Probate, Legal and Tax Implications of Conservation

Protecting Family Lands and Forests
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Morse House at Yale Forest
150 Centre Pike
Eastford, CT

CT Forest and Park Association

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Attorney Dakin graduated magna cum laude from the University of Connecticut where he received a Bachelor of Arts Degree in 1976. He received his Juris Doctor Degree in 1979 from the University of Miami (Florida) School of Law. He received a Graduate Degree in Taxation from Boston University School of Law in 1987. Attorney Dakin is also a Certified Public Accountant.

Attorney Dakin is a member of the American Bar Association Committee on Taxation and the Connecticut Bar Association Committees on Taxation, Estate and Probate. He is a member of the Estate and Gift Tax Committee of the Connecticut Society of Certified Public Accountants and a member of the Tax and Probate Committees of the Connecticut Bar Association. He was also an adjunct faculty member of the University of Hartford Graduate Tax Program for numerous years, teaching courses in Corporate Tax and Estate Planning.

In addition to his professional activities, Attorney Dakin is a frequent lecturer on estate planning and tax matters. He was the founder and past President of the Business and Estate Council of Northeast Connecticut. He was also involved in many community activities including Windham Hospital, Eastern Connecticut Health Network, AHM Youth Services, and Moderator of the Bolton Congregational Church.
Probate, Legal and Tax Implications of Conservation

WHAT ARE YOUR OBJECTIVES AND CONCERNS?
1. Why did you decide to come tonight?
2. Make a list of your assets
3. Make a list of your most important objectives
4. Who will receive which assets?
   - Do you have a Will? What does it say?
     i. Is equal shares to your children the best approach?
   - If you leave it to your spouse, will he/she honor your wishes?
     i. Absent special provisions, a beneficiary may do as they choose
        with inherited assets.
   - If two or more people will share an asset, do they get along?
     i. Partition rights – forced sale!
   - Is the life of the beneficiary “stable”, or does he/she have problems?
     i. Divorce? Creditors? State assistance?
   - Fair versus equal?
   - Do you need to make the “pie” bigger?
     i. Life insurance?
   - Without a Will, CT law allocates your assets among your family
5. What are your objectives regarding your forest land?
   - Who should get it?
   - Would you like for it to simply stay in the family?
     i. Have you made special plans to insure this result?
   - Do you want to permanently protect the land from development?
     i. Have you begun analysis of a conservation easement?
   - Will the beneficiary cherish your forest land?
6. When do you want to implement your plans for your forest land?
   - Now – work out the details
   - Upon death – leave the details to chance

WHAT POTENTIAL PROBLEMS INTERFERE WITH YOUR PLANS?
1. Property Tax
   - Classify property under PA-490 to reduce property tax
2. Income Tax
   - Property tax deduction
3. Gift tax
   - Gifts having a value of $2,000,000 or less not taxable
   - Gifts having a value of $5,250,000 may pay a minor tax
4. Creditors/Liability
   - Can your creditors attach your land?
   - Are your other assets protected from potential liability occurring on the
     land?
   - Do you have adequate liability insurance for your property?
5. Incapacity
   - Do you have a power of attorney?
   - Does it include the power to make gifts; including conservation gifts to charity?

6. Longterm care costs – a growing problem for us all !!
   - Who will take care of you when you can no longer live alone
   - What will it cost?
   - Where will the money come from to pay these costs?
   - Are you relying on Medicaid (Title 19)?

7. Estate tax
   - Similar exemptions as gift tax
   - Few estates are projected to ever pay an estate tax

8. Probate
   - Have you taken action to minimize probate requirements upon death
   - Will there be a fight among your heirs over your assets?

**BASIC CHOICES ON HOW TO PROCEED**

1. Deeds
   - Donate some or all of the property to a qualified conservation organization
     i. Choices
        1. Transfer land in its entirety
        2. Transfer a segregated portion of the land
        3. Transfer the conservation rights
     ii. Effective immediately
     iii. Permanent
     iv. Certainty – You set the rules
     v. Can either Gift or Sale (or combination of both)
     vi. Effectively, BOTH income and estate tax deduction
     vii. No gift tax on transfer to charity
     viii. Will the charity ask for a cash bequest as well to fund the conservation goal?
   - Sell your property?
     i. Not usually consistent with conservation objectives
        1. Sale of development rights?
        2. Sale to municipality?
     ii. Income tax upon the sale
        1. Likely capital gains tax
        2. Tax on amount of appreciation
        3. Federal rate now 20%, plus 6+% CT
   - Combination – part donation/part sale

2. Wills
   - Effective at death
   - Uncertainty in outcome
     - You might *not* own the property at death
• Your Will might not be successfully admitted to probate for administration
• Relying on others to implement your plans
• Include a bequest in your Will as to your conservation objectives
  • What if the organization will not accept the gift upon the terms that you have stated?
• No income tax deduction
• Reduces risk of estate tax

3. Trusts
• Leave others in charge to manage your assets and implement your conservation goals
• Can establish during life or upon death
• Can be revocable (modifiable) or irrevocable (permanent)
• Can include cash and other resources to aid in conservation goals
• Choices as to income tax consequences
• Can couple with use of Deed or Will

4. Limited Liability Company (LLC)
• Historically a business entity
• Leave others in charge of the land and your conservation goals
• Flexibility to modify rules and terms over time
• Flexibility to purge rights of future family members not involved in conservation goals
• Pass through income tax treatment
• Can couple with Deed

GENERAL GIFT AND ESTATE TAX RULES
1. Federal
• Gift tax
  i. First $14,000 each year per recipient of gifts made during lifetime excluded from taxation- doubled to $28,000/year if married
  ii. Any excess value offset by $5,250,000 exclusion
     1. Must file gift tax return (form 709)
  iii. Recipient of gift receives carryover income tax basis
• Estate Tax
  i. No estate tax due if value of decedent’s assets are less than $5,250,000 in 2013.
  ii. Exemption “doubles” if married
  iii. Portability – surviving spouse automatically receives unused exemption from first spouse (federal rule only – n/a for CT tax)
  iv. Wills/Trusts properly drafted and assets properly titled better approach
  v. Estate tax election to reduce value of certain farmland
  vi. Election to pay estate tax over 14 years, in order to avoid forced sale of farm.
2. Connecticut
   • Gift Tax:
     • First $14,000 each year per recipient of gifts made during lifetime
       excluded from taxation - doubled to $28,000/year if married
     • Any excess value offset by $2,000,000 exclusion
       1. Must file gift tax return (form 709)
     • Recipient of gift receives carryover income tax basis
   • Estate tax
     • In 2013, $2,000,000 estate tax exemption
     • Tax rates range from 7.2%-12%.

KEEP IT IN THE FAMILY
1. Non-permanent solution to conservation goals
2. Simple bequest to spouse, children and other family members may not work
3. Consider restricting the group of beneficiaries that will inherit. Choose only those that will and are able to honor your wishes
4. Impose legally binding restrictions
   a. Conservation easement - See below
   b. Trust agreement
      i. Create rules by which the property will be managed and used
      ii. Pick someone to be in charge
      iii. Inevitably will end for lack of money or family interested in
           preserving your wishes
      iv. What should happen to property when the trust terminates?
      v. Such trusts are irrevocable. No ability to modify rules as time or
         changes in circumstances dictate
      vi. Likely some degree of State monitoring and oversight
   c. Limited Liability Company (LLC)
      i. Create rules by which the property will be managed and used
      ii. Pick someone to be in charge
      iii. Inevitably will end for lack of money or family interested in
           preserving your wishes
      iv. Buyout/redeem disgruntled owner – liquidity to do so?
      v. What should happen to property when there is no further interest
         in maintaining property?
      vi. Such operating rules can be altered by the members of the LLC.
          There is an ability to modify rules as time or changes in
          circumstances dictate
      vii. Unlikely that State will monitor and oversee

DONATION OF QUALIFIED CONSERVATION EASEMENTS
1. Transfers during lifetime
   A. Contributions are deductible
   B. Deductions offset income otherwise taxable.
   C. No deduction for Connecticut income tax purposes.
   D. No deduction for the contribution of services.
E. Amount of deduction each year is limited.
   (1) By the type of organization receiving the contribution.
   (2) By the contributors adjusted gross income (“AGI”).
      (a) 50% of AGI limit applies to public charities & municipalities.
      (b) 30% of AGI limitation applies to gifts of capital gain property.
      (c) Can elect to use 50% limitation (rather than 30% AGI limitation) if the fair market value of the gift is first reduced by the long-term capital gain component.

F. Contributions in excess of limitations can be carried over 5 successive years.

G. Contributions of $250 or more must be substantiated in writing by the donee organization.

H. Noncash contributions in excess of $500 require completion and filing of IRS Form 8283, which requires:
   • Identify the conservation purpose
   • shows the before and after value
   • states whether the donation was done in order to obtain zoning approval or required by contract, and
   • describes the interest of the donor or related person in other property located nearby.

I. For easements, valuation typically done using the “before and after” method.

J. Donor must retain written records of the conservation purpose served by the contribution.

K. Generally, no deduction is available for gifts of a partial interest in property

L. What constitutes a qualified conservation contribution?
   (1) Property must be qualified real property
   (2) Donated to a qualified organization
   (3) Exclusively for conservation purposes

M. Qualified real property interest
   (1) The entire interest of the donor in the property
   (2) Remainder interest
   (3) Perpetual conservation restriction

N. Qualified organization
   (1) Must be eligible to receive conservation contribution
   (2) Must have a commitment to protect the conservation purpose of the property; operated primarily for the conservation purposes of IRC 170(h)(4)(A).
   (3) Must have resources to enforce the restriction
   (4) The donee cannot thereafter reconvey without preserving the conservation purpose.

O. Exclusively for conservation purposes
   (1) Preserve land for outdoor recreation or education of the general public;
   (2) Preserving land areas for education of the general public;
   (3) Protecting, in a relatively natural habitat, fish, wildlife, or plants, or similar ecosystems;
   (4) Preserving open space (including forest land for the scenic enjoyment of the general public or local government conservation policy yielding significant public benefits); or
(5) Preservation of historically important land or certified historic structure.

P. The regulations provide that scenic enjoyment is evaluated on the basis on all pertinent facts and circumstances, including
(1) The compatibility of the land use with other land in the vicinity;
(2) The degree of contrast and variety provided by the visual scene;
(3) The openness of the land;
(4) Relief from urban closeness;
(5) The harmonious variety of shapes and textures;
(6) The degree to which the land use maintains the scale and character of the urban landscape to preserve open space, visual enjoyment, and sunlight for the surrounding area;
(7) The consistency of the proposed scenic view with a methodical state scenic identification program; such as state landscape inventory; and
(8) The consistency of the proposed scenic view with a regional or local landscape inventory made pursuant to a sufficiently rigorous review process, especially if the donation is endorsed by an appropriate state or local governmental agency.

Q. An easement satisfied the exclusively-for-conservation requirement
(1) Protect and preserve the conservation values;
(2) Prevent any use or activity that would significantly impair the conservation values;
(3) Conserve and protect in perpetuity the protected area as a “relatively natural habitat of fish, wildlife or plants or similar ecosystem” and as an “open space; or
(4) Protects ecological and natural resources, including birds, tree ecosystems, diversity of wildlife habitat, water quality values, open space and scenic value, and historical and cultural values.

R. The terms of the easement may set forth the reserved rights of the grantors, provided not inconsistent/detrimental to conservation. Reserved rights include:
(1) Plant, grow, harvest, sell, and manage forest;
(2) Engage in agricultural;
(3) Engage in recreational activities;
(4) Engage in scientific research activities;
(5) Conduct wildlife management activities; and
(6) Construct new ponds limited in size to 400 acres.

S. The easement terms may also restrict the grantors in several other ways, including:
(1) Prohibiting subdivision;
(2) Imposing limitations relating to the construction, enlargement, and replacement of residential, agricultural, and other structures on the protected property;
(3) Prohibiting the use of impervious surfaces, other than fencing and gates;
(4) Prohibiting industrial and commercial uses, activities, and structures;
(5) Limiting road construction and use;
(6) Limiting the paving of any road to use of non-permeable materials and roads;
(7) Prohibiting/limiting mining and recovery of oil, gas, or minerals;
(8) Limiting additional residential structures;
(9) Allowing/limiting agricultural structures;

2. Transfers Upon Death
   A. There is an unlimited deduction for estate purposes for gifts to municipalities or qualified tax-exempt charitable organizations.
   B. Fractional interest transfers are only allowed for certain trusts, and for qualified conservation contributions.
   C. Executor may elect to exclude from the federal gross estate the value of land subject to a qualified conservation easement. The election is made on a timely filed return, and once made is irrevocable.
   D. Land must have been owned by the decedent or his family during the 3 years prior to death.
   E. "Family" means:
      • An ancestor of the individual,
      • The spouse of the individual,
      • A lineal descendant of the individual, of the individual's spouse, or of a parent of the individual, or
      • The spouse of any lineal descendant described immediately above.
   F. Qualified conservation easement is same as for income tax purposes, except that:
      (1) Preservation of historically important land or certified historic structure does not qualify
      (2) Perpetual restriction must include a prohibition of commercial recreational activity
   G. The exclusion is limited. It is the lesser of:
      (1) Not more than 40% of the value of the property, or
      (2) $500,000
      (3) The 40 percent factor is reduced by 2 percent for each one percent by which the value of the qualified conservation easement is less than 30 percent of the value of the land.
   H. Value the land with and without the qualified conservation easement
   I. This exclusion should not prevent property from later qualifying for special-use valuation (farmland value),
   J. The exclusion may apply on land owned by an entity (corporation, LLC or trust) in which the decedent owned (directly or indirectly) a 30% interest.

3. Example
   • Land has a value of $2M. The owner donates a qualified conservation easement. After the easement, the land has a value of $1.25M.
     o The donor is entitled to a $750K income tax deduction, which may be carried over for 15 years until the deduction is fully utilized.
     o Assuming a 30% income tax rate, the deduction results in income tax savings of 225,000.
   • Upon the death of the donor, the land would be worth $2.5M but for the easement. The land has a value of $1.5M when considering the easement.
- The easement had a value of $750K on the date of donation, exceeding 30% of the value of the land at that time ($750K / 2M = 37.5%). Thus there is no reduction in the normal 40% limitation.
- The estate is entitled to exclude $500k of value from the estate; the lesser of 40% of the date-of-death value of land ($2.5M x 40% = $1M) and the $500k cap.
- The estate is also effectively reduced by the date-of-death value of the donated easement ($1M)
- Assuming a 45% estate tax rate, the estate tax savings is $675K ($1.5M exclusions x 45% = $675K).

- The combined income and estate tax savings is $900K ($225K + $675K)