

# STATE CONSERVATION TAX CREDITS IMPACT AND ANALYSIS



**CONSERVATION RESOURCE CENTER**

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*Cover photo: Autumn mountains, Colorado*  
*Back cover photos: Conserved land in Colorado and Virginia*

# STATE CONSERVATION TAX CREDITS

# IMPACT AND ANALYSIS

*Authored by  
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## **The Conservation Resource Center's Tax Credit Exchange**

The Conservation Resource Center's (CRC) Tax Credit Exchange is a nonprofit land conservation organization and a Colorado tax credit facilitation organization. It is run by conservation attorneys with more than 30 years of combined experience in conservation law and policy. In 2000, the Conservation Resource Center established the first transfer market for conservation tax credits. The Tax Credit Exchange also works at the state and national levels on tax credit law and policy.

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Connecticut Land Trust Service Bureau  
Conservation Trust for North Carolina  
Delaware Department of Natural Resources and Environmental Control  
Environmental Edge, South Carolina  
Georgia Land Trust Service Bureau  
Kentucky Sierra Club  
Maryland Environmental Trust  
Massachusetts Chapter of The Nature Conservancy  
Mississippi Chapter of The Nature Conservancy  
Mississippi Land Trust  
Nebraska Land Trust  
New Mexico Land Conservancy  
New Mexico State Forestry Division  
New York Chapter of The Nature Conservancy  
North Carolina Department of Environment and Natural Resources  
Virginia Outdoors Foundation  
West Virginia State Senator John Unger



*Wetlands, Florida*


**The purpose of this report** is to assess the effectiveness of state income tax credits (Conservation Credits) in advancing land conservation and to guide states through issues related to the development of a tax credit program.<sup>1</sup>

It has been twenty-three years since North Carolina enacted the nation's first state tax credit program for land conservation donations. Since that time, the tool has become increasingly popular, with eleven additional states passing tax credit legislation since 1999. With many programs at least five years old, it is an appropriate time to evaluate the effectiveness of Conservation Credits in advancing land protection and to provide guidance to other states considering such programs. Part One of this report addresses the effectiveness of state tax credit programs. Part Two provides guidance for program development.

The Conservation Resource Center (CRC) has conducted an in-depth analysis of the nation's twelve Conservation Credit programs. The information and conclusions presented in this report are based on:

- Detailed examination of state Conservation Credit legislation and supporting regulations.
- Interviews with land conservation professionals in each of the twelve states having state tax credits.
- CRC's nearly ten years of work in Conservation Credit law, policy, and transactions.

This report is intended both to provide a snapshot of the current effectiveness of Conservation Credit programs and to serve as an aid to states that are rethinking existing legislation or drafting new programs.



THE  
PURPOSE  
OF THIS  
REPORT



*Sunset, Texas*



# PART ONE

# PART

## **Effectiveness of State Income Tax Credits in Advancing State Land Conservation Goals**

**A Conservation Credit is an income tax credit available to landowners who voluntarily preserve their land through the donation of a conservation easement and/or fee title.** The donation must protect conservation values as defined by individual states and must be made to an entity qualified to hold such property interest by the terms of the legislation creating the credit. Typically, this includes state and local governments and 501(c)(3) land conservation organizations. Whether stated explicitly or not, Internal Revenue Code (IRC) §170(h), pertaining to federal tax deductions, is often the starting point for setting eligibility guidelines for a program.<sup>2</sup> Most states also add their own layer of requirements to those required by IRS guidelines for federal deductibility.

Conservation Credits were developed to complement existing state and federal incentive structures for land conservation. Depending on their value, Conservation Credits can provide greater and more direct financial benefits to landowners than those provided by federal tax deductions. State Conservation Credits, as distinguished from federal deductions, are dollar-for-dollar write-offs of state income taxes. However, as with federal deductions, landowners with little or no taxable income derive less benefit from tax credits than do wealthier landowners with higher taxable incomes.

To partially address this inequity, nearly all Conservation Credit programs allow credits to be carried forward so that the credit may be applied to reduce taxes over a number of years. While this can help, many times landowners still can not realize the full benefit of their credit. To further address this issue, several states have made their credits transferable or refundable. This will be discussed later in greater detail.

Twelve states (California, Colorado, Connecticut, Delaware, Georgia, Maryland, Mississippi, New Mexico, New York, North Carolina, South Carolina, and Virginia) and Puerto Rico<sup>3</sup> currently offer state Conservation Credits to landowners who donate lands for conservation.<sup>4</sup> Georgia and New York are the states that most recently enacted new programs, having done so in 2006. Several of the states with tax credit programs anticipate running legislation to increase program incentives in 2007. Another six states have either attempted to pass legislation within the past year or are actively considering a Conservation Credit program. Massachusetts and Idaho are currently working to create programs. Nebraska and West Virginia both introduced legislation in 2006, but their plans for 2007 are uncertain. Groups in Kentucky and Minnesota are

## BACKGROUND: WHAT IS A CONSERVATION CREDIT?



*Desert Plateaus, New Mexico*

in the very early stages of considering programs. See Figure 1, Map of State Conservation Credit Programs, for states with current or pending programs. Attachment A, Summary of State Conservation Credit Programs, can be found on pages 32-34 of this report.

B.

**CONSERVATION  
CREDIT  
PROGRAM  
EFFECTIVENESS**

**A Conservation Credit program can be a highly effective tool to promote land conservation.** With a thoughtfully crafted program, everyone benefits. Landowners receive a financial reward for protecting their land, the state advances its goals of land conservation through tax policy rather than general-fund expenditures, and the public reaps the benefit of lands preserved as open space at a fraction of their cost. As a tool that provides tax relief, benefits agriculture, and encourages land conservation, Conservation Credit programs receive strong bipartisan support.

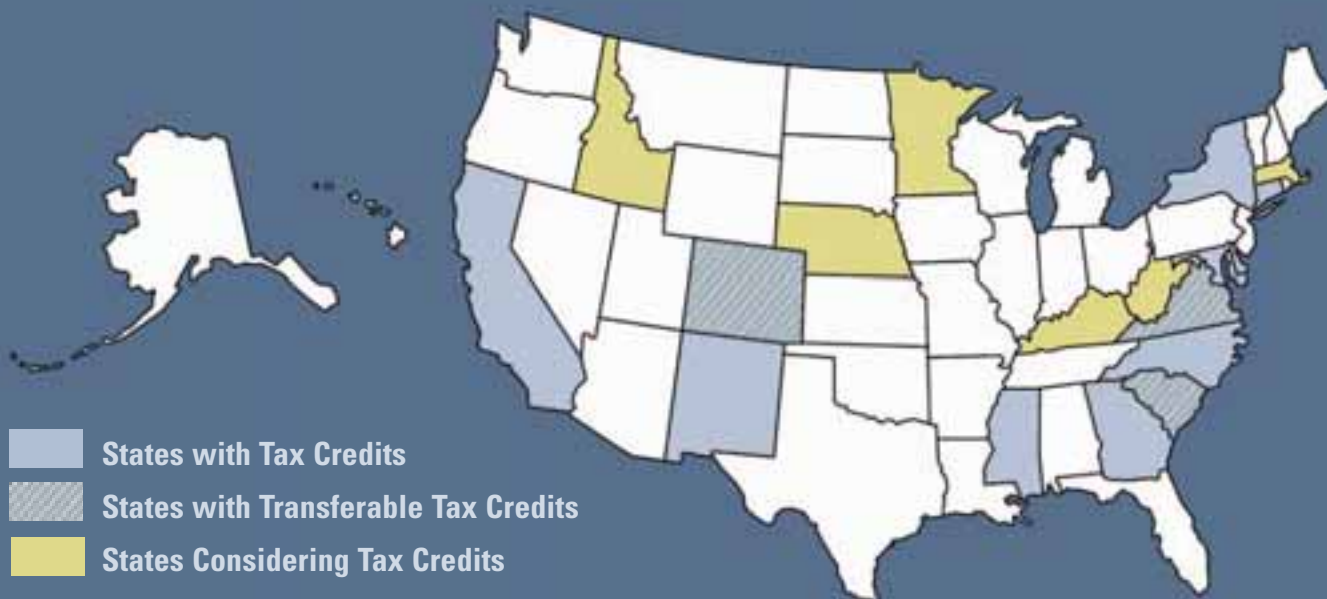
For the purposes of this report, program effectiveness is judged by the extent to which the programs drive additional land conservation and protect important conservation values.

**1. Effectiveness in driving additional land protection – Statistics**

The effectiveness of Conservation Credit programs in driving additional land protection varies widely among the twelve states. This is attributable to substantial

Figure 1

**STATES USING INCOME TAX INCENTIVES FOR LAND CONSERVATION**



\*Beginning January 2008, New Mexico credits will be transferrable

differences among programs. In a perfect world, program success in spurring greater land protection would be determined by comparing donation statistics before and after enactment of a program. Unfortunately, according to the organizations interviewed, accurate protection numbers are unavailable due to a lack of comprehensive statewide tracking of donations before legislation was passed. Virginia has the most reliable statewide donation statistics prior to the creation of its Conservation Credit program. The Virginia Outdoors Foundation (VOF) holds approximately 90 percent of conservation easements in the state and has tracked its easement donations since 1968.

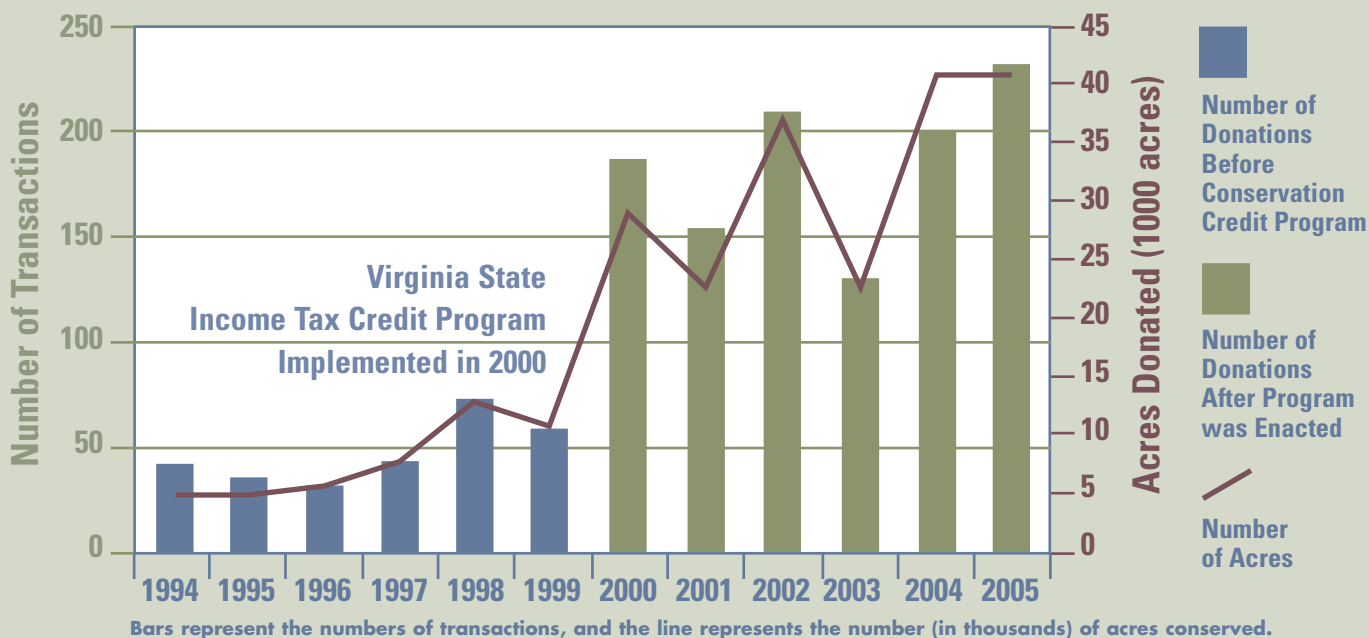
Fortunately, once Conservation Credit programs are created, states typically keep detailed records of donations that generate tax credits. To demonstrate program effectiveness in driving land protection, this report relies on detailed statistics from both Virginia and North Carolina. The statistics provide documentation of what can occur when a credit program is enacted (Figure 2), when credit value is increased (Figure 3), and when credits are made transferable (Figure 4). Please note that the statistics from Virginia and North Carolina are from programs having high-value credits and, in the case of Virginia, transferability. Not all programs include these elements.

**a. Enacting a Conservation Credit program**

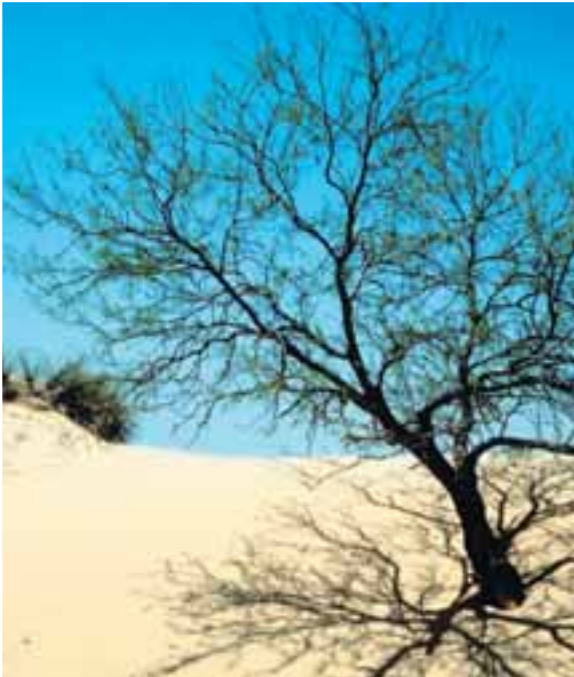
Virginia Outdoors Foundation statistics demonstrate that after passage of Virginia’s Conservation Credits, the average number of conservation easements donated and the acres represented in those donations nearly quadrupled from

**ENACTING A CONSERVATION CREDIT PROGRAM:  
VIRGINIA OUTDOORS FOUNDATION**

Figure 2



Bars represent the numbers of transactions, and the line represents the number (in thousands) of acres conserved.



Sand Dune, Texas

the six years prior to enactment of the program to the six years after enactment. Please note that these numbers represent conservation easement donations only and do not include fee title donations.

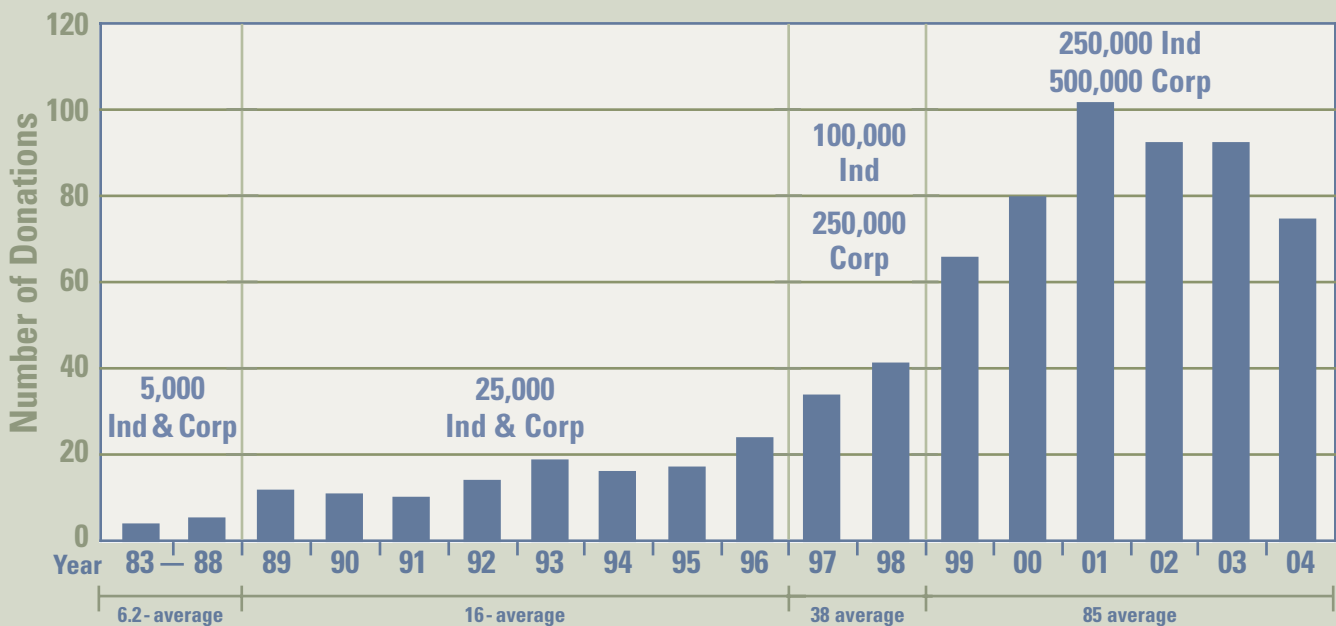
**b. Increasing credit value**

North Carolina first enacted Conservation Credits in 1983, making its program the oldest ongoing state Conservation Credit program. The statistics gathered by the state demonstrate how increasing the value of a conservation tax credit can impact both annual donations and annual acres donated. Over the years, the maximum allowed credit was raised from \$5,000 to \$250,000 for individuals and from \$5,000 to \$500,000 for corporations.

The average number of conservation easements donated more than doubled when the credit cap was raised from \$25,000 to \$100,000 per individual and from \$25,000 to \$250,000 per corporation. The average number of donations more than doubled again when the cap was raised to \$250,000 for an individual and \$500,000 for a corporation. While not shown in Figure 3, average annual acres donated also rose significantly from 1983 to 2004, climbing from an average of 397 acres to 11,500 acres.

Figure 3

**INCREASING CREDIT VALUE:  
NORTH CAROLINA CONSERVATION TAX CREDIT STATISTICS**



### c. Making credits transferable

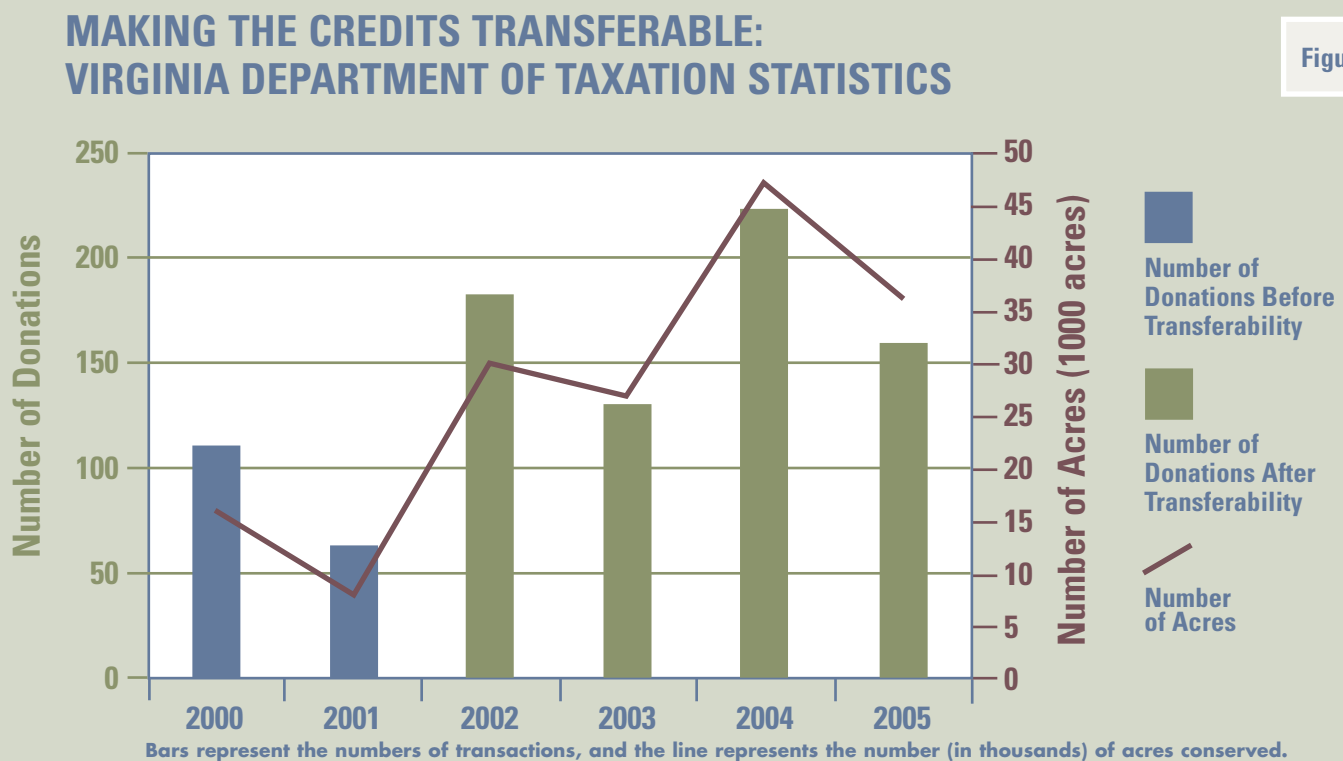
Figure 4 demonstrates the impact of making credits transferable. It compares donation activity in the first two years of Virginia's program, when the credit was not transferable, with activity in the next four years of the program, when credits were transferable. The average number of donations doubled and the acres protected tripled once credits were made transferable. Since 2002, the average percentage of credits transferred by landowners to third parties has been 75 percent.

## 2. Effectiveness in driving additional land protection – Expert opinion

To assess program effectiveness where accurate statistics are not readily available, CRC relied on the estimates of land conservation professionals in each state. The experts shared their opinions about what level of increased land protection, if any, is directly attributable to their states' Conservation Credit programs. Generally, programs with credits valued at less than \$100,000 reported no significant increase, and programs with credits valued at or greater than \$100,000 reported varying degrees of increased donations. The two states with transferability reported the highest increases.

### a. Effectiveness where credit value is less than \$100,000

Five states—Delaware, Maryland, Mississippi, New York and South Carolina—have credit values less than \$100,000. Legislation in Delaware, Maryland, and Mississippi explicitly caps credit value at some amount less than \$100,000.



Credits in New York and South Carolina are kept under \$100,000 by virtue of their valuation<sup>5</sup>. In Delaware, Maryland, and South Carolina, programs have been in place for several years. Professionals in these states noted that although Conservation Credits provide additional incentives, they “are not a driving force for land conservation,” and that there has been “no significant increase” in land donations as a direct result of the credits<sup>6</sup>. Experts in each state implied that program effectiveness would be enhanced if credit values were increased.

South Carolina is the only state with credits valued at under \$100,000 that offers transferability. While generally, transferability increases program effectiveness, this has not been the case in South Carolina due to the low credit value, the unlimited carry-forward period, and the requirement that all transfers must be approved by the state. These factors combine to make transferring credits less appealing, as landowners can realize much of the value of the credit through an unlimited carry-forward period without the burden of state review.



*Everglades, Florida*

#### **b. Effectiveness where credit value is equal to or greater than \$100,000**

Seven states—California, Connecticut, Colorado, Georgia, New Mexico, North Carolina, and Virginia—offer credits valued at or greater than \$100,000. Land conservation professionals in five of these states reported that their programs were effective (or, for Georgia, were expected to be effective) in driving additional land conservation.<sup>7</sup> Conservation Credit programs in North Carolina and New Mexico were credited with generating 20 percent and 25 percent increases in land conservation donations, respectively. While these gains are important, professionals in both states believe that land donations would greatly increase if the credits were either transferable or refundable.

Please note that at the time of the publication of this report, New Mexico passed legislation that raises the cap on its credit to \$250,000 and makes them transferable, effective January 2008. Colorado and Virginia both have transferable credits. Professionals in these states estimate that land donations have tripled in Colorado and quadrupled in Virginia as a direct result of the creation of transferable Conservation Credit programs.

Not surprisingly, existing statistics and expert opinions together confirm that Conservation Credit programs with high-value, transferable credits will drive significant additional land protection. Programs with high-value credits that are not transferable and programs with low-value credits that are transferable do not approach the success of programs that combine high-value credits with transferability.

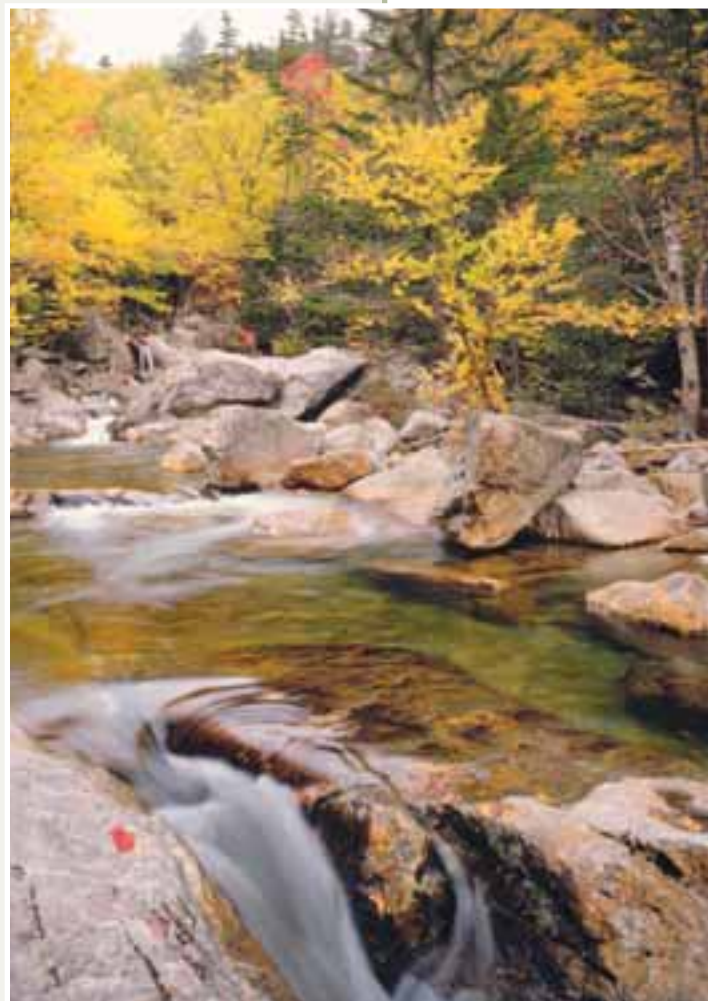
### 3. Effectiveness in protecting important conservation values at a reasonable cost

Although Conservation Credits can work well to encourage donations, the number of donations made and acres of land protected are not the only gauges of program success. For programs to be successful, there should also be assurance that sufficient conservation values are being protected in perpetuity at a reasonable cost to the public.

Most experts interviewed for this report stated that their programs effectively protected important conservation values at a reasonable cost. Programs with certification programs and/or appraisal reviews (discussed later in this report) were most confident of this. However, experts in several states expressed concern about what they believed was a small percentage of donations that may have: had low conservation values, were overvalued, and/or had been accepted by entities lacking the intent or resources to preserve the conservation values of the land in perpetuity.

Fortunately, each of these concerns can be minimized or eliminated through careful drafting of program guidelines. In fact, Colorado and Virginia each recently amended their existing legislation to directly address some of these concerns. States with newer legislation, such as Georgia, have designed their legislation and supporting regulations to avoid these pitfalls from the outset.

It is clear that through drafting, states can enact Conservation Credit programs that successfully drive additional land donations with high conservation values at a reasonable cost to the public. By looking to other states' experiences, proponents of Conservation Credit programs and state legislatures can increase the chances of developing effective programs and can minimize or avoid risks. The remainder of this report walks those drafting legislation through the major issues to be considered in program development.



*Forest, New Hampshire*



# PART

**Creating a**

**State Conservation**

**Credit Program:**

**Drafting Considerations**

**States have not followed a uniform model in creating their Conservation Credit programs.**

While the programs all share the same basic elements—limitations on credits, definition of conservation values, and eligibility of entities that may claim credits— they vary dramatically within these categories. For example, Connecticut offers only corporate tax credits. Mississippi’s credit is valued at 50 percent of a project’s transaction costs rather than the value of donated land, and credits may be earned only through donations of land of a certain type. New York’s credit, while it is applied to income taxes, is valued at 25 percent of a landowner’s property taxes. California’s program requires a significant investment of time and resources from both donor and donee prior to earning a credit, severely curtailing use of the program. Colorado and Virginia offer high-value transferable credits, attracting many landowners to make use of the program.



*Forest, Alaska*

Legislatures, land conservation organizations, and other program supporters must determine exactly what they are trying to accomplish with a conservation tax credit program to ensure that the provisions in their legislation will achieve the desired results. This section presents the primary questions to be considered in program development and includes lessons learned from existing programs to assist those currently developing or amending Conservation Credit legislation.

**Land protection through both fee title and conservation easement donations is important to an overall land protection strategy.** However, drafters must determine which type of donation they want to encourage through their Conservation Credit program. The majority of programs award credits for both. In contrast, Colorado, Maryland, and New York award Conservation Credits only for the donation of conservation easements. In Colorado, where one-third of the State’s land is already in public ownership, the general preference is that lands remain in the hands of private landowners rather than be donated in fee to a government or land conservation entity. The structure of programs in Maryland and New York is also more consistent with providing incentives to landowners who continue to hold title to their properties. Maryland’s Conservation Credit (\$5,000 per year with a 15-year carry-forward) layered an additional incentive on existing property tax credits for land donations. In form, New York’s credit is an income tax credit, but it functions more like a property tax credit.

A.

**WHAT TYPE  
OF LAND WILL BE  
PROTECTED?  
FEE TITLE,  
CONSERVATION  
EASEMENT,  
OR BOTH?**

B.

## WHAT CONSERVATION VALUES ARE TO BE PROTECTED?

### Conservation Credit programs must sufficiently define the conservation values they are established to protect.

Some states have broadly defined conservation values, while other states narrow the definitions to promote specific land preservation goals. Somewhere in between is where most states end up. More precisely defining the conservation values to be protected will provide guidance to landowners and will make the program more effective in achieving state land protection goals.

#### 1. Broad definitions of conservation values and IRC §170(h)

Many Conservation Credit programs characterize conservation values or benefits very broadly, defining them either in the Conservation Credit statute or referring to preexisting definitions in conservation easement enabling legislation. In addition, seven of twelve programs specifically require that donations satisfy the requirements of a “qualified donation” pursuant to IRC §170(h).<sup>8</sup>

Requiring compliance with IRC §170(h) for a donation to earn a state tax credit allows a simplified method of setting program rules. However, drafters should consider the full implications of doing so. States may have different goals for their state tax credits than the federal government does for its deductibility program. If certain provisions are acceptable and desired for use in a state’s program, it might be better to use the specific language rather than merely requiring compliance with IRC §170(h). Otherwise, when IRS requirements are amended or interpretations evolve over time, states may not be happy with the resulting impact on their programs.

#### 2. More detailed definitions of conservation values

Many states go beyond IRC §170(h) by providing additions to or restrictions on those requirements. Delaware, for example, provides within its Conservation Credit statute its own brief definition of open space and natural habitat. Georgia and North Carolina list categories of eligible conservation benefits in their legislation. Both also provide much more detailed guidance in supporting regulations and procedural documents. In 2006, Virginia passed legislation authorizing the Virginia Land Conservation Foundation to describe “the objective characteristics of lands that have important conservation values.”

California and Mississippi provide the most guidance on lands eligible to earn a credit. In addition to setting out broad categories of conservation lands that qualify, California goes further, requiring a donation to meet one or more requirements such as the land being a part of a conservation plan.<sup>9</sup> Mississippi goes the furthest, requiring that only lands designated as priority sites by the state’s Natural Heritage Program or lands adjacent to and along streams nominated for the state’s Scenic Streams Stewardship are eligible to earn a credit.



*Field of wildflowers, Virginia*

Finally, some states have chosen to specifically make certain types of lands ineligible for tax credits. For example, both South Carolina and Georgia explicitly exclude golf courses and lands directly associated with golf courses from eligibility.

**Another critical decision for program drafters is the level of financial incentive the program will provide.** Most often, credit value is set as a percentage of the fair market value of the donated land or some predetermined cap on value, whichever is less.

Some state legislatures express concern over the potential fiscal impact of a Conservation Credit program. However, as is discussed in the following sections, there are numerous ways to limit the fiscal impact of a program while still maximizing the public benefit. These include offering a credit for only a portion of the donated value of the land, placing caps on the credits, and setting a sunset date at which time costs and benefits of the program can be reviewed. In addition, it should be noted that the full value of each potential tax credit that could be earned is not always realized. There are pipeline losses. First, not all landowners claim credits. Second, in states with certification, some credits may be rejected. Finally, a landowner may not be able to make use of the entire value of the credit, especially in states without transferability.

### 1. Credit valuation

All but three programs base credit values on some percentage of fair market value of the donated land.<sup>10</sup> This ensures that there is a significant public benefit for any dollars awarded as tax credits. For example, when credits are valued at 50 percent of the fair market value of the donation, the public receives \$2 of land protection for every \$1 offered as a tax incentive. Credit valuations range from 25 percent the donated value in North Carolina to 100 percent in Maryland. The average credit value is 48% of the donated value.<sup>11</sup>

### 2. Caps that may be placed on credit transactions

States have capped credit transactions in four different ways, as described here.

#### a. Maximum value of credit

All but five states have a cap on the total value of the credit. Considering the programs that value credits based on the fair market value of the donation, individual and corporate caps range from \$50,000 in Delaware to an unlimited credit in Virginia, Connecticut and California.

C.

WHAT  
FINANCIAL  
LIMITATIONS WILL  
BE PLACED ON  
THE CREDITS?



*Blooming cactus, Arizona*

Connecticut's credits are available only to corporations. California's credit program, due to its onerous program requirements, is not readily accessible to the typical landowner. Virginia faces the greatest fiscal impact because its credits are both unlimited and transferable. However, after scrutinizing its program in 2006, Virginia elected to keep both an unlimited credit and credit transferability, recognizing the importance of these elements in dramatically increasing land conservation in the state. As discussed earlier, New York and South Carolina do not set explicit limits on credits, but credits are kept low through valuation methods.

#### **b. Amount of credit that may be applied to taxes in any given year**

Three states allow a higher credit to be earned than can be applied to taxes in a given year. In Maryland, credits of up to \$80,000 can be earned, but only \$5,000 can be applied to offset taxes each year. There is no upper limit on credit values in Virginia and New York (25 percent of each year's property taxes). However, in Virginia no more than \$100,000 can be applied by the donor to his or her state income tax annually and in New York the maximum amount that can be applied in a given year is \$5,000.

#### **c. Number of credits earned annually**

In Colorado and New Mexico, landowners may not earn more than one credit a year. Colorado's law goes on to require that when a landowner earns a credit, he or she may not earn another credit until all value from the first credit is applied to income taxes or is relinquished.<sup>12</sup> Mississippi allows only one credit in a lifetime. Most other states do not have a similar limitation. So long as the cap on the amount of credit that may be applied to taxes in any given year is not exceeded, multiple credits may be earned.

#### **d. Statewide cap on tax credits that may be earned**

Statewide caps offer state legislatures certainty regarding the maximum annual fiscal impact a program may have. California, Delaware, and now Virginia have caps on the total value of credits that may be earned statewide. California's cap is \$100 million (or whatever has been spent by FY 2007–2008, whichever is less). Delaware's cap is \$1 million in any given year. Virginia's cap is set at \$100 million a year. No other programs have a statewide cap on the overall value of credits that may be earned.

The difficulty with statewide caps is that if credits are awarded on a first-come, first-served basis, projects that are pushed through most quickly—and not necessarily those projects with the highest conservation value—may be the projects that receive funds. Conservation easement donations can be complex and time-consuming transactions when done correctly. Donors and donees trying to put together solid deals thus may be punished for their diligence. Other methods of allocating limited funds also come with unintended consequences. A lottery system leaves too much to chance, and setting standards



*Redwood forest, California*

and criteria turn the tax credit program into more of a grant award program with its associated layers of bureaucracy. Each of these allocation methods reduces the certainty of whether a credit will be earned, thereby reducing the effectiveness of the program.

### 3. Sunset date

Finally, two states have sunset dates in their Conservation Credit legislation. Conservation Credit supporters generally disfavor sunset dates because of the additional investment of time and resources necessary to extend the sunset or make the credits permanent at the time the program expires. However, if a legislature is unwilling to make the leap to a permanent program, this offers a more conservative approach. California and Delaware both have sunset dates for their legislation in fiscal years 2008 and 2010, respectively.

These restrictions on Conservation Credit programs are valuable tools to limit the overall fiscal impact of a program. However, such limitations may work against strategic use of the credit program. If an entity is working to preserve land in a particular geographic area, it may be important that a particular landowner be able to earn more than one credit over a certain period of time. Landowners may own multiple parcels in a given protection area. In trying to maintain a high degree of control over a program through tight drafting, one must be watchful of unintended consequences that may impair the program's effectiveness.



*Rock formations, Utah*

D.

WHO WILL  
BE ELIGIBLE  
TO EARN  
A CREDIT?

**With regard to who will be eligible to earn a Conservation Credit, it must be considered whether the program is intended to protect as much land as possible, to provide incentives to the greatest number of taxpayers, or to reward a specific group of landowners.** Having more eligible land donors provides the greatest opportunity to protect land. However, several states have decided to limit eligibility in this area. Although most states allow both individual and corporate taxpayers to claim tax credits, three do not. Connecticut offers credits only to corporations, while Maryland offers credits only to individuals. Colorado provides credits only to individuals who are residents. Arizona's program, in existence until January 2006, was available only to agricultural districts. In one western state, a pending program may make benefits available only to agricultural landowners.

Related considerations include the treatment of pass-through entities, married couples, trusts, and estates, and whether there should be residency requirements on individuals and/or corporations.

E.

**WHAT  
ENTITIES WILL  
BE ELIGIBLE  
TO HOLD  
A DONATION?**

**Conservation Credit programs vary widely in the entities they deem eligible to accept donations of land or conservation easements that generate credits.** This is an important issue to consider, as some of the actual and perceived program abuses relate to the qualifications of the entities that accept the donations. The concern is that some entities may form for the specific purpose of holding fee or conservation easement donations deemed inadequate by the more established land trusts and government open space programs. To protect the public investment of dollars, states should ensure that the entities eligible to hold Conservation Credit land or easement donations possess sufficient expertise and funding for long-term management and monitoring.

**1. IRC §170(h)**

Most Conservation Credit programs provide that the entities that qualify under IRC §170(h) are eligible to hold easements earning a tax credit. This includes government entities and nonprofit 501(c)(3) organizations. Nine states specifically require compliance with §170(h).

**2. Additional state requirements on land trusts or other entities holding easements**

Other programs have added requirements beyond the general provisions of IRC §170(h). These additional requirements may exist in the state's conservation

easement enabling legislation or may be within its Conservation Credit legislation. Georgia requires that eligible entities must adopt and implement the standards and practices of the Land Trust Alliance. It also places annual monitoring requirements on the land trusts and requires that copies of monitoring reports be sent to the state. Colorado requires a two-year waiting period before an entity may hold conservation easements. Virginia requires that an entity accepting a donation have an office in the state for at least five years.

In 2008, the Land Trust Accreditation Commission, an independent program of the Land Trust Alliance, plans to initiate a national accreditation program for land trusts. In the future, Conservation Credit legislation may cite accreditation as an eligibility requirement for accepting donations that generate tax credits.



*Blossoming tree, Virginia*

### 3. State-approved land trusts

Finally, California and Maryland have taken the strictest line, allowing only approved land trusts to hold easements generating tax credits. In California, nonprofits must be designated by a qualified government entity and must have experience in land conservation. In Maryland, only the Maryland Environmental Trust and the Maryland Agricultural Land Preservation Foundation are eligible.

**Research demonstrates that by far the most important element of a successful Conservation Credit program is making the credits transferable.** Legislatures have been averse to make credits refundable.<sup>13</sup> However, it would be expected that full refundability would likewise increase the effectiveness of Conservation Credit programs. Having a carry-forward provision helps, but alone it is insufficient to significantly improve the performance of a program. These provisions also work to make Conservation Credit programs more equitable. Without transferability and/or refundability, the wealthy will disproportionately benefit from the program.

#### 1. Carry-forward

To help ensure that landowners can realize much of the value of their credits, all Conservation Credit programs allow their credits to be applied to state income tax for a minimum of five years. Some programs offer the option to carry-forward for an unlimited amount of time. However, in circumstances where credits are large but landowners have a low taxable income, these carry-forward provisions may be insufficient to ensure equitable treatment of both the wealthy landowner and the land rich/cash poor landowner. In these cases, the best way to ensure that conservation tax credits are an incentive to all landowners is to make credits transferable or refundable.

#### 2. Transferability

Currently, South Carolina, Colorado, and Virginia all have transferable credits. Reliable transfer markets exist in Colorado and Virginia, making it simple for landowners to transfer credits to third parties and realize an immediate financial benefit for their credits.<sup>14</sup> Market rates can fluctuate, but currently landowners receive between 70 percent and 82 percent of the value of their credits.<sup>17</sup> Third parties purchase the credits at a discount and in turn reduce their own tax liability. In Virginia, an average of 76 percent of the total credit value earned in the state is transferred each year.

In states with transferability, Conservation Credit facilitators provide an additional layer of due diligence review to ensure that easement donations that earn Conservation Credits meet program standards. In addition, facilitators negotiate for the highest price for their landowners and schedule credit transfers to meet the landowners' needs. Facilitators are often reimbursed for their services from the proceeds of the credit transfer.

F.

**HOW CAN THE  
EFFECTIVENESS  
OF THE TAX CREDIT  
BE MAXIMIZED?  
Carry-Forward,  
Transfer, and  
Refund Provisions**



*Smoky Mountains, Tennessee*

Of the professionals interviewed for this report, in the eight states that do not currently have transferability or refundability, five stated that they would like to see their states' credits be made transferable. Two others wanted to wait to see the experience of other states with transferability, and only one said he did not want his state's credits to be transferable.

### 3. Refundability

Legislatures are generally loath to make any type of tax credits refundable. Although refundable credits clearly streamline the process, most legislatures find credit transfers more palatable than writing government checks to refund credits. Only two states offer refunds, and both are capped at a low annual value. Colorado's legislation has a rarely used partial-refund provision; landowners may seek refunds of up to \$50,000 per year during state surplus years. However, since the enactment of the program, there have only been two surplus years.<sup>15</sup> In New York, where credits have a maximum annual value of \$5,000, if the income tax credit earned exceeds taxes due, the remainder may be refunded.

G.

## WHAT INFORMATION SHOULD BE TRACKED FOR REPORTING PURPOSES?

**Any tax credit program should have methods by which to track usage to allow future analysis of program effectiveness.** Both Virginia and North Carolina have the ability to obtain detailed information regarding the Conservation Credits earned in their states. Colorado has less ability to access program data, and organizations are currently working to devise a detailed and reliable tracking system for Colorado credits. States considering Conservation Credit programs should determine what information they would like to have available and how they intend to collect it for the future evaluation of program effectiveness. Information to track might include the following:

- Annual number of credits earned,
- Value of credits earned,
- Value of land protected,
- Number of acres protected through donation,
- Types of land protected through donation (agricultural, wildlife, wetlands, and so on),
- Type of donor claiming credit (individual, corporation, other),
- Type of holder of the conservation easement (land trust, government, other),
- Number of credits transferred and
- Value of credits transferred.

Most tax credit programs already have a form that must be filed with the tax department to claim the credit. It will be a simple matter to expand this form to include requests for the types of information discussed above. The state department of revenue or taxation may then compile these statistics on an ongoing basis.

**To ensure wise use of public funds, it is important to consider the appropriate mechanisms to guarantee that credits earned are supported by qualified land donations.** Land Conservation professionals in four of the ten states with established Conservation Credit programs reported one or more transactions that pushed the envelope too far, suggesting that the easement donation might be unqualified. Issues of concern include:

- Overvaluation of the donation,
- Questionable conservation benefits,
- Inappropriate phrasing of a transaction,<sup>16</sup> and
- Conservation easement donations being made to entities that may be inexperienced or that lack a true dedication to land conservation.

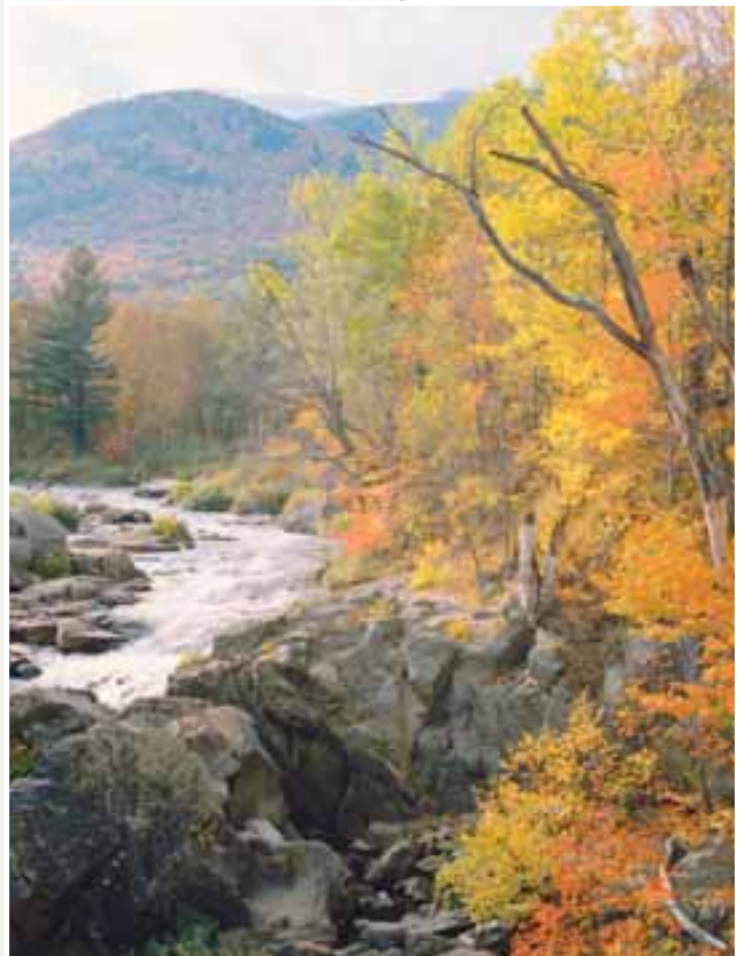
These are the same issues that have been of potential concern for the federal government for decades. The creation of state Conservation Credit programs has not created these problems. However, such programs have suddenly put these issues into play at the state level. Without checks on the system, the opportunity for significant financial reward poses the risk that some may attempt mediocre deals that may not have otherwise been pursued.

Two principal approaches have been used to ensure that credits are supported by qualified transactions. One is the audit approach, which allows taxpayers to unilaterally claim tax benefits on their tax returns, and those benefits are allowed unless a post-return audit disallows them. The second approach involves certification of the credits, whereby the tax credits involved must be certified by the government before a taxpayer can claim them on a tax return. Each of these approaches has its benefits and drawbacks.

### 1. Audit approach

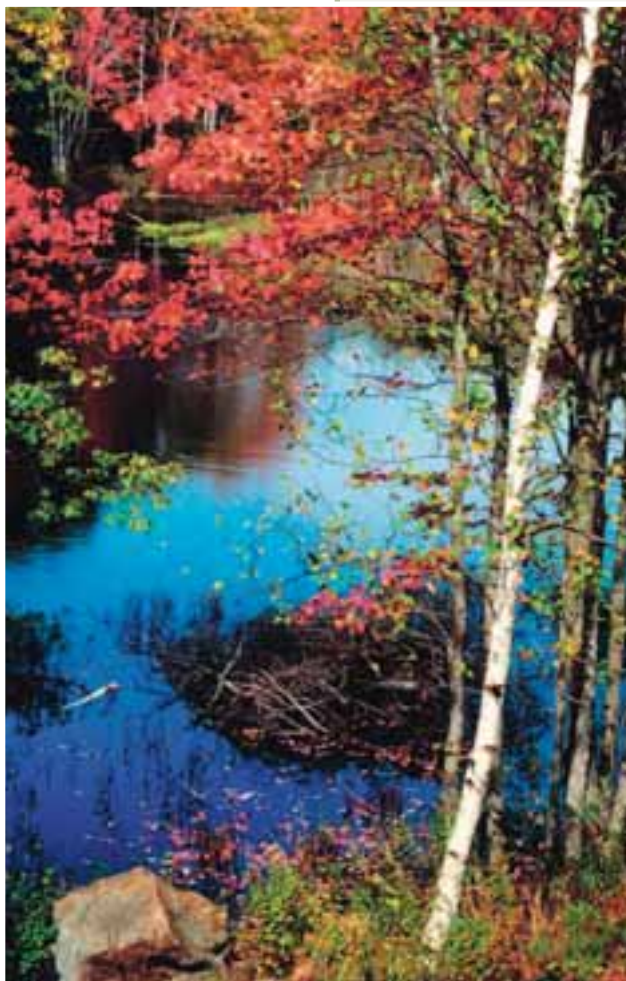
The general approach employed in the world of taxation relies on taxpayers honestly reporting their taxes on tax returns, followed up by the potential for a post-return audit, which could happen at any time before the expiration of the statute of limitations. For example, a credit springs to life as soon as a donation is made. A state would review the credit, if at all, only after the credit has been claimed on a tax return. Programs in Colorado, Connecticut, and New York rely exclusively on this approach for controlling the use of the credits. South Carolina and Virginia rely primarily, but not exclusively, on the audit approach. However, South Carolina

## WHAT IS THE APPROPRIATE LEVEL OF PROGRAM OVERSIGHT?



*Forest stream, Michigan*

requires certification where a credit will be transferred to a third party. New in 2006, Virginia requires certification of a credit valued at more than \$1 million. The chief benefits of an audit approach are speed and simplicity. Because there are no governmental prerequisites for creating credits, the credits spring into existence as soon as a donation is made. Practice shows that many easements are finalized at the end of the tax year; the audit approach thus allows the maximum number of easement donations to occur in any given year. Also, because a system already exists for post-return audits, this approach does not require any new governmental infrastructure or bureaucracy to administer the credit program.



*Birch Trees, Maine*

One disadvantage of an audit-based approach is that users of credits do not know for certain that the credits are valid, because the credits could later be reversed upon an audit. This is of particular concern when a program allows the credits to be transferred, because the transferees of the credits cannot be certain that they are acquiring good credits. Instead, many transferees rely on indemnification provisions from credit sellers and/or on credit facilitators, who perform due-diligence review on transactions before placing them with buyers to ensure their interests are protected. Another disadvantage of an audit-based system is in determining who will conduct the audits. If a state creates the credits, the financial burden is on the state budget. In such a case, if the state is relying on the IRS to conduct the audits, the state might find that the IRS is not auditing all of the transactions that the state would like to see reviewed. On the other hand, states often lack the resources and expertise to conduct full audits on their own.<sup>17</sup> Despite these shortcomings, the audit approach is elegant in its simplicity. Virginia recently upheld the use of the audit approach for credits valued at under \$1 million.

## 2. Certification approach

Seven programs rely primarily on a state certification process for donations prior to awarding a credit.<sup>18</sup> The certification means that the transaction meets state standards for earning a state tax credit. State certification generally empowers a state department of natural resources or some other authorized arm of the state to conduct a substantive review of a conservation easement credit transaction. Such certification programs vary greatly in their requirements. In California, a donor must submit materials to the Wildlife Conservation Board to ensure that the project is generally consistent with the requirements of the program. If approval is granted for the project to advance, the donor and donee must then hold a public hearing about it. After the public hearing, an application must be submitted to the Wildlife Conservation Board for consideration. Although this procedure is atypical, it exemplifies one extreme example of what a certification process might entail.

New Mexico's legislation requires that donors must submit deed information, mineral reports, baseline reports, appraisals, and title work by January 31 of the year in which the credit will be earned. This timing does not work well for landowners. Based on the normal timeline for land donations, this information would not be available until very late in the year. The state has decided to accept materials up until April 16 to, in part, address this hardship.

Georgia's certification program sets a 90-day turnaround time from submittal of materials to decision. For a landowner to be certain he or she may earn a credit in the year in which the donation is made, all materials must be in final form and submitted to the state by early October. However, if any materials are missing or if changes need to be made, they may not receive a decision by December 31.<sup>19</sup>

Before adopting a certification program, states must consider what their standards for certification are. Is the goal of certification to reject the clearly abusive transactions? Such transactions might lack any real conservation values, have highly over inflated appraisals, or have unqualified entities accepting the donation. At the other end of the spectrum, certification standards might be set to ensure that only the highest-quality transactions are approved. This might include a detailed examination of conservation values and baseline documentation, appraisal reviews to ensure that appraised values are indisputable, and review to ensure that entities accepting donations of

conservation easement and/or fee title meet standards and practices set by the Land Trust Alliance. The latter purpose of identifying the highest quality transactions can be difficult to achieve. Unless the meaning of the term "conservation value" is clearly defined in a state's statute, nearly every parcel of land may contain an important conservation value in someone's opinion. As appraising is not an exact science, there is often room for debate with respect to the value of a donation. In-depth investigation of each entity accepting a donation would also be a lengthy process.<sup>20</sup> Bad transactions are typically fairly easy to identify. Attempts to award credits to only the best transactions requires a much higher level of investigation and oversight.

Based on responses from experts in the field, there seems to be a need for some middle ground between the audit and certification approaches. Several experts in states that rely on audit systems (without certification) wished there was more pro-



*Shoreline, New Mexico*

gram oversight and infrastructure. Several experts in states with certification said that their certification procedures were too onerous and that they would simplify the process and shorten the time required to determine certification. Moreover, several expressed concern that certification, if too onerous, serves as a deterrent to landowners, curtailing the effectiveness of the programs. Given the desire for some level of oversight to protect against gross violations and the concern that too onerous a process will harm the program, the appropriate level of oversight is probably somewhere in between an audit system and a full certification process.

### 3. Transactional screen

A transactional screen is a limited, nonbinding review of a transaction that occurs either before or after a donation is made.<sup>21</sup> It allows states to immediately reject the worst deals while preserving the right to raise objections on more detailed questions at a later date. The review is expedited to ensure that the transaction

meets minimum standards. The screen may review three basic areas: the technical aspects of appraisal methodology, whether land donated meets the conservation-value criteria of the program, and other basic due diligence to ensure the transaction is complete and correct. As soon as a transaction passes this screen and the donation is made, a credit may be claimed. Such a screen is similar to the review most tax credit facilitators conduct in states with transferable credits. However, there is no reason a state could not provide a similar review.



*Field of poppies, Arizona*

If a project is approved through a transactional screen, credits may be earned and claimed on a tax return. However, there is no guarantee that credits will not be reduced or disallowed upon a subsequent audit. For several reasons, transactional screens appear well suited for regulating conservation easement donations. Most important is the fact that the transactional screen may be the only regulatory scheme that would be acceptable to the state revenue departments that must enforce it. Any system that is more thorough and final poses problems for those reviewing the credit. First, the short turnaround time that the timeline of a land conservation donation requires would be a significant hardship to those doing the review, especially in connection with appraisal review. Many easement transactions involve high-value lands and are increasingly accompanied by exceedingly thorough and sophisticated appraisals (some contain hundreds of pages of text) whose in-depth review might require months.

Additionally, as noted previously, the IRS may choose to conduct its own audit of the subject transaction. It is uncertain how a state would react if it approves a

certain transaction that is subsequently disqualified by the IRC.<sup>22</sup> This uncertainty is further complicated if the state's legislation makes compliance with IRC §170(h) a requirement of the program. In addition, most states have conformity laws that allow the state to rely on adjustments in tax value made by the IRS. It is highly unlikely that a state taxing authority would be willing to waive that right in favor of a binding certification.

Aside from the pragmatic basis discussed above, transactional screens have immediate practical benefits. First, they cull many bad transactions from the system before damage can be done. As noted previously with respect to programs that allow transferability, once credits are sold, it can be very difficult to get the toothpaste back into the tube.<sup>23</sup> Any kind of after-the-fact audit will not prevent that unfortunate problem. Additionally, it appears that a competent transactional screen can be accomplished in a manner that will not interfere with an efficient market for the sale of the credits. This is an essential component that allows the powerful tool of transferability to accomplish its ends.

Finally, the experience of Conservation Credit facilitators seems to provide real-world evidence that transactional screens work and that they can be done in a reasonably short time frame so as to not interfere with the marketability of credits. As noted previously, almost all of the facilitators of tax credit sales conduct some sort of due diligence. The experience of the Conservation Resource Center in reviewing more than five hundred transactions has shown that a substantial number of the transactions had problems that initially prevented their sale. However, the vast majority of these problems were fixed relatively easily, ultimately permitting the credits to be sold. It is certainly preferable to find and fix these problems at an early stage rather than to identify them long after the fact, at a time when repair may no longer be practical or possible. See *Appendix B, Sample Transactional Screen*, for one example of a transactional screen.



*Sunset, New Jersey*



# PART

## Conclusion and Appendices



**A Conservation Credit program can be a valuable tool in a state's overall land protection strategy.** It has the potential to dramatically increase voluntary land protection. The amount of additional land protection attributable to a Conservation Credit program is primarily driven by two factors: (1) the maximum value of credit that may be earned and (2) whether the credit may be deferred over several years, transferred, and/or refunded.

The continued success of tax credit programs will depend on diligent attention to such issues as (1) ensuring that transactions earning credits are worthy of public investment and (2) tracking the lands conserved and conservation benefits protected so that program success can be shared with the legislature and the public. As a compendium to this report, the Conservation Resource Center is developing model conservation tax credit legislation that states may use as a starting point for developing new legislation or amending existing programs. Its release is anticipated in mid-2007.



*Green mountains, Virginia*

A.

## APPENDIX A: SUMMARY

	CALIFORNIA	COLORADO	CONNECTICUT
<b>LEGISLATION</b> (Date of Enactment) Statutory Citation	Natural Heritage Preservation Tax Credit Act of 2000 (2000) Cal. Public Resource Code §§37000-37042	Credit Against Tax – Conservation Easements (1999) Colo. Rev. Stat. § 39-22-52	Tax Credit For Donation of Open Space (2000) Conn. Gen. Stat. §12-217dd
<b>LANDS ELIGIBLE TO EARN CREDITS</b> <ul style="list-style-type: none"><li>• Fee title, Conservation easement, or both</li><li>• IRC § 170(h) = explicit requirement to meet federal eligibility requirements related to conservation values</li><li>• State additions to/restrictions on federal standard</li></ul>	<ul style="list-style-type: none"><li>• Fee Title &amp; Conservation Easement</li><li>• IRC § 170(h)</li><li>• Water conservation for protection of threatened or economically important species. Wildlife habitat must be identified by CESA/ESA. Agricultural land must be threatened by development.</li></ul>	<ul style="list-style-type: none"><li>• Conservation Easement only</li><li>• IRC § 170(h)</li><li>• Agriculture lands and environmental quality benefits are recognized per se.</li></ul>	<ul style="list-style-type: none"><li>• Fee Title &amp; Conservation Easement</li><li>• Conservation of (i) water resources, (ii) soils, wetlands, beaches or tidal marshes, (iii) agriculture lands, (iv) forestry lands (over 25 acres), and (v) promotion of orderly urban or suburban developments is recognized per se.</li></ul>
<b>CREDIT VALUE AND LIMITATIONS</b> <ul style="list-style-type: none"><li>• Value as a % of FMV of donated land unless otherwise noted.</li><li>• Maximum credit, if any</li><li>• Cap on credits applied to taxes/yr., if any</li><li>• Limitation on # credits that may be claimed by one individual/entity, if any</li><li>• Statewide cap, if any</li><li>• Sunset date, if any</li></ul>	<ul style="list-style-type: none"><li>• 55% FMV</li><li>• Unlimited credit</li><li>• Statewide cap of \$100,000,000/program lifetime.</li><li>• 2008 sunset date.</li></ul>	<ul style="list-style-type: none"><li>• 50% FMV</li><li>• \$375,000 max credit.</li><li>• \$375,000 cap on credit applied to taxes/yr.</li><li>• Individual/entity limited to one credit /yr.</li></ul>	<ul style="list-style-type: none"><li>• 50% FMV</li><li>• Unlimited credit</li></ul>
<b>ENTITIES ELIGIBLE TO EARN CREDITS</b>	Individual/Corporate/Pass-Through Entities	Resident Individual/Corporate/Pass-Through Entities	Corporate
<b>ENTITIES ELIGIBLE TO HOLD A DONATION</b> <ul style="list-style-type: none"><li>• IRC § 170(h) = explicit requirement to meet federal eligibility requirements</li><li>• State eligibility requirements</li></ul>	<ul style="list-style-type: none"><li>• IRC § 170(h)</li><li>• Governmental entities limited to State or its subdivisions; Nonprofits must be designated by a qualified governmental entity and have experience in conservation.</li></ul>	<ul style="list-style-type: none"><li>• IRC § 170(h)</li><li>• Nonprofits must have operated for 2 years.</li></ul>	<ul style="list-style-type: none"><li>• Governmental entities limited to State or its subdivisions; Nonprofits must be conservation organizations; Water Companies eligible.</li></ul>
<b>CARRY FORWARD?</b>	8 yrs.	20 yrs.	15 yrs.
<b>TRANSFERABLE?</b>	No	Yes	No
<b>REFUNDABLE?</b>	No	Conditional on State Surplus and limited to \$50,000/yr.	No
<b>CERTIFICATION?</b>	Yes – by CA Wildlife Conservation Board. Scope of review: appraisal, conservation value, donor/donee eligibility, public comments etc...	No	No

DELAWARE	GEORGIA	MARYLAND	MISSISSIPPI	N. CAROLINA*
Delaware Land & Historic Resources Protection Incentives Act of 1999 (2000) Del. Code Ann. tit. 30, §§1801-1807; tit. 7, §§6901-6902.	Credit for Donation of Real Property for Conservation Purposes (2006) Ga. Code Ann. § 48-7-29.12	Income Tax Credit for Preservation and Conservation Easements (2001) Md. Code Ann §10-723	Tax Credit [for] Natural Heritage Priority Conservation or Scenic Streams Land Donations (2003) Miss. Code Ann. §27-7-22.21	North Carolina Conservation Tax Credit Program (1999) N.C. Gen. Stat. §105-151.12 and §105-130.34
<ul style="list-style-type: none"> <li>• Fee Title &amp; Conservation Easement</li> <li>• IRC § 170(h)</li> <li>• Conservation of water resources is recognized per se.</li> </ul>	<ul style="list-style-type: none"> <li>• Fee Title &amp; Conservation Easement</li> <li>• IRC § 170(h)</li> <li>• Conservation of (i) water quality, (ii) wetlands, (iii) prime agricultural lands, (vi) forestry lands, (v) from floods, and (vi) from erosion is recognized per se. Agricultural land must be cultivated under a USDA developed conservation plan.</li> </ul>	<ul style="list-style-type: none"> <li>• Conservation Easement only</li> <li>• Conservation of (i) agriculture lands, (ii) forest lands, (iii) watersheds, and (iv) view sheds is recognized per se.</li> </ul>	<ul style="list-style-type: none"> <li>• Fee title &amp; Conservation Easement</li> <li>• IRC § 170(h)</li> <li>• Land must be listed by the MS's Scenic Streams Stewardship Program, or Land be priority site under MS's Natural Heritage Program.</li> </ul>	<ul style="list-style-type: none"> <li>• Fee Title &amp; Conservation Easement</li> <li>• Wildlife habitat should exceed 25 Acres. Forest land should be managed under a Forest Stewardship Plan using best practices, with restrictions on prescribed burning, timber harvesting, and herbicide application. Conservation developments are recognized.</li> </ul>
<ul style="list-style-type: none"> <li>• 40% FMV</li> <li>• \$50,000 max credit.</li> <li>• Statewide cap of \$1,000,000/year.</li> <li>• 2010 sunset date.</li> </ul>	<ul style="list-style-type: none"> <li>• 25% FMV</li> <li>• \$250,000 Ind. max credit/ \$350,000 Corp. max credit.</li> </ul>	<ul style="list-style-type: none"> <li>• 100% FMV</li> <li>• \$80,000 max credit.</li> <li>• \$5,000 cap on credit applied to taxes/yr.</li> </ul>	<ul style="list-style-type: none"> <li>• 50% Transaction costs</li> <li>• \$10,000 max credit.</li> <li>• individual/entity limited to one credit/lifetime.</li> </ul>	<ul style="list-style-type: none"> <li>• 25% FMV</li> <li>• \$250,000 Ind. max credit/ \$350,000 Corp. max credit.</li> </ul>
Individual/Corporate/Pass-Through Entities	Individual/Corporate	Individual	Individual/Corporate/Pass-Through Entities	Individual/Corporate
<ul style="list-style-type: none"> <li>• IRC § 170(h)</li> </ul>	<ul style="list-style-type: none"> <li>• IRC § 170(h)</li> <li>• Governmental entities limited to State or its subdivisions; Nonprofits must adopt LTA Standards and receive IRS Determination Letter.</li> </ul>	<ul style="list-style-type: none"> <li>• Only Maryland Environmental Trust and Maryland Agricultural Land Preservation Foundation are eligible.</li> </ul>	<ul style="list-style-type: none"> <li>• IRC § 170(h)</li> </ul>	<ul style="list-style-type: none"> <li>• Governmental and Nonprofit entities are eligible.</li> </ul>
5 yrs.	5 yrs.	15 yrs.	10 yrs.	5 yrs.
No	No	No	No	No
No	No	No	No	No
Yes – by the DE Division of Revenue of the Department of Finance. Scope of review: appraisal issues.	Yes – by GA Department of Natural Resources. Scope of review: conservation values, legality of CE, and donee's eligibility....	Yes – by the MD Board of Public Works. Scope of review: cost-benefit analysis.	Yes – by the MS Scenic Streams Stewardship Program or MS Natural Heritage Program. Scope of review: conservation values and 170(h).	Yes – by NC Department of Environment and Natural Resources. Scope of review: conservation values.

\* North Carolina's first credit program was enacted in 1983. However, the legislation in its current form was enacted in 1999.

## A.

(summary continued)

	NEW MEXICO*	NEW YORK	S. CAROLINA	VIRGINIA
<b>LEGISLATION</b> (Date of Enactment) Statutory Citation	Land Conservation Incentive Act (2004) NM Stat. §§75-9-1-5, §7-2-18.10; N.M. Code R. §3.13.20	Conservative Easement Tax Credit (2006) NY Tax §606(kk)	South Carolina Conservation Incentives Act (2001) S.C. Code Ann. §12-6-3515	Virginia Land Conservation Incentives Act of 1999 (2000) Va. Code Ann. §§ 58.1-510-513
<b>LANDS ELIGIBLE TO EARN CREDITS</b>  • Fee title, Conservation easement, or both  • IRC § 170(h) = explicit requirement to meet federal eligibility requirements related to conservation values  • State additions to/restrictions on federal standard	<ul style="list-style-type: none"> <li>• Fee Title &amp; Conservation Easement</li> <li>• IRC § 170(h)</li> <li>• Conservation of agriculture lands, forest lands, and watersheds is recognized per se.</li> </ul>	<ul style="list-style-type: none"> <li>• Conservation Easement only</li> <li>• IRC § 170(h)</li> <li>• Preservation of agriculture lands and watersheds is recognized per se.</li> </ul>	<ul style="list-style-type: none"> <li>• Fee Title &amp; Conservation Easement</li> <li>• IRC § 170(h)</li> </ul>	<ul style="list-style-type: none"> <li>• Fee title &amp; Conservation Easement</li> <li>• IRC § 170(h)</li> <li>• Conservation of water resources is recognized per se.</li> </ul>
<b>CREDIT VALUE AND LIMITATIONS</b>  • Value as a % of FMV of donated land unless otherwise noted.  • Maximum credit, if any  • Cap on credits applied to taxes/yr., if any  • Limitation on # credits that may be claimed by one individual/entity, if any  • Statewide cap, if any  • Sunset date, if any	<ul style="list-style-type: none"> <li>• 50% FMV</li> <li>• \$100,000 max credit.</li> <li>• \$100,000 cap on credit applied to taxes/yr.</li> <li>• Individual/entity limited to one credit/yr.</li> </ul>	<ul style="list-style-type: none"> <li>• 25% Property Tax</li> <li>• Unlimited credit</li> <li>• \$5,000 cap on credit applied to taxes/yr.</li> </ul>	<ul style="list-style-type: none"> <li>• Lesser of \$250/Acre or 25% of Federal Conservation Easement deduction</li> <li>• Unlimited credit</li> <li>• \$52,500 cap on credit applied to taxes/yr.</li> </ul>	<ul style="list-style-type: none"> <li>• 40% FMV</li> <li>• Unlimited credit</li> <li>• \$100,000 cap on credit applied to taxes/yr. (Note unlimited amount may be transferred and used by 3rd parties.)</li> <li>• Statewide Cap of \$100,000,000/year</li> </ul>
<b>ENTITIES ELIGIBLE TO EARN CREDITS</b>	Individual/Corporate/Pass-Through Entities	Individual/Corporate/Pass-Through Entities	Individual/Corporate/Pass-Through Entities	Individual/Corporate/Pass-Through Entities
<b>ENTITIES ELIGIBLE TO HOLD A DONATION</b>  • IRC § 170(h) = explicit requirement to meet federal eligibility requirements  • State eligibility requirements	• IRC § 170(h)	• IRC § 170(h)	• IRC § 170(h)	<ul style="list-style-type: none"> <li>• IRC § 170(h)</li> <li>• Governmental entities limited to State or its subdivisions; Nonprofits must have office in State for 5 yrs.</li> </ul>
<b>CARRY FORWARD?</b>	20 yrs.	**	Unlimited	10 yrs.
<b>TRANSFERABLE?</b>	No	No	Yes	Yes
<b>REFUNDABLE?</b>	No	Yes	No	No
<b>CERTIFICATION?</b>	Yes – by NM Energy, Minerals, and Natural Resources Department. Scope of review: conservation values.	No	No, unless credits are being transferred. If transfer, certified by SC Department of Revenue.	Yes – but <i>only</i> on transactions where credit value is <i>greater than \$1 million</i> . Scope of review: conservation values and appraisal issues.

\* In March 2007, New Mexico passed legislation raising the cap on its credits to \$250,000 and making them transferable, both effective January 2008.

\*\* Annual credit of 25% of the property tax, up to \$5,000, runs with the land and continues in perpetuity.

### SAMPLE TRANSACTIONAL SCREEN

A transactional screen might look like the following:<sup>i</sup>

1. Before state credits can be used (either by the original donor or by a transferee), the credits must be screened and registered with the state.
2. To pass the screening process, an easement donor must submit certain easement documents to a review board. These documents would include, at a minimum, the easement and the appraisal. The system should be set up to allow review of both the completed transactions and the draft documents (before the easement is executed and recorded) so donors can make modifications to any deficiencies that may be found.
3. An application for screening would be accompanied by a nonrefundable processing fee, which would be used by the state to fund the cost of the prescreening system.<sup>ii</sup>
4. The review board would be required to rule on screening requests within 60 days of submittal. In cases of resubmittals (in which deficiencies pointed out by the review board have been corrected), the board would be required to issue a ruling within 30 days.
5. The scope of review of the review board would be limited to three areas, and in all three cases the standards would be intentionally low:
  - a. **Appraised value:** Does the appraisal appear to meet minimum standards for a qualified appraisal; does the valuation appear to be manifestly abusive?
  - b. **Conservation values:** Does the property arguably have values worthy of conservation, and do the restrictions set forth in the easement arguably protect those values?
  - c. **Documentation:** Does the easement document (and any other documents that may be reviewed as part of the process) arguably comply with minimum standards for a qualified easement?
6. The board would be composed of three members (who may be floating, and may change for the review of any easement or group of easements):
  - a. **A tax and valuation expert** (presumably an appraiser from a state department that deals with property tax valuations) who would be familiar with appraisals of conservation easements (see a. above).
  - b. **A conservation expert** (presumably from the State Department of Natural Resources or Agriculture and/or some other appropriate state agency) who would be familiar with the conservation elements involved (see b. above).
  - c. **A land conservation attorney** (from the state or private practice), familiar with the legal requirements of conservation easements.

Challenges to decisions of the review board would generally be in the form of resubmissions to the board for reconsideration. True appeals would take place under the state's applicable administrative procedures act. It is anticipated that there would be few if any such appeals, since even if a transaction were approved through a screen, it would always be subject to future full audit by the state or IRS under a much more rigorous standard of review.

- <sup>i</sup> Please note that this is merely one example of how a screening process may be structured. The particulars of any screening process could easily be crafted to meet a state's individual needs.
- <sup>ii</sup> At \$500 per transaction, programs like Colorado's would raise in excess of \$100,000 per year, which should cover the costs of a modest-sized review board.

## APPENDIX B:

### Sample Transactional Screen



## APPENDIX C: FOOTNOTES

**1** State tax incentives for land conservation include income tax credits and deductions, property tax credits, and low property assessment categories. Each has varying levels of effectiveness, but by far the most successful has been the state income tax credit. For this reason, the focus of this report is on state income tax credits rather than other state tax incentives.

**2** The federal government has long allowed federal income tax deductions for conservation easements. A body of conservation easement law has been developed around 170(h), and consistency seems appropriate as landowners claiming state tax credits are often also claiming federal tax deductibility.

**3** The unofficial English translation citation for Puerto Rico's program is Act No. 138, June 4, 2004. However, an evaluation of this program is not included in this study.

**4** A thirteenth state, Arizona, had a state income tax credit of \$33,000 a year for conservation easements donated in an agricultural preservation district. Although this program showed promise, there were no agricultural preservation districts in existence to accept donations. The income tax credit sunset in January 2006.

**5** New York's credit is valued at 25 percent of the property taxes on the land. It is an annual credit of up to \$5,000. Because this is an annual credit, it could eventually exceed \$100,000, but as it is a remote possibility it is treated as having a cap of under \$100,000. South Carolina's credits are valued at \$250/acre or 25% of an individual's federal tax deduction, whichever is less, limiting the value of its credits.

**6** Although experts in Maryland stated that Maryland's income tax credit has not had significant impact, they believed that its property tax credit has been a strong incentive. The property tax credit predated the income tax credit and credits 100 percent of property taxes over fifteen years, after which time the property under easement is taxed at the lowest property tax rate.

**7** California's credit program, due to significant costs involved in meeting procedural requirements, has not been accessible to most landowners. Connecticut's credits are only available to corporations. As a result, credits in these states have generated important donations, but not a significant number of additional donations.

**8** A "qualified donation" includes the preservation of land areas for outdoor recreation by, or the education of, the general public; the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; and the preservation of open space (including farmland and forest land) where such preservation is for the scenic enjoyment of the general public or for other "significant" benefit. Note that conservation values for the purpose of federal tax deductibility and some state programs include the donation of land for historic uses as eligible for receiving a tax credit. Historic purposes are outside the scope of this report and are not discussed here.

**9** Additional California requirements include that the protected land must: meet the goals of a conservation plan; protect species or habitat; conserve threatened

farmland in unincorporated areas, areas zoned for agricultural use, including water rights; and/or must be used for access to parks and open space.

**10** As mentioned, Mississippi and New York base their credits on transaction costs and property taxes, respectively. South Carolina bases its valuation on a percentage of federal tax deduction earned, or \$250 per acre, whichever is less.

**11** To discourage the fragmentation of conservation easements, valuation should be set at a flat percentage or a lower percentage rising to a higher percentage. For example, Colorado originally set its valuation at 100% of the value of the donation up to \$100,000 and then 40 percent for the next \$400,000, for a maximum credit of \$260,000. This had the unintended consequence of encouraging landowners to donate in \$100,000 increments of value, thus requiring many smaller easements over a larger parcel of land. Legislation was passed in 2006 that corrected this by setting the valuation at a flat 50 percent up to a maximum credit of \$375,000.

**12** This is true even if it is a third party that has purchased the credit. If the third party does not use the entire credit, the landowner originally earning the credit may not generate a new credit until the third party uses the entire value or relinquishes the remainder.

**13** Only one state, New York, has full credit refundability. However, its credit is capped at \$5,000 per year.

**14** Note that while South Carolina's program permits credit transfers, it does not have an active transfer market. There is less need for one, as credits are capped at \$52,500 and transferred credits must be certified by the state.

**15** Further, due to legislation passed in 2005, there will not be another surplus year until after 2010.

**16** Project phasing—dividing a parcel into several conservation easements to maximize the benefit a landowner receives from the Conservation Credit program—has been mentioned as an issue of concern. However, so long as each phase of a transaction can stand on its own and meet the conservation benefits test, phasing may be appropriate in many circumstances.

**17** Colorado has language in its easement statute making it clear that the state is empowered to audit all matters related to the easement, including compliance with IRC §170(h) and related federal matters. However, as a practical matter, the state typically relies on the IRS for audit of all federal matters, including the appropriateness of the easement valuation.

**18** In addition, Virginia's and South Carolina's programs require certification in limited circumstances, as discussed earlier.

**19** Georgia also offers a nonbinding precertification review that may be conducted before a donation is made.

## C.

(footnotes continued)

**20** This may be simplified once the Land Trust Alliance's Land Trust Accreditation Program is implemented.

**21** Georgia's nonbinding pre-certification option is similar to the transactional screening process discussed here.

**22** At least one state with certification has clarified that the credits are still subject to audit even after certification. For example, the North Carolina Conservation Tax Credit Issue Paper written by the Conservation Trust for North Carolina and the North Carolina Land Trust Council notes that both the IRS and the state revenue department have existing authority "to audit any tax returns, including those claiming the CTC (Conservation Tax Credit), and both have authority to pursue significant civil and criminal penalties against appraisers that aid individuals in filing fraudulent tax returns."

**23** The state of Virginia is now running into this problem. The Virginia Department of Taxation has undertaken the review of at least one very large transaction (with a donated amount well in excess of \$10 million dollars). This state review was initiated several years after the easement donation was made and also after the resulting state credits had been sold to a large number of purchasers. Although the reviews are not complete (and may not be for years), the result of any adjustments to the donation amount may require the further adjustment of a large number of individual tax returns.





# STATE CONSERVATION TAX CREDITS IMPACT AND ANALYSIS



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