



New York Agricultural Land Trust
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New York Agricultural Land Trust

Agricultural Conservation Easements and Appraisals

Introduction

An agricultural conservation easement is a deed restriction, comprised of a set of land-use restrictions a landowner voluntarily places on his or her property in order to conserve the land's agricultural features and related characteristics. The easement is conveyed by the landowner to a land trust or another qualified conservation easement holder.

Protecting these natural resources provides important benefits to the community—protecting the opportunity for working farms and forests, as well as their associated attributes of wildlife habitat, preserving water quality, and rural character. Although the landowner retains ownership of the property, an agricultural conservation easement limits the use and development of the property in order to conserve the agricultural and forestry assets of the property as they may evolve in the future, and to allow for compatible uses.

The New York Agricultural Land Trust's (NYALT's) agricultural conservation easements allow for compatible uses such as rural enterprises, a limited amount of residential housing, alternative energy production, educational programming, and other uses directly related to agriculture and forestry.

Most conservation easements—including all of those held by NYALT—are perpetual, meaning that they “run with the land” through time as the land is sold or transferred to new landowners.

By permanently restricting property, a landowner often reduces the land's market value. This reduction in value can be attributed to the conservation easement, especially if it restricts the development potential of the land. An appraisal estimates the value of a conservation easement by calculating value before the agricultural conservation easement is placed on the property, and after the easement is granted. This technique is called a “before and after” appraisal.

The discussion below addresses several of the basic questions and rules regarding conservation easement appraisals. *Please be aware that there have been a number of recent changes to the conservation easement appraisal rules.* For more precise detail on rules regarding conservation easement appraisals, please refer to the resources listed below.

1. What is the purpose of an appraisal of a conservation easement?

A conservation easement appraisal may have several uses. For non-cash charitable contribution purposes, the appraised value of the easement is used to determine the amount of any income tax deduction available. In this case, the appraisal procedure and report must conform to specific IRS standards noted below.

An appraisal may also be important for estate planning, for mortgage subordination, for the sale of a conservation easement, or for reviewing a property's assessed value for property tax purposes. For NYALT, the appraisal is an important part of completing a New York State Farmland Protection grant, since it is used to substantiate the purchase price for the transaction and, if applicable, to substantiate the value of the farmland owner's income tax deduction.

2. *Is an appraisal required to complete a conservation easement with the New York Agricultural Land Trust?*

An appraisal is not always necessary. If you are donating a conservation easement but do not plan on seeking a federal and state income tax deduction, you do not need any appraisal at all. If you are working with NYALT and seeking a New York State Farmland Protection Grant, but you do not plan on seeking an income tax deduction, you also do not need an appraisal (the IRS and New York State have very similar requirements; you should carefully review the NYS Agriculture and Markets Guidance Document #4).

However, if you are working with NYALT to complete a New York State Farmland Protection grant project, and you are planning on applying for an income tax deduction towards the 12.5% value of development rights the state is not paying for – those rights you are contributing – you must obtain a *qualified appraisal*, certified to NYALT.

The Internal Revenue Code requires a landowner seeking a deduction to obtain a “qualified appraisal” if the gift – either land in fee or a conservation easement – is valued at more than \$5,000. So if you are going to participate in the NYS farmland protection program with a “bargain sale” (i.e., you are going to donate some of the development rights value pursuant to the state's program), and you plan on seeking federal income tax deductions (worth more than \$5,000) and state income tax deductions to offset the farmland protection grant, you will need a *qualified appraisal*.

3. *What is considered a “qualified appraisal”?*

For federal income tax purposes and until further guidance is issued, the IRS currently considers a *qualified appraisal* to be one that complies with the requirements in Treasury Regulations Section 1.170A-13(c) and is conducted by a *qualified appraiser* in accordance with *generally accepted appraisal standards*, and subject to other guidance of the Secretary of the Treasury.

4. *What are “generally accepted appraisal standards”?*

An appraisal will be treated as having been conducted in accordance with *generally accepted appraisal standards* if the appraisal is consistent with the substance and principles of the Uniform Standards of Professional Appraisal Practice or “USPAP.” These standards can be found on the web site of the Appraisal Foundation, www.appraisalfoundation.org.

5. *Who is a “qualified appraiser”?*

The IRS defines a *qualified appraiser* as an individual who:

- Has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Secretary of the Treasury;
- Regularly performs appraisals for which the individual receives compensation;

- Demonstrates competence in valuing the type of property for which the appraisal is performed; and
- Meets other such requirements as may be prescribed in federal regulations or other guidance.

For returns filed after October 16, 2007, an appraiser is considered to have met “minimum education and experience requirements” if s/he is licensed or certified by the State of New York for the type of property being appraised. Please note that a New York State certified appraiser may not automatically be a “qualified” appraiser for IRS income tax deduction purposes.

6. *What should landowners consider in selecting an appraiser?*

Landowners should ask a number of questions when considering who should conduct this critical part of the conservation easement process. If you are working with NYALT on a state-funded farmland protection grant, NYALT will send out Request for Proposals that will allow appraisers to address the following:

- Is the appraiser designated by a recognized appraiser organization and/or licensed by the State of New York? What type of license does the appraiser hold? There are four levels of licensure in New York State: certified general real estate appraiser; residential real estate appraiser; licensed residential real estate appraiser; and licensed real estate appraiser assistant. Given the advanced scope of practice required for such complicated analysis, a conservation easement appraisal requires an appraiser licensed at the highest level—certified general real property appraiser, one who may, to cite the License Law, “...appraise all types of real property.”
- How much will the appraisal cost and how long will it take to complete? Easement appraisals are complex by nature, since they require conclusions of value both “Before and After” the grant of the conservation easement, and other related considerations. Landowners should closely review the appraiser’s written proposal that estimates the time and fee required, and question extraordinarily inexpensive or speedy appraisals.
- Does the appraiser have experience in and regularly perform conservation easement appraisals? Has the appraiser taken classes specifically focused on conservation easement appraisals? Knowledge and experience are not only essential to obtaining a competent appraisal: they are now part of the definition of having that appraisal qualify for charitable contribution purposes.
- Can the appraiser provide an *independent* appraisal of the value of the easement? Landowners should avoid contracting with an appraiser who is in any way related to the land, the landowner or the transaction. The IRS prohibits appraisals by immediate family members or their spouses.
- Is the appraiser experienced in appraising property in your geographic area and under similar circumstances? If not, how does the appraiser plan to acquire the knowledge and experience necessary to competently undertake your assignment? Landowners should feel free to ask the appraiser for references of other clients who have commissioned conservation easement appraisal assignments.

- Is the appraiser aware of the new regulations and penalties for appraisers that are now being imposed for returns filed after February 16, 2007? Is s/he including in every appraisal an additional statement attesting to that awareness? Has s/he had to defend appraisals in front of the IRS?

7. How does an appraiser estimate the value of a conservation easement?

Typically, an appraiser determines the value of an easement by comparing the market value of the property without the easement restrictions in place and the market value of the property with the restrictions in place. The difference between the two is the inferred value of the easement itself. This procedure is known as the “Before and after Approach.”

As a simple example:

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| Value of the land before the conservation easement: | \$600,000 |
| Value of the land after the conservation easement: | <u>\$275,000</u> |
| Difference = value of the conservation easement: | \$325,000 |

Proportionate value of the conservation easement: 54% (\$325,000/\$600,000)

Generally, a more restrictive easement will result in a higher proportionate value. But each parcel of land and each set of conservation restrictions are unique. *Therefore, no set or average percentage of value can be attributed to the rights relinquished in an easement.*

8. What does an appraiser need to consider to estimate the value of a conservation easement?

An appraiser will look at a variety of factors concerning both the specific property subject to the easement and the surrounding area. Relevant factors will include:

- Location and character of the property and prevailing land-use patterns in the area;
- Existing zoning regulations and other laws or contracts that affect the property, and
- Development potential of the land, and future land use trends in the surrounding areas.

The appraiser will need to understand the specific restrictions placed on the land and the specific rights reserved by the landowner in the conservation easement being appraised. Change in the highest and best use of the land resulting from the easement and its impact on market value is at the heart of this type of appraisal.

The appraiser will also need to evaluate the easement in the context of any other property, contiguous or nearby, that is also owned or controlled by the landowner or the landowner's family, in order to quantify the potential of the easement to enhance the value of that other property. Any such enhancement value is subtracted from the amount that a landowner can take as a charitable deduction for the donation of an easement.

NOTE: If this pertains in any way to your situation, please consult NYALT early on in the grant application process, as well as the approve project initiation, as this would likely involve more time and expense to complete the appraisal assignment.

9. What information needs to be included in an appraisal?

While the specific format, length, and content of appraisals vary, the IRS requires very specific information for charitable gift appraisals, as identified on the attached summary.

10. When should the appraisal be completed?

For charitable deduction purposes, the appraisal must be completed *no earlier than 60 days before* the date of the gift (the date the conservation easement is signed and accepted by NYALT) and *no later than the date the tax return for that year is due*.

In some circumstances, a qualified appraisal can be updated with more current data, especially if that appraisal was begun a while ago as a preliminary valuation analysis to provide a rough estimate of the conservation easement's value. For other non-tax purposes, timelines may vary. Conservation easement appraisals are complex and time-consuming. *As such, landowners who plan on applying for federal or state income tax deductions should contact an appraiser early in the process, as it may take up to four to six months or more to complete an appraisal. If the project involves a New York State Farmland Protection grant, NYALT will work with the landowner to commission the appraisal.*

11. Is it necessary to be concerned about the integrity of the appraisal?

YES. The IRS views this issue very seriously and may impose substantial penalties on both the landowner and the appraiser for claimed gifts that are overvalued for tax purposes. Congress recently created new lower thresholds and penalties for donors and appraisers who artificially inflate the value of an easement for tax purposes. Landowners are well advised to choose an appraiser carefully and to work closely with the appraiser, their own tax advisor and NYALT throughout the process of completing a conservation easement.

Remember the simple rule: if it looks too good to be true, it probably is too good to be true.

12. What are some additional resources for conservation easement appraisals?

Please refer to the following references for more detail on conservation easement appraisals:

- New York State's Department of Agriculture and Markets Appraisal Guidance Document #4, "Drafting Conservation Easements"
- Treasury Regulations §1.170A-13(c) and §1.170A-14(h)
- IRS Publication 561 *Determining the Value of Donated Property*
- IRS Notice 2004-41 *Charitable Contributions and Conservation Easements*
- Pension Protection Act of 2006, Section 1219
- IRS Notice 2006-96 *Guidance Regarding Appraisal Requirements for Noncash Charitable Contributions*
- *Appraising Easements, Third Edition*, published by the Land Trust Alliance in cooperation with the National Trust for Historic Preservation

13. More Questions?

Please feel free to contact NYALT if you have additional questions. We look forward to working with you.

Adapted with permission from the Minnesota Land Trust