CONSERVATION EASEMENTS AND TAX BENEFITS

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CONSERVATION EASEMENTS

I. Definitions of Conservation Easement

A. A negative easement in gross with affirmative obligations enables the owner of the easement to prohibit or require a limitation upon or an obligation to perform acts on or with respect to the land owned by the grantor appropriate to the retaining or maintaining of such land;

B. A legally binding agreement that permanently restricts the development and future uses of the subject property in order to protect certain conservation values;

C. A property right that is less than fee generated by a non-possessory interest with affirmative obligations and negative easement implications surrounding a parcel of land and created by a deed conveyance that is executed with the same formalities associated with other forms of real estate conveyances.

II. Characteristics of Conservation Easements

A. Voluntary

B. Private

C. Unique

D. Perpetual

III. Misconceptions about Conservation Easements

A. Ownership of land is given up with conservation easement;

B. Land encumbered by a conservation easement can not be sold, mortgaged, or passed on to future generations;

C. Public access generally is required once you grant a conservation easement;

D. Easements cannot be sold, or sold and donated.

E. Easements are not interests in real property that can be used in tax-free, like-kind exchanges.

IV. Federal Tax Benefits and Qualification: Income Tax Deduction, Estate Tax Reduction, Estate Tax Exclusion

A. Qualifying for Income Tax Deduction**.** (Internal Revenue Code §170(h) (26 USC §170) and Treasury Regulations §1.170A-14 (26 CFR 1.170A-14))

1. A "**qualified conservation contribution**" satisfies the Internal Revenue Code requirements for a charitable contribution and income tax deduction. A "qualified conservation contribution" is a:

    a. "**Qualified real property interest**",

    b. Donated to a "**qualified conservation organization**",

    c. For "**conservation purposes**". (26 USC §170(h)(1))

2. A "**qualified real property interest**" is an "**easement or other interest** in real property that under state law has attributes similar to an easement". (26 USC §170(h)(2))

3. A "**qualified conservation organization**" is either a:

    a. A qualified, tax-exempt **501(c)(3)** charitable organization, which must generally be in the land conservation field or have a mission of land conservation, or

    b. A **governmental entity** (26 USC §170(h)(3)), and

    c. With the **resources** and **commitment** to protect the conservation values of the gift in perpetuity.

4. "**Conservation purposes**" include the following:

    a. The preservation of land for **outdoor recreation or education** for substantial and regular use for the public;

    b. The protection of the **natural habitat** of fish, wildlife or plants;

    c. The preservation of **open space, including farmland and forestland**, where such preservation is for the scenic enjoyment of the general public or is pursuant to a clearly delineated governmental conservation policy and will yield a significant public benefit; and

    d. The preservation of **historically important land** or a certified historic **structure**. (26 USC §170(h)(4))

5. The Easement's conservation purpose(s) must be protected in **perpetuity**. (26 USC §170(h)(5)). Protected in perpetuity according to the Code and Regulations requires several factors:

    a. **No surface mining** on the easement property is permitted.

i. The general rule is that **no charitable deduction** is allowed if the landowner does **not own the minerals** under the property and if at any time there may be a removal of those minerals by any surface mining method.

ii. The exception, however, swallows the general rule, stating that a landowner may obtain a charitable deduction if the probability of "**extraction or removal of the minerals by any surface mining method is so remote as to be negligible**". (26 USC §170(h)(5))

iii. Relevant factors to be considered in determining if the probability of extraction or removal of minerals by surface mining is so remote as to be negligible include: **Geological, geophysical or economic data showing the absence of mineral reserves on the property, or the lack of commercial feasibility at the time of the contribution of surface mining the mineral interest**. (26 USC §170(h)(5))

iv. Example 1. K owns 5,000 acres of bottomland hardwood property along a major watershed system in the southern part of the United States. Agencies within the Department of the Interior have determined that southern bottomland hardwoods are a rapidly diminishing resource and a critical ecosystem in the south because of the intense pressure to cut the trees and convert the land to agricultural use. These agencies have further determined (and have indicated in correspondence with K) that bottomland hardwoods provide a superb habitat for numerous species and play an important role in controlling floods and purifying rivers. K donates to a qualified organization his entire interest in this property other than his interest in the gas and oil deposits that have been identified under K's property. K covenants and can ensure that, **although drilling for gas and oil on the property may have some temporary localized impact on the real property, the drilling will not interfere with the overall conservation purpose of the gift**, which is to protect the unique bottomland hardwood ecosystem. Accordingly, the donation qualifies for a deduction under this section. (26 USC §170(h)(5))

b. **Mortgage** holders must subordinate to the right of the easement holder to enforce the terms of the conservation easement. (26 CFR §1.170A-14(g))

i. Subordination by lender does not mean that they will not be able to foreclose on their security.

ii. It does mean that in the event of a foreclosure, the conservation easement will remain in *effect* as a restriction on the property.

iii. Whether the lender realizes the amount on its security will depend upon the value of the property with the easement in place.

c. **Documentation** of the conservation easement sufficient to establish the condition of the property at the time of the gift is required, usually in the form of a baseline inventory. (26 CFR §1.170A-14(g))

d. **Extinguishment and proceeds** from sale or conversion if the easement is terminated. If subsequent unexpected changes in the conditions surrounding the property subject to easement make impossible or impractical the continued use of the property for conservation purposes, the easement may be extinguished by judicial proceeding. Holder is entitled to proceeds in proportion to the easement's value. (26 CFR §1.170A-14(g))

6. **Valuation** of the easement gift requires a "Qualified Appraisal" by a "Qualified Appraiser" to be created and available to submit or submitted with donor's tax return (26 CFR §1.170A-14(h)(3)(i), (ii) and 26 CFR §1.170A-13):

a. Typically appraised using the **Before and After Method** of Valuation: Before Valuation—Determine Highest and Best Use—evaluate potential for continuation of existing uses and alternative uses such as subdivision, redevelopment, expansion, renovation, timbering, etc.;
After Valuation—Determine Highest and Best Use—by comparing easement restrictions to existing zoning regulations and other controls.

b. **Timing of appraisal**: can be completed no earlier than 60 days before easement is donated and no later than filing of landowner's tax return.

c. **Enhancement**: If the grant of easement has the effect of increasing the value of any other property owned by the donor or a related person, the amount of the deduction for the conservation contribution shall be reduced by the amount of the increase in the value of the other property, whether or not such property is contiguous.

d. **Contiguous land/related parties**: The amount of the deduction in the case of a charitable contribution of a perpetual conservation restriction covering a portion of the contiguous property owned by a donor and the donor's family (as defined in section 267(c)(4)) is the difference between the fair market value of the entire contiguous parcel of property before and after the granting of the restriction.

7. Taxpayer **allocates basis** to reduce his/her tax basis in the land in proportion to the value of the conservation easement, so that the conservation easement value is proportionate to the value of the land, owner incurs a higher capital gain tax rate when selling the land encumbered by the conservation easement. (26 CFR 1.170A-14(h)(3)(iii)

8. The conservation easement must be **donated**, or sold for less than market value (as a bargain sale), to yield a charitable contribution income tax deduction.

   a. A conservation easement that is granted in return for something, i.e., where there is a "*quid pro quo*," will not satisfy the "donative intent" requirement established by case law surrounding the Internal Revenue Code provision for charitable donations and will not qualify for a charitable deduction.

   b. An example is a conservation easement granted by a landowner to a city in exchange for or as required by annexation or favorable zoning of the property.

B. <u>Tax Benefits of Income Tax Deduction</u>.

A **charitable income tax deduction** for the value of the conservation easement. For income tax purposes, this difference in value is a charitable deduction that can be used for a period of up to six years for reducing the income tax of the grantor of the easement.

If a conservation easement satisfies the Internal Revenue Code requirements, then the grantor of a conservation easement may receive a charitable income tax deduction (<u>not</u> a tax credit) for the difference in value of the property before the easement was granted compared to the value of the property after the granting of the conservation easement.

i. May be used against **ordinary income as well as capital gains**. (26 USC §170(e))

ii. **Limited to basis** until the property is owned for one year; or elect to limit to basis with **50%** limitation of adjusted gross income. (26 USC §170(b),(e))

iii. **Limited to fair market valu**e if property is owned for over a year; limited to **30%** of adjusted gross income. (26 USC §170(b), (e))

iv. May be used in the year of the donation; and each of the following five years (**five year carry-forward**). (26 USC §170(d))

v. **Pension Protection Act 2006**: Expands tax deductions for conservation easement donors for 2006 and 2007: (26 USC §170(b))

   a. Easement deduction percentage limitation for **individuals** raised to **50% of AGI** with **fifteen year** carry forward;

b. Easement deduction percentage limitation for **qualified farmer and rancher individuals** (a taxpayer whose gross income from the trade or business of farming (per §2032A(e)(5)) is greater than 50% of gross income for year) raised to **100% of AGI** with **fifteen year** carry forward for donors with more than 50% of income derived from farming or ranching, provided that "property remain available for agriculture or livestock production";

c. Easement deduction for **corporate farmers and ranchers no longer limited to 10%** of taxable income, but is now **100% of AGI** or that amount "allowed to the extent the aggregate of such contributions does not exceed the excess of the taxpayer's taxable income over the 10% of taxable income limit" with a **15-year** carry forward.

vi. **Pension Protection Act 2006/Farm Bill 2008-2009, Jobs Bill 2010**: For tax years 2006 and 2007, conservation easement donors were allowed to **deduct 50%** of their adjusted gross income (or **100%** if they are a "**qualified farmer or rancher**") with a **15-year** carry-forward. Expired in December 2007, but the **2008 Farm Bill** extended the conservation benefit for two more years **to 2010**. Currently expired in 2010, but same benefits part of a bill to be retroactive for 2010 only.

vii. **Tax Benefits for Entities**:

i. **C Corporation**: deduction limited to 10% of corporation's contribution base (taxable income with certain adjustments); **affected by Pension's Act** to extent corporation is a farming or ranching corporation, in which case 10% limitation does not apply.

ii. **S Corporation**: deduction passes through to shareholders but limited to their basis in their stock; **affected by Pension's Act**—question is whether when an S corporation makes a charitable contribution, it flows through to the shareholders without regard to their basis in the S corporation stock.

iii. **Partnerships, limited liability companies**: deduction passes through to owners without the basis limitation.

C. <u>Qualifying for and Benefits of Estate Tax Reduction</u>. (Internal Revenue Code §2055 (26 USC §2055) and Treasury Regulations §1.2055 (26 CFR 1.2055)

Estate subject to tax includes **land** upon which qualified **conservation easement** is placed.

A gift of a conservation easement can be **made by will**. A gift made by will is considered effective as of the date of death and will reduce the estate taxes of the decedent.

An **Estate Tax Reduction,** removing the value of the conservation easement from the taxable estate. For estate tax purposes, the grant of the easement results in a lower value for the property and therefore a lower value of the estate for the federal estate tax, and may generate an additional exclusion from the valuation of an estate for property subject to a conservation easement. (26 USC §2055)

i. Lowers value of property to "**after**" value.

ii. Removes a portion of the property's **appreciation** from estate.

The "**phase out**" of the estate tax is a complete repeal for 2010 only; if no further Congressional action is taken, the estate tax returns in full at its highest rates in 2011.

i. The **highest estate tax** will be reduced in 2007 from 50% to 45% through 2009 and to 0% in 2010 with return to 55% without further Congressional action.

ii. The **Unified Exemption Amount** (the amount of value that can be transferred tax-free at time of death) is increased to $2 million in 2006 through 2008 and $3.5 million in 2009 and zero in 2010 with the repeal of the estate tax, and will return to $1 million in 2011 without further Congressional action.

iii. After repeal, the basis for larger estates is no longer "**stepped up**" but taken to be the lower of the basis of the decedent or the fair market value of the property upon the date of death.

D. <u>Qualifying for and Benefits of Estate Tax Exclusion</u>. (Internal Revenue Code §2031(c) (26 USC §2031(c) with no Treasury Regulations to date)

In certain circumstance, a **partial exclusion from estate taxes** for the residual value of the land subject to the conservation easement. **1997 Taxpayer Relief Act**. Pursuant to Internal Revenue Code §2031(c), a provision of the 1997 Taxpayers Relief Act, if the value of the easement equals at least **30%** of the original value of the land (or if less, reduce the 40% exclusion available by two percentage point for each percentage point the value is below 30%), the taxpayer's estate may **exclude 40%** of the residual value of the land (the value of the property remaining after the granting of an easement) from the taxable estate, up to a maximum exclusion of $500,000 by 2002 and thereafter, if:

i. The conservation easement is granted **post mortem** by election of a family member or the estate's executor. (Colorado Senate Bill 99-101 grants authority to executors to make this election under Colorado law, subject to notice to interested parties.)

ii. The land is within the **United States** or any possession of the United States.

iii. The conservation easement prohibits more than "a ***de minimis*** **use** for a commercial recreational activity."

D. Conservation easements are interests in real property that can be used in **tax-free, like-kind exchanges**.

E. Caution: For estate tax purposes, property is valued without regard to any restriction unless it satisfies the requirements for a charitable deduction or unless it is a bona fide business arrangement. A donated conservation easement that does not satisfy the requirements for a charitable deduction may be a **taxable gift**.

V. State and Local Tax Benefits and Qualification: Easement Enabling Act, Income Tax Credit, Property Taxes

A. Qualifying Conservation Easement Donation: A fully transferable interest in real property interest that is a conservation easement in gross. (CRS §38-30.5-101 *et seq*.)

1. **Purpose**: Maintaining the land predominantly in a natural, scenic, or open condition, or for wildlife habitat, or for agricultural, horticultural, wetlands, recreational, forest, or other use or condition consistent with the protection of open land, environmental quality or life-sustaining ecological diversity, or appropriate to the conservation and preservation of buildings, sites, or structures having historical, architectural, or cultural interest or value. (CRS §38-30.5-102)

2. **Holder**: To qualify as a property interest under Colorado law, a conservation easement must be granted to or reserved by either:

a. a governmental entity; or

b. a qualified, tax-exempt 501(c)(3) charitable organization recognized under the Internal Revenue Code, which organization was created at least 2 years prior to the receipt of the easement. (CRS §38-30.5-104(2))

3. **Perpetual**: The easement is deemed perpetual unless otherwise stated. (CRS §38-30.5-103(3)

4. **Water**: An easement that encumbers water or a water right may be created by the owner of the water or water right and may be revoked after sixty days' notice and in accordance with the applicable requirements of the mutual ditch or reservoir company, to whom sixty days' notice must be provided. (CRS §38-30.5-103(5), 104(1))

5. **Validity**: Instruments creating, assigning, or otherwise transferring easements must be recorded upon the public records affecting the ownership of real property in order to be valid and shall be subject in all respects to the laws relating to such recordation. (CRS §38-30.5-106)

6. **Termination**: Easements may, in whole or in part, be released, terminated, extinguished, or abandoned by merger with the underlying fee interest in the servient land or water rights or in any other manner in which easements may be lawfully terminated, released, extinguished, or abandoned. (CRS §38-30.5-107)

7. **Damages**: In addition to the remedy of injunctive relief, the holder of an easement shall be entitled to recover money damages for injury thereto or to the interest to be protected thereby, and in assessing such damages, there may be taken into account, in addition to the cost of restoration and other usual rules of the law of damages, the loss of scenic, aesthetic, and environmental values. (CRS §38-30.5-108)

8. **Property Tax**: Real property subject to one or more easements shall be assessed with due regard to the restricted uses to which the property may be devoted. (CRS §38-30.5-109)

B. <u>Qualifying for Conservation Easement Tax Credit</u>: Credit against income tax for Colorado taxpayers who donate conservation easements. (CRS §39-22-522)

1. **Taxpayers:** Taxpayers qualified to claim the gross conservation easement credit (including transferees of these credits) include:

a. Colorado residents,

b. C corporations,

c. trusts,

d. estates,

e. partners, shareholders or members of pass-through entities who receive the credit from such entity, regardless of whether such individuals are Colorado residents:

i. Joint tenancy, tenancy in common, pass through entity such as a partnership or S corporation, or other similar entity or group must **allocate the credit** to the entity's owners, partners, shareholders or members in proportion to their distributive shares of income or ownership percentage from such entity or group.

ii. A **single-member limited liability company** will generally be **disregarded** for federal tax purposes (I.R.S. Regulation 301.7701-3) as well as for state tax purposes and will not qualify as a "member of a pass-through entity" so will not qualify for the credit unless the member is a Colorado resident.

iii. Individuals who are **not residents** of Colorado cannot claim the credit for a donation they make or for a credit they purchase. Part-year residents may claim the credit, but only if they make the donation while they are a Colorado resident. **Only a credit apportioned to nonresident partners, shareholders, or members of a pass-through entity can be claimed by nonresidents.** Nonresident owners included in a joint tenancy, tenancy in common, and similar groups cannot claim the gross conservation easement credit.

2. **Conservation Easements:** A credit is generated from the donation of a **single** perpetual conservation **easement** in gross which must be a **qualified conservation contribution** per 26 USC §170(h), but NOT if:

a. The Easement is not made exclusively for conservation purposes (subjective at best; arguably more strict than the federal test);

b. Land already protected by non-profit 501(c)(3) ownership (presumes non-profits do not have trade lands and always protect the land they own);

c. Donation made to an unqualified organization;

d. Water rights encumbered are revocable.

Phased conservation easements permissible provided each easement stands alone and prior tax **credits are used** by transferor or transferee prior to making subsequent donation for new tax credit.

3. **Tax Credits:** A taxpayer can claim only **one tax credit per income tax year** that is generated by the donation of a perpetual conservation easement in gross by the taxpayer, either directly or by a pass-through entity in which the taxpayer is a partner, shareholder or member. A taxpayer **cannot earn multiple credits** in one year from multiple donations even if the donations are made by **different pass-through** entities. (C.R.S §39-22-522(6))

a. A taxpayer **cannot claim** a tax credit on a donation made during a tax year if:

i. the **taxpayer** has a **carryover** credit from a prior tax year, or

ii. another taxpayer that has **purchased** a credit from the taxpayer is **carrying** all or part of the purchased credit to the tax year.

b. Credit **survives death** of donor and is transferable or can be claimed by estate (HB 05-1244).

c. **DR Form 1305** for both transferee and transferor for each credit, along with **DR Forms 1299, 1303, and 1304, and federal form 8283, with complete appraisal** filed with state tax return, and **summary appraisal** filed with federal tax return, depending on amount of deduction claimed.

d. Federal deduction **add-back** if charitable deduction claimed at federal level and amount deducted at federal level added back to state taxable income.

C. Tax Benefits of Income Tax Credit.

1. **State Income Tax Credit** (CRS §39-22-522):

a. **Amount of Credit Through 2006**: Colorado law (HB 99-1155; CRS §39-22-522(4)(a)), creates income tax credit with 100% match of up to $100,000 for a donated conservation easement with a 20-year carry forward. January 1, 2003, income tax credit increases to maximum amount of the credit totaling $260,000 (HB 01-1090; § 39-22-522(4)(a)) with any amount over $100,000 credited 40% of each dollar and total maximum easement value of $500,000 taking full advantage of the credit. [$100,000 + (40% of $400,000) = $260,000]. Law effective for easements donated through December 31, 2006.

b. **Amount of Credit 2007 Forward**: Colorado law (HB 06-1354) changes formula for tax credit to do away with 100% match of first $100,000 and 40% thereafter up to $500,000, to create earning rate of 50% across the board up to total maximum easement value of $750,000, which earns maximum credit totaling $375,000. Law effective for easements donated after January 1, 2007.

i. The total amount of credit a **married couple** can generate in a year, regardless of whether they file jointly or separately, is $375,000 for tax year 2007 and after.

ii. The sum total of credits that all **partners, shareholders or members of a pass-through entity** making a donation can generate is $375,000 for tax year 2007 and after.

ii. The total credit generated by **tenants in common, joint tenants, and similar ownership groups** making a donation is $375,000 for tax year 2007 and after.

c. **Carry Forward**: 20 years plus year of donation.

d. **Refund** of Credit: (HB 00-1348; §39-22-522): income tax credit may be refunded in years in which the state has a budget surplus only:

i. Not available again until after **2010 per TABOR** suspension;

ii. Cannot also **transfer** credit in same year;

iii. Maximum amount of refund is **$50,000**;

iv. **Transferees** not eligible for refund;

v. Multiple taxpayers must **coordinate** refund among them.

e. **Transfer** of Credit:

i. A taxpayer can transfer all or part of a credit to a transferee who meets the **qualifications of a taxpayer** who can claim the credit. The portion of the credit being transferred must not be claimed by the transferor to offset tax or to claim a refund on any income tax return.

ii. A credit can be transferred **only once**. A transferee, to whom a credit is transferred, cannot thereafter transfer the credit to another taxpayer.

iii. The donor can **transfer all or any pro-rated** portion of the credit, but only once; credits **cannot be re-transferred**, even back to the original donor.

iv. A transferred credit claimed by a transferee can **never exceed the net tax** liability reported on the tax return.

v. A **pass through entity** can directly transfer a credit if:

a. Each partner, shareholder or member **consents** to the transfer, and

b. Each partner, shareholder or member **could**, under the restrictions of the law and this regulation, **have** claimed and **transferred** their pro rata share of the credit directly.

c. And, must **transfer or distribute** the credit to its members for year of donation or will lose it without any carry forward

f. **Purchase** of Credit:

i. A taxpayer can **purchase** and claim an **unlimited number** of credits. A taxpayer **cannot purchase** a tax credit during a tax year if:

a. the taxpayer **claimed a credit** generated from the donation of a single perpetual conservation easement in gross made during the tax year, or

b. the **taxpayer** has a **carryover** credit from donation of a conservation easement available during the tax year from a prior year, **except** if the carryover credit is a result of an unused **purchased** credit from a prior year, or

c. another taxpayer that has **purchased** a gross conservation easement credit from the taxpayer is **carrying** all or part of the purchased credit to the tax year.

ii. A pass through entity **cannot (buy)** qualify as the transferee of a credit.

g. Transfer **Timing**.

i. For transfers completed prior to June 7, 2005, a transferee of a conservation easement credit must **purchase the credit prior to the end of the tax year** to be able to claim the credit during that tax year. A purchased credit cannot be claimed or carried back to a tax year that ended prior to the day the credit was purchased.

ii. For transfers completed on or after June 7, 2005, a transferee of a conservation easement credit must **purchase the credit by the due date of the income tax return,** not including extension of time for filing, on which the credit will be claimed. However, the donation of the conservation easement must occur prior to the end of the transferee's tax year.

h. **Income** from sale of credit taxed as **ordinary income** or **capital gains?** (Ordinary Income based on FYI 39 04/07 and IRS audits, but not 2002 IRS promise of guidance).

i. Transferees of tax credits do not lose **federal deduction** for state income taxes when apply credit to Colorado income tax liability. (IRS TAM No. 200126005)

j. **Review** of Credits: (HB 05-1244; §39-22-522) DOR authorized to review, accept, reject or require additional information related to credit; donor of easement is contact/Tax Matters Representative for any protest and communications with the Department of Revenue; **transferee will be held liable** for the disallowed credit that was claimed plus any applicable penalty and interest; DoR's final resolution regarding credit is binding on buyer.

k. Proposed Tax Credit Cap: (HB 10-1197). *Aggregate cap of $26 million annually for entire tax credit program; effective January 1, 2011 with sunset in 2013, rather than be a permanent change to the program; cap would only apply to easements conveyed in 2011, 2012, and 2013; administered through the Division of Real Estate; and waitlist would be created that would not exceed $52 million (overall "cost" to the State remained at a $26 million/year or $78 million/three years). For example, if $78 million in credits were generated in 2011, the limits for 2012 and 2013 would be met.*

D. Qualifying for and Benefits of Property Tax Retention and Reduction:

1. Under Colorado law (H.B. 95-1268; CRS 39-1-102 (1.6)(a)(III)) there is an **agricultural property tax retention** for lands classified as agricultural prior to easement donation, meaning that the land will be taxed at an agricultural rate after the donation or sale of a conservation easement, provided that the property consists of at least eighty **(80) acres**, or, if less than **(80) acres**, if it does not include any residential structures; the grant of the easement was to a qualified organization; if the easement was granted exclusively for conservation purposes, and if all current and contemplated future uses of the land are described in the conservation easement.

   Proposed 2010 HB 1197 attempts to clarify permitted uses and assessment by informing that the law not be construed *to require or permit the reclassification of agricultural land or improvements, including residential or nonagricultural residential property, due solely to subjecting the land to a perpetual conservation easement*, and defines "Agricultural land" to exclude any portion of such land that is actually used for nonagricultural commercial or *nonagricultural* residential purposes.

2. For **non-agricultural or non-qualifying land**, there *should* be a **property tax reduction** based on language of CRS §38-30.5-109 stating that "real property subject to one or more easements shall be assessed with due regard to the restricted uses to which the property may be devoted".

VI. Typical Restrictions/Requirements in/of Conservation Easements

A. No or limited **subdivision**.

B. Limit on **development** or additional building. A landowner may reserve several homesites for present and future use.

C. No **commercial or industrial** uses other than ranching, farming, lodging, and cottage industry.

D. No/limited separation of **water rights** from property, or no separation greater than that required to support conservation values.

E. Management of agriculture or forestry uses through **management plans**.

F. A **cash donation** to the land trust as an endowment for monitoring and enforcement of the conservation easement is usually part of the transaction.

VII. Landowner Steps to Creating and Donating/Selling a Conservation Easement

A. Identify your property's potential conservation values;

B. Consider if/where to reserve rights for development, other uses, consider working with land planner to create land plan for property;

C. Locate a land trust or government entity whose mission is consistent with your vision of the property's protection;

D. Identify your financial goals; consult with your tax advisor/accountant to determine whether you should donate an easement;

E. Obtain an appraisal of the conservation easement to determine before and after values;

F. Obtain a title report for your property to review status of ownership, mortgages, covenants, minerals, etc.

G. Obtain a baseline inventory of the property to establish ecological status of property at time of grant and to describe conservation values;

H. Obtain a mineral report/remoteness letter if you do not own minerals associated with property;

I. Obtain subordination of any mortgages on property;

J. Prepare the deed of conservation easement—both sides should have legal counsel; and

K. Sign and record the conservation easement.

VIII. State Tax Issues

A. Striving for Oversight/Accountability/Curbing Abuse/Appraisals: 2007 (**HB 1361**)

1. Holder to submit information to DoR, Department of Agriculture, and Department of Natural Resources showing locations of all CEs;
2. Donor to submit statement of value, location, nature of easement and credit, info to be made public;
3. Affidavit from appraiser as to value, property, and methodology;
4. Qualified appraisals and licensed, qualified appraisers, violations reported to real estate board; and
5. Second appraisal may be required by DoR at landowner's cost.

B. Curbing Abuses of Conservation Easement Tax Credit: 2008 (**HB 1353**)

1. Increased accountability for conservation easement appraisals by requiring appraisals to be submitted upon their completion to the Colorado Division of Real Estate for review with a $600 fee to cover those costs;
2. Certification for conservation easement holders with a fee of up to $5,810 to cover the cost of certification;
3. Increased oversight and enforcement of the state tax credit by Department of Revenue; and
4. Conservation Easement Oversight Commission will advise the Division of Real Estate and Department of Revenue and consist of nine members: Great Outdoors Colorado, the Colorado Department of Natural Resources, the Colorado Department of Agriculture, a local land trust, a state or national land trust, a local government open space or land conservation organization, an historic preservation group, a landowner, and a certified general appraiser.

C. Changing the Fees: 2009 (**HB 1014**), proposes to eliminate the fee caps for both the appraisal review and easement holder certification programs and will change the certification program from a 3-year program to a one-time certification with an annual renewal with fee (estimates: Year 1 -- $4,000, Year 2 -- $4,000, Year 3 -- $3,000, Year 4 and beyond -- $2,000 or less annually).

D. Proposed Tax Credit Cap: 2010 (**HB 1197**)

1. *Aggregate cap of $26 million annually for entire tax credit program;*
2. *Effective January 1, 2011 with sunset in 2013, rather than be a permanent change to the program;*
3. *Cap would only apply to easements conveyed in 2011, 2012, and 2013;*
4. *Administered through the Division of Real Estate; and*
5. *Waitlist would be created that would not exceed $52 million (overall "cost" to the State remained at a $26 million/year or $78 million/three years). For example, if $78 million in credits were generated in 2011, the limits for 2012 and 2013 would be met.*

E. Non-profits eligible for tax credits?

IX. Federal Tax Issues

A. **Dealer Issues**. Different tax rules apply to "dealers" under the Internal Revenue Code than apply to typical landowners. Query: If the landowner is a developer, and a developer is a dealer, is the landowner limited to a tax deduction equal to her "basis" (or cost) of the donated property? And, what is the effect when the property at issue is owned by a dealer, and the land has appreciated substantially in value since its purchase?

B. "**Donative Intent**". A conservation easement that is granted in return for something, i.e., where there is a "*quid pro quo*", does not satisfy the "donative intent" requirement established by common law and does not qualify for a charitable deduction? Easement grant is not made with donative intent out of disinterested generosity but is made to satisfy the *quid pro quo*.

1. An example may be a conservation easement granted by a landowner to a city in exchange for annexation or zoning of the property. Query Treas. Reg. reference to public interest in conservation project above and beyond financial gain or incentive of donor, implying bare *quid pro quo* may not vitiate donative intent.

2. A conservation easement granted to take advantage of a rural cluster zoning may be another example, depending on how constructed.

3. BUT: Query how a "limited" or "protective" development circumnavigates this issue: A "limited" or "protective" development is one in which a limited number of lots are sold to generate revenues sufficient to allow for the preservation of the balance of the property. The lots may be clustered or otherwise sited in such a way as to protect the conservation values of the property on the undeveloped portion of the property. A conservation easement may be used in this situation to preserve the balance of the property and may generate a charitable income tax deduction if properly structured.

4. BUT: Query how the "gift" or donation of land in excess of that required by the quid pro quo is to be treated—is it donated or does the pure requirement of an easement *per se* defeat the disinterested generosity of the gift above and beyond that required by the deal struck? Conflict of common and statutory law: case-law suggests you need the disinterested generosity defeated by the requirement; statute suggests as with the purchase of a charitable meal ticket, that in excess of the quid pro quo is still deductible.

C. **Mortgage Subordination.** Is a "consent of lienholder" document agreeing to allow conservation easement to continue after foreclosure sufficient, or must lienholder subordinate in a subordination agreement and use that terminology in order for the easement grant to qualify for a tax deduction? Is the subordination required to precede or be contemporaneous with the easement grant or can it be procured after the grant as long as the lender agrees to subordinate to the terms of the easement in perpetuity?