Land Preservation Tax Credit

Joint House/Senate Finance Subcommittee

November 10, 2005

Legislative History - LPC

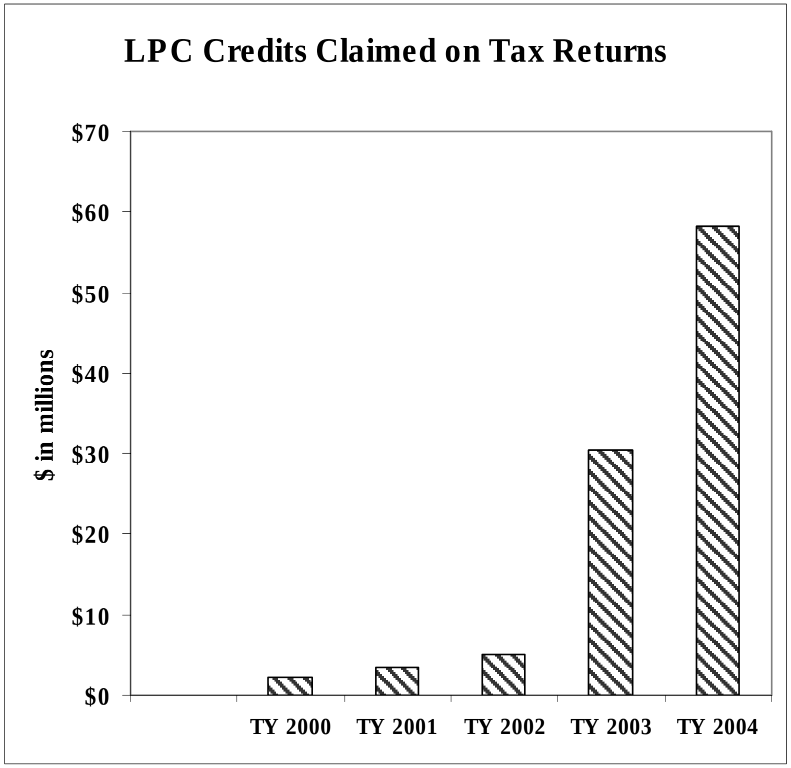
- Original legislation:
  - **Capped tax credit for land placed in perpetual conservation easement**
    - Smaller of 50% of fair market value or $600,000 per conveyance
    - State financial exposure was limited by $600,000 cap
- 2002 legislation:
  - **Added ability to transfer unused credit to another taxpayer**
    - Interpretation of change is that each taxpayer who has access to the credit can claim $600,000
    - Practical effect of interpretation = substitutes 50% of fair market value for the $600,000 overall cap
    - State financial exposure is unlimited because there is no limit on the amount of property that can be conveyed

What sent up the caution flag?

- State financial exposure has increased exponentially.
  - $58.3 million claimed on 2004 tax returns through September
  - Total of $99.5 million in credits have been claimed since program began
  - **$179.2 million in registered credits remain to be claimed**
  - Meter continues to run as additional land is conveyed

- Wide variance on easement value.
  - Small donations LT $1.2 million FMV have average credit of $1,209/acre
  - Large donations GT $10.0 million FMV have average credit of $13,692/acre

- Easements with FMV over $1.2 million produced less than 1/3rd of acreage but 2/3rds of cost.



What the Tax Department data show:

- 71 percent of the acreage to date has come from easements with less than $1.2 million FMV (tax credit under **$600,000; $1,209/acre average cost**)
  - Landowners originally targeted by the program are producing most of the results
- 15 percent of the acreage to date has come from easements with tax credit between $600,000 and $1.2 million ($3,087/acre cost)
- 4 percent of the acreage to date has come from easements with tax credit between $1.2 million and $1.8 million ($3,613/acre cost)
- 3 percent of the acreage to date has come from easements with tax credit between $1.8 million and $2.5 million ($4,909/acre cost)
- Remaining acreage has come from easements with tax credit over $2.5 million ($11,713/acre cost)

What the Tax Department data suggest:

- The ability to “market” tax credits has encouraged certain types of participation that may not have been anticipated.

- Some easements are granted where development potential is questionable.

- Speculative appraisal techniques are producing suspect easement values (donation value = reduction in land value).

  – A typical rule of thumb is that value is reduced 30-40 percent by donating a conservation easement.
  – Twenty percent of donations under the Land Preservation program reflect reduced value of over 50 percent.
  – 30 easements reflect reduced value of over 76 percent.
  – Easement value has even exceeded recent purchase price.

Policy questions raised

- Should the state's financial exposure be open-ended?
- Should the program provide cash-flow for developers or development-related activities?
- Should the program provide cash-flow for tax-exempt entities whose mission is preservation?
- Are all open-space objectives equally worthy of state support?
- Should non-developable land or land with limited development potential be viewed differently?
- Should multiple benefits be provided for the same property, i.e., grants and more than one type of tax preference?

Staff Activities Since Last Meeting

- Met with Tax Department staff
- Met with representatives of work group established by Secretary Murphy
- Developed range of possible options for subcommittee's review that address policy questions raised
- Two options are obvious – do nothing or repeal the tax credit
- Other options are described on the following pages:
  - Option A: Retain current structure and strengthen enforcement.
  - Option B: Retain transferability but apply a cap to each donation rather than to each taxpayer.
  - Option C: Limit transferability of the tax credit.
  - Option D: Establish a cap on annual financial exposure.

Option A

- **Retain current structure and strengthen enforcement**
  - Pre-certification that donation meets specific state objectives (to be determined).
  - Permit TAX to verify value on any donations above $10 million FMV by securing two independent appraisals (value recognized would be based on average of two independent appraisals, if donor's value exceeds this amount by a specified percentage).

Option B

- **Retain transferability of credit, but apply credit cap to each conveyance rather than to each taxpayer**.
  - Re-establish a cap per parcel donated.
    - 71% of acreage to date has come from easements with tax credit under $600,000;
    - 15% of acreage has come from easements with tax credit between $600,000 and $1.2 million;
    - 4% of acreage has come from easements with tax credit between $1.2 million and $1.8 million;
    - 3% of acreage has come from easements with tax credit between $1.8 million and $2.5 million.
  - Increase annual amount of credit that can be claimed from $100,000 to $150,000 and extend the time to redeem credit from six years to ten years;
  - Preclude tax credit if donated land was part of a larger parcel within a specified number of years (to keep donor from getting around the cap by subdividing property).

Option C

- **Limit transferability of tax credit**
  - Limit transfer of unused tax credit to relatives through one-time inheritance.
  - Increase annual amount of credit that can be claimed from $100,000 to $200,000 and extend the time to redeem credit from six years to ten years.
  - Preclude tax credit if donated land was part of a larger parcel within a specified number of years (Same as Option B).

Option D

- **Redesign program to cap total annual state financial exposure (what state can afford to spend).**

  – Purchase conservation easements through expanded state grant program.

  – Establish the tax credit program along the lines of the Neighborhood Assistance Act where land trusts would compete for credit allocations from a capped annual amount, or

  – Establish the tax credit program along the lines of the Enterprise Zone Act, where authorized credits are pro-rated against a capped annual amount.

  (Legal uncertainty as to whether tax credit or grant program might affect federal deduction).

Features Common To All Options, Unless Noted Otherwise

- Preclude tax credit for land that is contained within an existing development or that is included as part of a development plan (proffer issue).
- Preclude tax credit for a specific property that has received an appropriation grant.
- Deny tax-exempt entities access to tax credits altogether, or deny access to those tax exempts whose mission is preservation of land and/or structures. (Not applicable to Option C)
- Clarify intent of existing Code language disallowing a double credit.
- Codify current temporary provisions on façade easements.
- Direct some portion of annual savings from changes to a Chesapeake Bay Trust Fund for clean-up activities.
- Either disallow subdivision method of appraisal or, if method is allowed, require pre-certification of value by TAX.
  - Value recognized would be based on average of two independent appraisals, if donor's value exceeds this amount by specified percentage.