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Tax Treatment of Conservation Easements

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Introduction

Conservation easements are a way for individuals, non-profit organizations, and units of government to maintain the flow of scenic and environmental benefits from private forestland without buying the land outright. An easement is the separation of designated rights held by the outright owner of forestland. The most frequently separated right is development when this would result in the loss of the scenic, environmental, or other benefits the land provides. Easement programs are almost exclusively voluntary. See Purdue Extension publication ID-231, *Conservation Easements in Indiana*, for an introduction to conservation easements.

This publication discusses tax aspects of conservation easements from the standpoint of a forest landowner, the person selling or donating an easement. Although it is intended to provide you with a basic introduction, footnotes on specific points of tax law are provided to help your attorney, CPA, or other tax advisor apply the law to your specific circumstances.

The discussion assumes the easement is granted to a qualified charitable organization or unit of government. Federal income and estate tax treatments are the focus, but state tax implications are discussed for residents of Indiana.

The total financial impact of a conservation easement depends on many factors. Before making a decision to sell, donate, or make a bargain sale of an easement, you should estimate the tax implications of each alternative. Your analysis should consider the tax implications to you, your spouse, and any heirs you desire to benefit.

"Conservation easement" is a general term applied to easements for scenic, ecological, wildlife, and almost any conservation purpose. The discussion here focuses on forestland, but it is applicable to easements on any type of undeveloped land.

An easement transaction can take three basic forms: (1) donation, (2) sale, or (3) bargain sale. A donation occurs when you do not receive anything of value in return for granting the easement. A sale is when you receive payments of cash or anything of value equal to the fair market value of the easement. A bargain sale is when you sell an easement for less than fair market value. This results in a transaction that is part sale and part donation.

The starting point for a discussion of any of these three types of transactions is the fair market value of the easement. The appraised value of the easement is the difference between the fair market value of your property with and without the easement. This is the value of the bundle of rights granted by you to the holder of the easement. It is determined by a complete appraisal of the property with and a complete appraisal without the easement, as demonstrated in Example 1.

A qualified professional appraiser must conduct the appraisal. The qualifications needed depend on whether federal funds are involved and whether you will be claiming a charitable deduction on your tax return.

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Example 1. Fair Market Value of Conservation Easement

Mr. and Mrs. Burkholder purchased 320 acres of forestland in 1975. They demarcated 5 acres as the homestead on which to build a house, outbuildings, pond, and other facilities. In 2002 the Burkholders sold a conservation easement on their forestland in order to reduce its value for estate tax purposes and to provide retirement income. The easement applied to the 315 acres of forestland. The 5-acre homestead and all improvements were excluded. Under the terms of the easement, the Burkholders and all subsequent owners are allowed to manage the timber and conduct harvests consistent with sustainable forestry practices.

The appraised fair market value of the 315 acres in 2002 without the easement was $6,000 per acre, for a total of $1,890,000. The appraised fair market value with the easement was $2,000 per acre, for a total of $630,000. This makes the value of the easement $1,260,000 ($1,890,000 - $630,000).

Federal Income Tax Treatment

This section discusses the income tax treatment under the Internal Revenue Code (IRC) of the transactions creating the easement. Sales, donations, and bargain sales are discussed separately.

Sale of Easement

The sale of an easement in forestland is treated the same as the sale of any real property, regardless of the tax status of the person or organization buying it. The initial discussion assumes your forestland qualifies as a capital asset. This means you are not holding the forestland primarily for sale to customers in the ordinary course of a trade or business,[1] or for use in a trade or business.[2] You determine the gain on the sale by reducing the sale proceeds by your basis in the easement portion of your property plus any expenses you incurred for the sale. The gain would be reported on Schedule D of your personal Form 1040. If you owned the forestland for more than one year prior to the sale, it would be reported as a long-term capital gain.

If your forestland is held for use in a trade or business, the gain would be aggregated with other IRC Section 1231 gains and losses. It would be reported on Form 4797 as part of the tax return for your business. Long-term capital gains treatment depends on the result of netting this transaction with your other Section 1231 gains and losses.

It would be unusual for a conservation easement to be executed on land held primarily for sale because such land is usually destined for development. If this occurs, net income from the transaction would be reported as ordinary income on the business's tax return.

You pay tax on the net gain from the transaction. The net gain is sale proceeds less basis and less expenses of sale. The sale proceeds are the contract price. This is the total fair market value of anything received of value, including cash, notes, or other personal or real property.

Basis Determination

Start with your adjusted basis of the property in the year of sale. This is the original basis as adjusted since the date of acquisition. At the time you acquired the forestland you should have allocated the acquisition cost among the land itself, the timber, and any improvements. The acquisition cost is the purchase price paid to the seller plus any costs you incurred to take legal title. If you inherited the forestland, you use its fair market value on the date of death of the deceased. If you never made this initial allocation, you need to do so based on conditions on the date of acquisition.

It would be unusual if you had allocated a portion of the original basis of your forestland

[1] Forestland is held primarily for sale to customers if you are a land broker or dealer who holds land in inventory ready for sale. A land developer who sells building lots is an example.

[2] Forestland is held for use in a trade or business if you are in the business of growing and selling timber, lease the land for hunting or other recreational activities, or otherwise conduct a business for which the forestland is an integral part.

Example 2. Sale of Conservation Easement

Mr. and Mrs. Burkholder purchased 320 acres of forestland in 1975. The total purchase price was $272,000. In addition, they paid $3,000 in fees to their forester and attorney. This made the total acquisition cost $275,000 ($272,000 plus $3,000). In 1975 they demarcated 5 acres as the homestead on which to build a house, outbuildings, pond, and other facilities. The fair market value of the merchantable timber in 1975 was $150,000. The fair market value of cutover timberland in 1975 was $500 per acre.

The original basis of the assets in 1975 was determined as follows. The total fair market value was $310,000, the sum of the $150,000 timber value and $160,000 land value. The timber and land accounted for 48.4% and 51.6% respectively of the $310,000 total fair market value. This makes the original cost basis of the timber $133,100 (48.4% of $275,000). Likewise, the original basis of the land is $141,900 (51.6% of $275,000). The allocation of basis to the homestead is based on the portion of the total acreage set aside, 1.56 % (5/320). The basis of the 5 acres of land is $2,214 (1.56% of $141,900). The basis of the timber on the homestead is $2,076 (1.56% of $133,100). This makes the basis of the 315 acres of land $139,686 ($141,900 – $2,214). The allowable basis claimed for timber sold on the stump in 1990 was $30,000. The basis of the timber on the 315 acres is $101,024 ($133,100 - $30,000 - $2,076).

The basis of the house, outbuildings, roads, etc. is $210,000, their construction cost of $245,000 less $35,000 of depreciation taken on the outbuildings used for the production of income.

In 2002 the Burkholders sold a conservation easement on their forestland in order to reduce its value for estate tax purposes and to provide retirement income. The easement applied to the 315 acres of forestland. The 5-acre homestead and all improvements were excluded. Under the terms of the easement, the Burkholders and all subsequent owners are allowed to manage the timber and conduct harvests consistent with sustainable forestry practices.

This easement has no effect on the $210,000 basis of the improvements or on the $101,024 basis of the timber. The basis used to determine the gain on the sale of the easement is the $139,686 basis of the 315 acres of land affected.

The appraised fair market value of the 315 acres in 2002 without the easement was $6,000 per acre, for a total of $1,890,000. The appraised fair market value with the easement was $2,000 per acre, for a total of $630,000. This makes the value of the easement $1,260,000 ($1,890,000 minus $630,000).

The Burkholders are paid the full fair market value of the easement, $1,260,000. In addition, they paid $5,000 for appraisal and legal services directly related to the sale of the easement. The gain they report on Schedule D is $1,115,314 ($1,260,000 - $139,686 - $5,000). This gain would generally be taxed at a maximum rate of 20% as a long-term capital gain of individual taxpayers.

to development rights. In most cases, you retain ownership of the timber, and the easement allows you to continue management for timber production. You also most likely retain ownership of improvements. Thus, the easement doesn't involve a disposal of these assets, and your basis in them would not change. The basis in the development rights is part of your basis in the land itself, separate from the timber and improvements. There is no rational basis for making an allocation between the land rights retained and the development rights sold. In such cases, no gain is realized until your basis in the land is fully recovered.[3]

The procedure for determining the gain on the sale of development rights in forestland is demonstrated in Example 2.

[3] Rev. Rul. 77-414, 1977-2 CB 299 Some tax practitioners would recommend an allocation of the basis of the forestland between development and timber production using the fair market value of the land for development and for timber production.

Example 3. Donation of Conservation Easement

Assume the same circumstances as in Example 2.

In 2002 the Burkholders gave a conservation easement on their forestland in order to reduce its value for estate tax purposes. The easement applied to the 315 acres of forestland. The 5-acre homestead and all improvements were excluded. Under the terms of the easement the Burkholders and all subsequent owners are allowed to manage the timber and conduct harvests consistent with sustainable forestry practices.

The value of the Burkholders' donation is the fair market value of the easement, $1,260,000. Their adjusted gross income in 2002 is expected to be $180,000. Because they have no net loss carryback, their contribution base is $180,000. Because the easement is long-term capital gain property, their charitable deduction limit is $54,000 (30% of $180,000). If their adjusted gross income stays at $180,000 for the next 5 years, their total deduction will be $324,000. Thus, $936,000, 74% of the value of the donation provides no income tax benefit.

The $5,000 they paid for appraisal and legal services directly related to the donation of the easement would be deducted as a miscellaneous itemized deduction on their Form 1040, Schedule A.

Like-Kind Exchange of Easement

You may be able to postpone paying income tax on any gain from the sale of a conservation easement by acquiring other real property, referred to as "replacement property."[4] The tax is postponed, not eliminated, because the basis of the easement sold becomes the basis of replacement property. If the fair market values of the easement and the replacement property are not exactly the same, the basis of the replacement property would be adjusted to reflect amounts paid in cash to complete the exchange. See IRS Publication 551, *Basis of Assets*, for details.

Donation of Easement

If a qualified easement is donated to a qualified organization, you may claim a charitable deduction for the fair market value of the easement. You must justify the fair market value claimed, determine if the organization qualifies under IRS regulations, determine the amount you can claim each year as a charitable deduction, and make necessary adjustments to your basis. Example 3 demonstrates the tax treatment of a donation of a conservation easement.

Qualified Easement

The easement must be perpetual. It must apply to you and all subsequent owners. The easement must be made for acceptable conservation purposes. These include:

1. Preservation of land areas for outdoor recreation by, or the education of, the general public;
2. Protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystems;
3. Preservation of open space (including farmland and forestland) where such preservation is,
   a. For the scenic enjoyment of the general public; or
   b. Pursuant to a clearly delineated federal, state, or local government conservation policy, and will yield a significant public benefit; or
4. Preservation of an historically important land area or a certified historic structure.

Qualified Organization

IRS regulations[5] require that the organization have a commitment to protect the conservation purposes of the donation and

[4] IRS has ruled that exchanging an easement on one tract of land for a fee interest in other land is an IRC §1031 like-kind exchange. See Rev. Rul. 72-549, 1972- CB 472 (utility easement), Ltr. Rul. 200201007 (conservation easement for other land), Ltr. Rul. 9851039 (agricultural conservation easement for other farm land), Ltr. Rul. 9621012 (deferred exchange of scenic easement on ranch land for timberland, farm land, or ranch land), Ltr. Rul. 9215049 (conservation easement on farm for other farm land), Ltr. Rul. 9232030 (deferred exchange of agricultural conservation easement for other real property).

[5] IRC Reg. §1.170A-14(c)

have the resources to enforce the restrictions. An organization operated primarily or substantially for one of the conservation purposes listed above is generally considered to satisfy this requirement. The organization you work with will tell you whether they qualify. If in doubt, you can check with the Internal Revenue Service to confirm their statements to you.

Qualified organizations include units of federal, state, county, and local government, if the unit has adopted a conservation plan for their area of jurisdiction. The Indiana Forest Legacy Program, for example, is administered by the Department of Natural Resources, a unit of state government. Participation in this program, which is funded in part by the federal government, requires federal approval of the overall program and each property for which purchase funds are requested. Thus, it is a qualified program administered by a qualified organization.

All the major conservation organizations, such as The Nature Conservancy and American Farmland Trust, also qualify. Local and regional land trusts established specifically to acquire land and easements for conservation purposes qualify. If you are working with an organization that is just starting a conservation easement program, you should verify that they have officially incorporated this activity into their legal structure and have adopted a conservation plan to guide their activities.

Amount of Charitable Deduction Allowed

You will not be able to eliminate all of your taxable income with charitable deductions. You are limited to a fixed percentage of your so-called "contribution base." This is your adjusted gross income calculated without any net operating loss carryback. The limit is determined by whether you are donating cash or property. Also, the limit is different for individuals and corporations. In the case of property such as forestland, your deduction will be limited to your basis in the property unless you have held it for more than one year. This qualifies the property as "long-term capital gain property." The rest of this discussion assumes your forestland so qualifies.

Individual taxpayers. Your deduction in the year the donation is made is limited to the lesser of 30% of your contribution base or the fair market value of the donation. Any amount in excess of this limit can be carried forward to the next 5 tax years until fully used. If you are not able to fully utilize the deduction over the 6 years allowed, any remaining amount is lost. The 30% limit also applies in these later years. These rules also apply to charitable contributions passed through to you from partnerships, S corporations, limited liability companies, and other so-called "pass through" business structures.

Corporate taxpayers. The limit for corporate taxpayers, that is, a corporation not electing to be taxed as a partnership, is 10% of taxable income. A 5-year carry forward also applies.

Step-down election. You may qualify to deduct 50% of your contribution base if you elect to reduce the total amount of the charitable contribution by 40% of the amount of the capital gain that would have been realized if the easement was sold. This is demonstrated in Example 4. The decision to make this election should be based on the calculation of the tax benefits of the two options.

Example 4. Step-Down Election for 50% Limit

Because they can deduct only 26% of the value of their donation under the 30% rule, the Burkholders determine the total deduction they would qualify for if they make the step down election.

As shown in Example 2, the gain realized if they sold the easement was $1,115,314. Under the step-down rule, the total deduction is reduced by 40% of this gain. This would give them a deduction of $813,874 ($1,260,000 – $446,126). Under the step-down election, they can deduct up to 50% of their contribution base. This gives them an annual limit of $90,000 (50% of $180,000). Over the 6 years this would allow them to take a charitable contribution of $540,000, which is 43% of the value of the easement. In this case, it is to the taxpayer's advantage to make the step-down election.

Example 5. Bargain Sale of Conservation Easement

Assume the same circumstances as in Example 2.

In 2002 the Burkholders sold a conservation easement on their forestland in order to reduce its value for estate tax purposes and to provide retirement income. The easement applied to the 315 acres of forestland. Because the conservation organization requires a 20% match, the Burkholders agree to sell the easement for $1,008,000 (80 percent of $1,260,000). The value of their gift is $252,000 (20% of $1,260,000).

This easement has no effect on the $245,000 basis of the improvements or on the $101,024 basis of the timber. The basis of the land, however, must be allocated between the sale and donation portions.

The basis used to determine the gain on the sale is $111,749 (80% of $139,686, total basis in the land). The remaining $27,937 is the basis of the donation portion of the transaction. Likewise the expenses allocated to the sale are $4,000 (80% of $5,000). The remaining $1,000 is allocated to the donation.

The gain they report on Schedule D is $896,251 ($1,008,000 - $111,749 - $4,000). This gain would generally be taxed at a maximum rate of 20% as a long-term capital gain.

Again assuming their adjusted gross income is $180,000 and they do not take the step-down election, their annual charitable contribution limit is $54,000. Over 6 years they could deduct a maximum of $324,000, which is more than enough to cover their donation of $252,000. Thus, they would deduct $54,000 in 2002 through 2005 and the $36,000 balance in 2006. The $1,000 of expenses allocated to the donation is recovered as a miscellaneous itemized deduction on the Burkholders' Form 1040, Schedule A.

Gift Tax

A federal gift tax is imposed on donations made during your life if the total taxable donations you make exceed the annual excludable amount, currently $11,000 to each recipient. No tax is due, however, unless total taxable donations exceed $1,000,000. However, there is an unlimited gift tax exclusion for contributions to qualified charities or units of government. Donations of conservation easements that qualify as a charitable contribution for income tax purposes also qualify as such for gift tax purposes.

Bargain Sale of Easement

The bargain sale is the most common form of conservation easement transaction. It allows you to optimize your tax situation, usually in terms of matching the donation portion to the maximum amount of charitable contribution allowed given your adjusted gross income. The donation portion can also be claimed by the conservation organization receiving the easement as a match. Many of the government and private programs providing funds to conservation organizations and units of government require the conservation organization to match a certain portion of the purchase price of easements.

The bargain sale transaction is reported as both a sale and as a donation. The donation portion is the difference between the fair market value of the easement and the amount you receive as payment. If, for example, you receive $500,000 as payment for a conservation easement with a fair market value of $750,000, you have made a donation of $250,000. Your basis in the easement must be proportioned between the sale and donation elements.[6] Your expenses are also proportioned between the sale and donation components. The procedures are demonstrated in Example 5.

[6] IRC Reg. §1.1011-2

Federal Estate and Gift Tax Treatment

You need legal and tax counsel to adequately assess the impact of a conservation easement in your specific circumstances. The discussion here simply highlights the basic considerations related to the estate and gift tax. The fundamental consideration is that a conservation easement on your timberland generally reduces the value of your estate. At your death, the timberland would be appraised for estate tax purposes based on the uses allowed under the easement, not at its market-based highest and best use. This is the case whether you sold, donated, or made a bargain sale of the easement.

Federal Estate Tax

The federal estate tax is a tax on your right to transfer your assets to succeeding generations. It is assessed on the fair market value of your assets on the date you die. The executor of your estate, however, can elect to value your assets as of 6 months after your death. The total value of your assets is your gross estate. It includes any taxable donations you made since 1976. Your gross estate is reduced by funeral expenses, debts you owe, donations to charitable organizations, among other deductions. It is also reduced by the value of any assets left to your spouse, the so-called marital deduction. The balance is your taxable estate.

Table 1. Estate Tax Rates

If the taxable estate is:				
Row no.	Over (1)	But not over (2)	Tax on amount in column 1 (3)	Rate on amount over amount in column 1 (4)
1	$0	$10,000	$0	$18
2	10,000	20,000	1,800	20
3	20,000	40,000	3,800	22
4	40,000	60,000	8,200	24
5	60,000	80,000	13,000	26
6	80,000	100,000	18,200	28
7	100,000	150,000	23,800	30
8	150,000	250,000	38,800	32
9	250,000	500,000	70,800	34
10	500,000	750,000	155,800	37
11	750,000	1,000,000	248,300	39
12	1,000,000	1,250,000	345,800	41
13	1,250,000	1,500,000	448,300	43
14	1,500,000	2,000,000	555,800	45
15	2,000,000	2,500,000	780,800	49
16	2,500,000	3,000,000	1,025,800	53
17	3,000,000	. . . .	1,290,000	55[7]

[7] Top marginal rate is reduced to 50% for 2002, then decreases incrementally to 45 for 2007, 2008, and 2009.

The tentative tax on your taxable estate is calculated using the estate tax rates shown in Table 1, p. 7. This tentative tax is reduced by the unified tax credit, Table 2, p. 9. The balance is the estate tax due. The procedure is demonstrated in Examples 6 and 7. Most discussions of estate taxes refer to the "applicable exclusion amount" shown in Table 2. No estate tax is due until the taxable estate exceeds this amount. The estates of decedents dying in 2002 and 2003, for example, wouldn't owe any estate tax unless their taxable estate exceeded $1 million. Thus, there is no estate tax benefit from a conservation easement unless the value of your assets exceeds $1 million. There may be an Indiana inheritance tax benefit, however.

Partial Exclusion from Gross Estate for Conservation Easement

If there is a conservation easement on your land when you die, your executor may elect to exclude from your gross estate up to 40% of the value of the land subject to a qualified conservation easement.[8] For example, if such land had a fair market value of $250,000 when you die, your executor could add $150,000 ($250,000 - $100,000, where $100,000 is 0.4 x $250,000), instead of $250,000 to the value of the other assets you own to determine your gross estate. The maximum amount that can be excluded is $500,000.

The Economic Growth and Tax Relief Reconciliation Act of 2001 eliminated the requirement that the land be located within a specified distance of a metropolitan area, a national park or wilderness area, or an urban national forest. Unless Congress acts to continue the provisions of the Act of 2001, these distance requirements will be in effect for decedents dying after December 31, 2010.

Federal Gift Tax

The gift tax is briefly summarized to explain the relationship between the estate and gift tax. If you made a donation of an easement to an organization that is not a qualified charitable organization, the donation may be taxable. If

[8] IRC §2031(c)

Example 6. No Estate Tax Benefit Realized

Mr. Smith died on October 1, 2002. His executor determined that the value of everything he owned on October 1, 2002 was $1,250,000, his gross estate. This included $500,000, his half of timberland owned jointly with his wife. The total appraised value of the timberland was $1,000,000. He left the timberland and $250,000 in other assets to his wife; $250,000 to his children; and $250,000 to qualified charitable organizations. This made his taxable estate $250,000, the amount left to his children. Since this is less than the applicable excludable amount of $675,000, Mr. Smith's estate does not owe any federal estate tax. In this case, there would be no estate tax savings if the timberland's value was reduced by a conservation easement.

Example 7. Estate Tax Benefit Realized

A reasonable estimate is that Mrs. Smith may die in 2005. She estimates that her gross estate will be about $2,000,000. The timberland will be worth $1,250,000. After deductions, her estimated taxable estate would be approximately $1,750,000. If she leaves her entire estate to her children, her estate would owe $112,500. This is determined by multiplying the marginal tax rate of 45% times $250,000, the amount by which the taxable estate exceeds $1,500,000, the 14th row in Table 1. If Mrs. Smith executed a conservation easement that reduced the fair market value of the timberland by at least $250,000, her estate would not owe any estate tax.

Planning note: In Example 1, Mr. Smith did not fully utilize his "applicable excludable amount" of $675,000. As a result, his wife's estate was large enough to incur a tax. Depending on the specific circumstances of each situation, it's generally beneficial to use as much as possible of the applicable excludable amount of the first spouse to die. In Smith's situation, however, this would have meant either leaving Mrs. Smith with the timberland but no liquid assets, or reducing the charitable contribution.

made to a qualified charitable organization, you must file IRS Form 709 to claim the charitable deduction for gift tax purposes.

The gift tax is a tax on the lifetime transfer of anything of value to others. An annual exclusion of $11,000 applies to donations you make to any one individual. This limit applies to any number of individuals. For example, if you had three children with spouses, you could make donations totaling $66,000, that is, $11,000 to each. You and your spouse could elect to make a joint donation of $22,000 to each, for a total of $132,000. Donations to qualified charities are not taxable regardless of the amount. Also, donations to your spouse in any amount are not taxable. Exclusions also apply for most donations made to pay for educational and medical expenses. See IRS Publication 448, *Federal Estate and Gift Tax,* for details.

Taxable donations are reported on IRS Form 709. No tax is due, however, until the total amount of taxable donations made over your lifetime exceeds the applicable excludable amount for gift tax purposes for the years taxable donations were made. This amount was the same as the applicable excludable amount for estate tax purposes, Table 2. The exclusion amount for donations made in 2002 through 2010 is $1 million. This is the case even though the applicable exclusion amount is more than $1 million for estate tax purposes. The gift tax and estate tax are no longer “unified.”

Indiana Tax Treatment

Gains from the sale of a conservation easement are subject to the Indiana personal income tax. A donation, however, does not provide an Indiana income tax benefit. The reduction in the value of an estate resulting from a conservation easement may reduce the inheritance tax.

State and Local Income Tax

The Indiana income tax is based on your federal adjusted gross income. Any capital gain realized from the sale of a conservation easement at fair market value or from a bargain sale increases your Indiana taxable income by this amount. The value of a donation of the entire value of the easement

Table 2. Estate Tax Credit and Applicable Excludable Amount

Year	Tax credit	Applicable exclusion amount
2000 – 2001	$220,550	$675,000
2002 – 2003	345,800	1,000,000
2004 – 2005	555,800	1,500,000
2006 – 2008	780,800	2,000,000
2009	1,565,000	3,500,000
2010	n.a.	n.a.
2011 and later	345,800	1,000,000

or the amount of the donation portion of a bargain sale does not, however, reduce your Indiana taxable income. This is because on the federal return charitable deductions reduce adjusted gross income to determine taxable income. Net Indiana taxable income is subject to the 3.4% Indiana income tax and to the applicable local income tax rate, if any.

Inheritance Tax

Indiana imposes an inheritance tax on certain transfers at death. An estate tax is also imposed to the extent of the state death tax credit allowed under the federal estate tax law. There is no Indiana gift tax. Thus, the only effect of the conservation easement is a reduction in any inheritance due because of reduction in the appraised value. The appraised value for federal estate tax purposes is used for Indiana inheritance tax purposes.

The amount of inheritance tax depends on your relationship to the person inheriting the property, Table 3, p. 10. Transfers to your spouse are totally exempt. Class A rates apply to lineal descendants and most adopted children. There is a $100,000 exemption for each recipient in this class. Class B includes siblings, their children, and spouses of your children. There is a $500 exemption for this class. Class C is for all other recipients. There is a $100 exemption for this class.

The calculation of the inheritance tax is demonstrated in Examples 8 and 9, p. 10.

Table 3. Indiana Inheritance Tax Rates

Value of share		Class A		Class B		Class C	
		Tax on column (1)	Rates on excess	Tax on column (1)	Rates on excess	Tax on column (1)	Rates on excess
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
$0	$25,000	$0	1%	$0	7%	$0	10%
25,000	50,000	250	2%	1,750	7%	2,500	10%
50,000	100,000	750	3%	3,500	7%	5,000	10%
100,000	200,000	2,250	3%	7,000	10%	10,000	15%
200,000	300,000	5,250	4%	17,000	10%	25,000	15%
300,000	500,000	9,250	5%	27,000	10%	40,000	15%
500,000	700,000	19,250	6%	47,000	12%	70,000	15%
700,000	1,000,000	31,250	7%	71,000	12%	100,000	15%
1,000,000	1,500,000	52,250	8%	107,000	15%	145,000	20%
1,500,000	. . . .	92,250	10%	182,000	15%	245,000	20%

Example 8. No Inheritance Tax Benefit

Given the facts in Example 6, the inheritance tax would apply only to the $250,000 left to Mr. Smith's children. This amount is first reduced by the $100,000 exemption per recipient. Assuming Mr. Smith had two living children, the taxable amount would be $50,000. The tax due would be $750, Table 3, column 3.

Example 9. Inheritance Benefit Realized

Given the facts in Example 7, the inheritance without the conservation easement would apply to the $1,750,000 Mrs. Smith leaves to her two children. After the two $100,000 exemptions, the taxable amount would be $1,550,000, and the tax due would be $92,250 plus 10% of $50,000, for a total of $97,250. With the conservation easement, the taxable amount would be $1,300,000 after the $200,000 exemption. The tax would be $52,250 plus 8% of $300,000, for a total of $76,250. Thus, the conservation easement reduced the inheritance tax paid by $21,000.

Conclusion

The examples in this publication indicate only a few of the possible outcomes. They clearly indicate, however, the potential advantage of a bargain sale of a conservation easement. You should not apply these results to your situation. Rather, you and your tax advisor should conduct an analysis of the facts in your particular situation. A tax accountant is especially well suited to assist you in doing so.

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