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Tax Policy: The Chafee Bill- Trick or Treat?

William T. Hutton
UC Hastings College of the Law, huttonw@uchastings.edu

Editorial

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For all of the attention to the balanced-budget morality play, a Revenue Reconciliation Act tax provision of immense interest to the conservation community has gone virtually unnoticed. It deserves to be skeptically noticed and rejected as wretched tax policy.

Section 12303 of the Senate version of the Act would create a new exclusion for estate tax purposes, permitting an executor to elect to diminish the decedent's gross estate by up to 50% of the value of land subject to a "qualified conservation easement." In order to achieve the maximum 50% exclusion, the conservation easement value would have to equal at least 30% of the value of the land (as appraised without regard to the easement), and the exclusion could not apply to the value of any "development right" retained upon the creation of the easement. ("Development right" is vaguely defined with reference to "any commercial purpose," not including, however, activities relating to farming.) The value of land with respect to which the exclusion could be computed is capped at $5 million, reduced by the value of certain "qualified family-owned business interests" (another new exclusionary provision of the Senate bill). Thus, the maximum estate tax exclusion achievable under this proposal would be $2.5 million (for a tax saving of $1,375,000 at the maximum 55% estate tax rate).

There are geographical conditions: land subject to a "qualified conservation easement" must be "located in or within 25 miles" of a "metropolitan area" (as defined by the Office of Management and Budget), or "a national park or wilderness area designated as part of the National Wilderness Preservation System," unless the Secretary determines that such land is not under "significant development pressure." (The reference to "Secretary" presumably means the Secretary of the Treasury, acting through the Internal Revenue Service — an agency not noted for its sophistication in determining the immediacy of environmental threats from development pressures.) There are a few other technical warts on the proposed new statute, but the foregoing capsule description will suffice as a primer.

This proposal is a slightly more sophisticated iteration of a bill that Sen. John Chafee (R-RI) has been lugging around like a dead fish in newspaper for two or three years. If unwrapped by itself, and subjected to the proverbial olfactory test, it would surely empty even the Senate Finance Committee chambers. In an era where virtually all tax "policy" is revenue-driven, a multi-billion-dollar conservation stimulus should at least provide rational incentives.

Before we offer a hypothetical situation to test the rationality of the Chafee proposal, we should note preliminarily that (1) the new estate tax break would apply, in effect, to the *remaining* value in property already reduced, for estate tax purposes, by the gift or bequest of a conservation easement, and (2) the statute does not distinguish between easements created before or after the enactment of the statute. For the thousands of taxpayers whose properties are appropriately located and already protected in perpetuity by conservation easements, this statute will restore belief in Santa Claus.

Now for the reality check. Edwina Blodgett is a 75-year-old widow with a potential $6 million gross estate. Her holdings are liquid, and she faces a 55% federal estate tax on those assets exceeding $3 million in value. Further assume that any asset now held or newly acquired will appreciate 50% in value from today until the date of her death.

First, suppose that Edwina purchases $2 million in securities. Those securities will be worth $3 million at her death, and will be subject to the maximum estate tax rate; i.e., her heirs will be left with just $1,350,000 of the $3 million pre-tax value. If, however, she purchases appropriately located land, with respect to which she can provide by bequest a "qualified conservation easement" reducing the value of that property by 30%, her gross estate will be doubly reduced — first by the deduction attributable to the conservation easement (IRC §2055(f); i.e., by $900,000), and then by the new exclusion (50% of the remaining value). Only $1,050,000 of the value of the easement-protected land will be subject to tax. The estate tax of $577,500 (55% of $1,050,000) leaves Edwina's heirs with $1,522,500 of property value—$172,500 ahead of the securities-investment plan.

But the game is not yet over. Once Edwina realizes that she can do so well by doing good, she may surely be persuaded to create the qualifying conservation easement by *inter vivos* gift, thus layering income tax savings onto the already top-heavy tax-benefit platter. For a taxpayer subject to a maximum (federal/state) income tax rate of 45%, the income tax benefits attributable to a present gift of a 30% conservation easement over a property worth $2 million could approach $270,000 (45% of the value of the easement at

the date of the gift, presumed to be shortly after acquisition of the property).

Toting up the total governmental tax-expenditure costs of this remarkable opportunity, we find that $900,000 of presumed conservation value (measured by the appraised easement value as of the time of death) has been acquired at a total cost to the revenue of $1,342,500; to wit:

Income tax savings	$ 270,000
Estate tax saving from exclusion of $900,000 easement value	$ 495,000
Estate tax saving attributable to new exclusion	$ 577,500
Total "tax benefit" acquisition cost	$1,342,000

One must hope that the Conference Committee, which must reconcile the House and Senate bills (the House bill contains no counterpart to the Senate proposal) will not find in these computations any hint of rational policy.

But perhaps we make too much of this; it may be a narrow, special-interest proposal, unlikely to be easily adapted to most estate plans. Hardly. The 25-mile geographical limitation would have applied to 254 "metropolitan areas" as of mid-1994 (OMB Bulletin No. 94-07, July 5, 1994). Areas of less than 100,000 persons may be so designated; it is virtually certain that most of the eastern seaboard, substantial areas of the industrial Midwest, and most of California, including the "Wine Country" counties, are so designated. With a stroke of the pen, all owners of *presently* protected properties in those areas will be the delighted beneficiaries of prospective estate tax savings totalling into the billions of dollars.

As we go to press, this remarkable giveaway is evidently the subject of serious consideration by the Conference Committee. If it survives, and if the bill itself is not the victim of a Presidential veto (a not unlikely prospect), it is apt to force a dramatic reorientation of land trust opportunities and priorities. Estate planners will henceforth drive the engines of local conservation programs, and God help the land trust that proves itself not sufficiently malleable to adapt to the new climate. Estate planners will strive to create the perfect "30% conservation easement," since tax benefits will be maximized where a conservation easement reduces the value of the property by at least, but not much more than, 30%. And once the phenomenon is noticed by guardians of the fisc more attentive than the current Senate Finance Committee, it is likely to be legislated out of existence, along, perhaps, with the conservation easement baby that has briefly enjoyed the bath.

Bad tax policy is bad tax policy, however benign the formative intentions. Yet the land trust community has made nary a peep about this potential fiscal atrocity, and, in fact, the Board of Directors of the Land Trust Alliance formally supported a prior version of the Chafee bill, and has made no public renunciation of that misguided endorsement. In the short run, the enactment of this legislation will create a climate of greed and expediency, and in the long run may do fundamental damage to the cause of voluntary land preservation itself.

--William T. Hutton