely reduce the value of the property and, thereby, your estate. Especially for families whose primary asset is their land, this can be critical in preventing the farm from being sold to pay estate taxes. If you have donated your easement rather than sold it, you may be eligible for a substantial estate tax exemption (up to \$500,000 per owner) from the Farm and Ranch Protection Act of 1997.

For a discussion of the role of easements in estate planning, see *Farmland Preservation: An Estate Planning Tool* (Fact Sheet of the University of Maryland Cooperative Extension Service):

<http://extension.umd.edu/publications/PDFs/FS779.pdf>

Capital Gains. The proceeds from a sale of an easement may be subject to capital gains. For a discussion of capital gains taxes when preserving your land, see *Taxes and Land Preservation: Computing the Capital Gains Tax* (Fact Sheet of the University of Maryland Cooperative Extension Service):

<http://extension.umd.edu/publications/PDFs/FS780.pdf>

If you have a substantial basis in your property because you have owned it for many years, you may wish to consider using the installment purchase agreement settlement option that allows you to defer the capital gains tax obligation until the end of the agreement, except for any cash taken at the time of settlement. For more information on this option, see:

<http://www.marbidco.org/land/ipas.html>

Like-kind Exchanges. A method to minimize your capital gains liability is to use the proceeds from an easement sale in a like-kind exchange of property. Capital gains taxes normally due on the sale of development rights are deferred under this

arrangement when the cash payment for the easement is used to purchase real estate. You should consult a real estate attorney if you are a landowner thinking about selling an easement and, also, buying more land. An explanation of this tool, along with several examples, is available on page 160 of *Holding Our Ground: Protecting America's Farms and Farmland* by Tom Daniels and Deborah Bowers, published by Island Press, 1997. (This can be purchased on-line or obtained by inter-library loan from your local library.)

If you have sold your easement or are considering doing so, see also the section below on "The Impact of Easement Sale or Donation on Property Taxes."

Bargain Sale of Donation of an Easement

If an easement is sold for less than its full easement value (a "bargain sale") or donated, the uncompensated value may be treated as a charitable contribution for state and federal income tax purposes. An independent appraiser hired by the landowner will determine if a charitable contribution has been created by the transaction and its value.

Please note that the Foundation's method of easement valuation is determined by Maryland law and is incompatible with the requirements of the Internal Revenue Service (IRS). MALPF's calculation of an easement value cannot be used to establish a charitable contribution for tax purposes. A bargain or discounted sale of an easement as calculated by MALPF may not result in a charitable contribution under IRS requirements. Please see the section on "Appraisal Guidelines to Establish a Charitable Contribution" below for more on appraising easement value.

Federal Tax Benefits. Until December 31, 2009, the Federal tax benefits are as follows:

- If the value of the charitable contribution is 50% or less of the landowner's adjusted gross income, it may be entirely deducted in one year. If the value is greater, it may be spread over as many as 16 years.
- Qualified farmers may deduct up to 100% of their income for up to 16 years.

If these benefits are not extended by Congress, then on January 1, 2010, the benefits will revert to the following:

- If the value of the charitable contribution is 30% or less of the landowner's adjusted gross income, it may be entirely deducted in one year. If the value is greater, it may be spread over as many as 6 years.
- There is no additional benefit for qualified farmers.

Maryland State Tax Benefits. Landowners may choose to take the deduction on their State income taxes as well, or they may choose to take the income tax credit. They may not take both. The credit is only available to individuals and single-member limited liability companies (LLCs), not to corporations, partnerships, etc. To qualify for the State income tax credit, either MALPF or the Maryland Environmental Trust must be a grantee or holder of the easement.

The maximum State income tax credit is \$5,000 per year. The remainder of the

credit (based on the appraised value of the charitable contribution) may be carried forward for up to 15 years for a maximum credit of \$80,000. When multiple individuals (owners) share a charitable contribution from the bargain sale or donation of an easement, each one is separately entitled to their proportionate share of the tax credit up to \$5,000 per year. For example, a husband and wife as owners of the easement property, even if filing jointly, may take up to a \$10,000 credit per year. To calculate the total credit that an individual may take, multiply the appraised value of the charitable contribution by the individual's percentage ownership of the property.

If you wish to donate an easement on your property rather than selling it, the Foundation encourages you to contact the Maryland Environmental Trust (410-514-7900 or, toll-free within Maryland, 877-514-7900) or one of the approximately 50 private land trusts statewide:

<http://www.dnr.state.md.us/met/landtrustslists.pdf>

If you have a strong preference for donating an easement on your property to MALPF and meet its eligibility requirements, the Foundation will accept the donation if you are willing to accept MALPF's standard easement. If you wish to donate an easement to MALPF, please contact your county's program administrator to start the process:

<http://www.malpf.info/PAcontact.html>

If you have already completed or are considering a bargain sale or donation of an easement, see also the preceding section entitled "Sale of an Easement" and the section below on "The Impact of Easement Sale or Donation on Property Taxes."

Appraisal Guidelines to Establish a Charitable Contribution

The IRS requires charitable gifts that exceed \$5,000 be substantiated to establish accurately their value. Donors "substantiate" their gifts by obtaining an appraisal of the value of the property they donate.

For the IRS, the value of an agricultural preservation easement is based on an appraiser's determination of the price that a willing buyer would be expected to pay the owner at the property's highest and most economically productive use. The appraiser will calculate the fair market value of the property without easement restrictions in place and the fair market value of the property with the easement restrictions in place. The easement value is equal to the difference between the fair market values with and without easement restrictions in place. The value of the charitable contribution is this easement value less any payment received for the easement.

To receive a deduction for this charitable contribution of value from an easement, a landowner must obtain this appraisal from an IRS-qualified appraiser and complete IRS Federal Form 8283 for non-cash charitable contributions. The landowner is responsible for the determination of the value of the donation. To be IRS-qualified, an appraiser should be state-licensed or certified, follow the Uniform Standards of Professional Appraisal Practice (USPAP), and meet the requirements of a "qualified

appraiser" as defined in IRS Notice 2006-96, entitled "Guidance Regarding Appraisal Requirements for Noncash Charitable Contributions" and all subsequent refinements of the definition of "qualified appraiser." The effective date of the appraisal must not be earlier than 60 days prior to the date of contribution (which is the same as the date of settlement on the easement) and no later than the tax return filing date for the tax year of the donation.

On Form 8283, an officer of MALPF must sign to acknowledge that the transaction for which the landowner is requesting a deduction took place as described. MALPF's acknowledgement is not automatic. MALPF requires that the Form 8283 submitted already be signed by the appraiser and a non-returnable copy of the appraisal or its signed summary including an adequate description of the property be included. MALPF staff will review the appraisal to determine that it adequately describes the gift, such as the configuration of the property, the number of development rights extinguished, the restrictions represented by the easement document, and/or other relevant facts. MALPF staff is not professionally trained in appraising property, so will generally not judge the validity of the value of the charitable contribution claimed. As stated on Form 8283, "This acknowledgement (the donee's) does not represent agreement with the claimed fair market value."

MALPF staff may, however, refuse to sign a Form 8283 if the facts surrounding the appraisal are inaccurate or incomplete or other obvious errors are identified in the appraisal, such as using non-easement property values as comparables for easement property values. If MALPF does not sign a Form 8283, the landowner will be informed why when the paperwork is returned. Please allow adequate lead-time before your tax filing deadline for MALPF staff to review the necessary documentation before signing your Form 8283.

The Impact of an Easement Sale or Donation on Property Taxes

Some landowners expect that selling an easement on their farm will reduce their property taxes. Farms already receiving an agricultural assessment will continue to receive that agricultural assessment as long as the land remains in active agriculture, which means that there will be no impact on the property tax obligation. Existing or new residential improvements will continue to have the most significant impact on assessment values, and such improvements are subject to changes in the residential real estate market, and not subject to the easement placed on the remainder of the property.

If the landowner donates an easement to the Maryland Environmental Trust, the landowner will pay no State property tax on that land for 15 years from the date of donation. At the end of the 15-year period, unimproved land under the donated easement will be assessed at the highest agricultural rate. This rate is currently \$500 per acre. Property will qualify for this assessment rate even if it is not actively farmed. If the property is in active farming, it will be assessed at the appropriate agricultural rate. The property tax credit and assessment rate will not apply to any residential improvements or to a minimum of one acre around those improvements. This benefit does not now apply to easements donated to MALPF.

Approximately one-third of Maryland's counties offer property tax credits or other

tax benefits for landowners committing not to develop their properties. You should consult with the program administrator in the county where your property is located to determine if you qualify for any additional county tax benefits from selling or donating an easement on your property:

<http://www.malpf.info/PAcontact.html>

This fact sheet is a public document and is provided for general information only. If you have a question about a specific law, regulation, or provision related to the MALPF program, its option contract or deed of easement, please consult legal counsel.

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