

## **House and Senate Finance Land Conservation Tax Credit Subcommittee**

### **June 21, 2005**

The House and Senate Finance Land Conservation Tax Credit Subcommittee held its first meeting on June 21 in Richmond in the General Assembly Building. The subcommittee members, all serving on either the House or Senate Finance Committees, are Delegates Lee Ware, Ben Cline and Vivian Watts and Senators Walter Stosch, Emmett Hanger and John Watkins. Delegate Harry Parrish and Senator John Chichester are ex-officio members. The chairman of the subcommittee is Delegate Lee Ware and vice chairman is Senator Emmett Hanger.

### **Presentations**

Tax Commissioner Ken Thorson --

Following Chairman Ware's opening remarks, Tax Commissioner Ken Thorson talked about the land conservation tax credit program from the Department of Taxation's perspective, beginning with its history. The tax credit came about through the Virginia Land Conservation Incentives Act of 1999, which was effective in 2000. The credit allowed is for 50% of the fair market value, based on a qualified appraisal, of any interest in land conveyed in perpetuity to a public or private conservation entity. The credit was originally capped at \$50,000 for tax year 2000; \$75,000 for tax year 2001; and \$100,000 per year for tax year 2002, and thereafter. Any unused credit may be carried forward for five years after the first year, limiting the credit to \$600,000 for the original taxpayer. No transfer of the credit was provided when the original legislation was enacted.

Then in 2002, language was added to the statute that provided "[a]ny taxpayer holding a credit under this article may transfer unused but otherwise allowable credit for use by another taxpayer on Virginia income tax returns." The

new language was retroactively effective to January 1, 2002. According to a 2002 Attorney General's opinion, the phrase "unused but otherwise allowable credit" authorized the transfer of the total amount of the tax credit allowed by law or, said another way, 50 percent of the fair market value of the donation, which could be more than the \$600,000 limit imposed on the original taxpayer donor. Therefore, because there is no limit on the value of property that may be donated, there is no limitation on the total amount of credit that may be transferred.

Since 2000, the first year credits were available, there have been 504 requests for credits on income tax returns equaling \$241,313,114. The number of credits and credit amounts has grown from 80 in tax year 2000 to 146 in tax year 2004. The total number of acres for which conservation easements have been designated is 92,876.

Any donation that exceeds the \$600,000 maximum credit amount that an individual taxpayer may claim is known as a "large" donation. In 2003 and 2004, these large donations comprised 75% or more of the total credit value applied for on income tax returns.

With regards to transfers of credits, \$165 million (77%) of the credit value for easements that were donated in 2002-2004 were transferred, most of which were sold to third parties for less than face value. Generally, credits are sold for 50-80% of their face value. Through May 2005, on 3291 tax returns, there have been \$61.9 million in land conservation tax credits claimed, leaving \$169 million in credits to be carried over or transferred in the future.

Donations of conservation easements are being made by four groups:

1. individuals with large estates;

2. business entities using professional corporations to create capital for business development;
3. speculators brokering structured deals using limited liability companies; and
4. real estate developers.

There have been issues involving the appraisals of some properties and the Department of Taxation has lowered some credit amounts on tax returns due to what it determined to be incorrect and inflated appraisals of easements. The Department is currently involved in a court case regarding the valuation of an easement donation and the transfer of credits which exceeded \$600,000. The federal government has also started to take a closer look at transactions involving improper deductions for conservation easements and has indicated that promoters, appraisers and others involved in such transactions may be subject to certain penalties under the Internal Revenue Code (see IRS Notice 2004-41 [June 20, 2004]). A provision was added to Section 58.1-512 of the Code of Virginia during the 2005 session that authorizes the Department of Taxation to disallow appraisals when the appraiser falsely or fraudently overstates the value of the property.

Secretary of Natural Resources Tayloe Murphy --

Secretary Murphy began his presentation by citing a portion of Article XI of the Constitution of Virginia which provides that "...it shall be the policy of the Commonwealth to conserve, develop, and utilize its natural resources, its public lands, and its historical sites and buildings." He continued by describing the methods of land conservation (fee simple title and conservation easements) and state agencies involved in land conservation. They include the Department of Conservation and Recreation, the Virginia Outdoors Foundation, the Department of Forestry, the Department of Historic Resources, the Department of Agriculture and Consumer Services, and the Department of Game and Inland Fisheries.

According to the Secretary, conservation easements compliment land acquisition and provide benefits to donors as well as to the Commonwealth. Conservation easements can allow donors to (i) preserve the family farm, (ii) attain conservation goals, (iii) maintain certain property rights, and (iv) receive financial benefits regarding estate taxes as well as income taxes. The Commonwealth benefits through minimal maintenance costs and, in some instances, as an addition to tourism. The program does have problems particularly in the overvaluation of easements and the quid-pro-quo, in some cases, for donations of easements. Self-regulating solutions are necessary to preserve the program and to restore the program's integrity.

Staff presentation--

Next, Mark Vucci, a senior attorney with the Division of Legislative Services, walked the subcommittee through an example showing the federal, state and local tax preferences that a taxpayer may benefit from for donating a conservation easement. They include federal and state charitable contribution deductions, the Commonwealth's land conservation tax credit, and reduced local real estate taxes (due to the loss in value of the land subject to the easement that cannot be developed).

Due to a lack of time, another staff presentation comparing how other states use conservation tax credits was postponed until the next meeting.

## **Conclusion**

The subcommittee decided its next meeting will be held in Richmond at noon on August 29th at which time the presentation on other states' conservation tax credits will be made. The remainder of the meeting will be a public hearing to allow interested parties to address the subcommittee concerning the conservation tax credit program and to present suggestions for its improvement.

The subcommittee also decided it would have a final meeting in November, following the elections, to decide what recommendations regarding the conservation tax credit it would propose to the 2006 General Assembly.

Handouts, including agendas, from the meeting and future meetings can be accessed on the Division of Legislative Services website at <http://dls.state.va.us/landconserv.htm>.