

## TAX PREFERENCES ASSOCIATED WITH CONSERVATION EASEMENTS

- ◆ There are federal, state, and local tax preferences for donating conservation easements.
  
- ◆ An example can illustrate why conservation easements are good tax planning devices.
  - Landowner has 300 acres and grants an easement to a nonprofit foundation promising not to develop 200 acres. Each acre has a fair market value of \$25,000 for a total value of \$5 million.

### Federal and State Charitable Deductions

- ◆ On his federal return, the taxpayer may take a charitable deduction for the easement donation. The deduction equals the loss in value from not being able to develop the land.
  - Assuming the land has lost 50% of its value, the federal charitable deduction equals \$2,500,000 (\$5 million X .50).
  - Because Virginia is in conformity with federal tax laws, the \$2,500,000 deduction will "flow-through" to the Virginia tax return as an itemized deduction.

### Virginia Land Preservation Tax Credit

- ◆ The Virginia Land Preservation Tax Credit may be taken for the donation of a conservation easement.
  - The state tax credit equals 50% of the fair market value of the donation, or in this case \$1,250,000 (\$2,500,000 X .50).
  - The maximum credit that the taxpayer can take is limited to \$100,000 each year over 6 consecutive years or \$600,000. The taxpayer can sell any credit not used.
  - Assuming that the taxpayer will take \$500,000 in tax credits, the taxpayer may sell the remaining \$750,000 in tax credits to be used by another taxpayer. The \$750,000 will be sold at a discount. Selling the \$750,000 at \$.85 on the dollar will net the taxpayer \$637,500. (Note: the exposure to the Commonwealth remains at \$750,000 since other taxpayers will claim the credit against their tax liabilities.)

### Reduced Real Estate Taxes

- ◆ The \$5 million of land cannot be developed and has lost \$2.5 million in value. If the tax rate in the locality is \$1 per \$100 of assessed value, real estate taxes will be \$25,000 less each year.

### What is it all worth?

One-time federal charitable deduction of \$2.5 million (at 35% federal tax)	\$ 875,000
One-time Virginia charitable deduction of \$2.5 million (at 5.75% state tax)	143,750
Land Preservation Tax Credits used	500,000
Land Preservation Tax Credits sold**	637,500
Reduction in real estate taxes (at the end of 15 years)	<u>375,000</u>
	\$2,531,250

\*\* The \$637,500 gain from the sale of Land Preservation Tax Credits is taxable income at the federal level. However, the taxpayer may take a subtraction for this gain when computing Virginia income tax.

- ◆ In this example, a Virginia taxpayer who grants a conservation easement valued at \$2.5 million (on land with a \$5 million fair market value) will receive \$2,531,250 in tax preferences.
  - The taxpayer still owns the land but it may not be developed. The land has to remain as open space or forestal, etc. in perpetuity. The taxpayer may bequeath the land to his heirs.

### Easement Donations of Concern

- ◆ Several easement donations have raised concerns. The Department of Taxation has received allocations for land preservation tax credits that substantially exceed the price paid for the land.
- ◆ In other cases, the land preservation tax credit is being used to enhance land development rather than impede it, by allowing developers to generate cash flow.
- ◆ Nonprofit organizations may also be eligible for the land preservation tax credit on land that they own and never intend to develop.
  - Although they normally would be exempt from sales and income tax (and, in many cases, real estate tax), nonprofit organizations can sell their land preservation tax credits and keep the proceeds from the sale.