



Aspen Valley Land Trust LANDOWNER INFORMATION SERIES

QUESTIONS YOU SHOULD ASK (IF YOU HAVEN'T ALREADY!)

(Revised April 2011)

1. Do I have to hire an attorney or accountant to represent me?

While AVLT does not require that you have independent counsel in a conservation transaction, we *highly* recommend it. At the very least, you should discuss your financial situation and any potential tax consequences with an experienced tax advisor prior to a conservation easement, and have them help you prepare your tax forms. In addition, it is your responsibility to understand the legal requirements and consequences of an easement. Conservation transactions are permanent, and while AVLT will guide you through the steps required to create an easement, we cannot provide legal or tax advice.

2. Can conservation easements ever be terminated, condemned, or amended?

Conservation easements are permanent encumbrances on a property that cannot be revoked or terminated, except by a court order. If the property is entirely condemned or circumstances change such that the purpose of the easement becomes impossible to accomplish, there are mechanisms by which the easement may be legally terminated in a court of law, with any condemnation proceeds to be distributed between the landowner and the land trust. Partial condemnation, such as by a utility company or public road department, can also not be prevented on conserved lands (though the land trust may be able to help you engage in negotiations), and as with full condemnation or termination, damage or condemnation proceeds paid as a result must be distributed between the landowner and land trust according to law.

Amendments to easements may be made to further the conservation purposes of the easement (such as to add additional acreage or increase protections); to correct typographical, clerical or factual errors; to clarify language or ambiguities in the easement deed; or in rare and warranted situations, to account for unforeseen or changed circumstances. No amendment may be made to confer private benefits onto a donor, landowner or any other individual that exceed the benefits gained by the general public. Amendments may also not affect the perpetual nature of the easement or its qualification according to Colorado Revised Statutes (C.R.S.) Section 38-30.5-101, *et seq.*, or Section 170(h) of the Internal Revenue Code (I.R.C.). Land trusts are under no obligation to amend an easement, and may decline to do so at their sole discretion. If approved, the party requesting the amendment (either the landowner or the land trust) is expected to pay any fees or costs associated the amendment.

3. Will placing my land under conservation easement reduce my property taxes?

It should. The treatment of conserved lands for property tax purposes is described in the C.R.S. Sections 38-30.5-109 and 39-1-102(1.6)(a)(III), stating that lands protected by conservation easement shall be assessed “with due regard to the restricted uses to which the property may be devoted,” and with regard to the agricultural status of the land at the time of the easement's grant. Actual assessment may vary from county to county.

In general, land assessed as agricultural prior to its placement under conservation easement will retain its agricultural assessment provided that the property is at least 80 acres, or less than 80 acres without any residential structures. Other non-agricultural conserved land

should be valued with regard to the restrictions placed upon the property, which in most cases will reduce its assessed value. If you are concerned about the impacts that a conservation easement might have on your property taxes, we recommend that you contact your county assessor.

4. How much does it cost to donate a conservation easement?

Believe it or not, donating an easement costs money. All land trusts require a one-time contribution to help cover the costs of ongoing monitoring and future legal defense of an easement, and the Internal Revenue Service (IRS) requires that a tax-deductible easement donation be supported by proper documentation – including an appraisal, baseline inventory and geologist’s report (even non-deductible easements will require a certain amount of this supporting documentation). In addition, we recommend that you hire an attorney and/or tax advisor to counsel you through the process. After all is said and done, granting an easement may cost \$25,000-35,000 (for a detailed accounting of this cost, please see AVLT’s *Financial Requirements for Creating a Conservation Easement*). For those to whom this is an unreasonable burden, AVLT may provide an interest-free loan for qualifying expenses, which must be repaid by April 15 of the following year, whether an easement is completed or not.

5. I hear a lot about “donated” easements. Does AVLT ever buy easements?

Not usually. Most easements in Colorado are *donated* precisely because Colorado offers such progressive and valuable incentives, including a way to convert tax credits into cash. There are very rare circumstances under which AVLT may seek grants in order help purchase an easement; however, this is a complicated, time-consuming process, and is usually reserved for particularly outstanding, large-scale projects that cannot be funded through other means. (Pitkin and Eagle counties have dedicated open space funds that landowners may apply for, often in conjunction or partnership with a land trust.)

6. AVLT has a list of recommended appraisers with whom they work. What is my responsibility as the client?

While AVLT has developed a list of appraisers who are experienced in the valuation of conservation easements, the quality of their work depends on your active cooperation. The appraisal is part of your documentation for tax benefits and the information you provide will go a long way to helping the appraiser understand your property. You will need to show the appraiser the property, and provide him or her with as much information as you can about water rights, rights you wish to reserve, covenants or restrictions already in place, floodplain/survey information, access issues, additional property you or your family own in the area, and any other relevant details about the property *before* they begin their analysis. An uninformed appraisal that returns an artificially high value will not be defensible. Please remember: *if it seems too good to be true, it probably is.*

After you receive a draft or completed copy of your appraisal, read it thoroughly and check for errors, accuracy of representations and consistency. State law requires that appraisers submit all conservation easement appraisals to the Colorado Division of Real Estate (DRE) for review within 30 days of completion, and to claim a tax credit, the donor must submit their appraisal to the Colorado Department of Revenue, so it is worth reading this document before they do!

Things to look for in your appraisal: Has the appraiser referenced the correct property and legal description? Have they considered all of the salient facts and comparable sales in the area of

which you are aware? Do the numbers add up and appear sensible? Are the conclusions believable and well-supported? Have they considered all of the land that you and your family own in the area, as well as any “enhancement” that the conservation easement may have on neighboring family land? Are reserved rights and special uses correctly listed and described (such as number of retained home sites)? This is the one document that assigns a monetary value to your donation, and it is your responsibility to assure it is reasonable and correct.

7. Do you have to be a Colorado resident to qualify for the Colorado tax credit?

According to C.R.S. Section 39-22-522, taxpayers who may qualify to claim the Colorado gross conservation easement credit (including transferees of these credits) include:

- Colorado residents,
- C corporations, trusts and estates established by a Colorado taxpayer,
- Partners, shareholders or members of pass-through entities (such as partnerships, S corporations, or LLCs) that receive the credit from a pass-through entity, *regardless of whether those individuals are Colorado residents.*

The following restrictions apply:

- Joint tenancy, tenancy in common, and pass-through entities must allocate the credit to the entity’s members in proportion to their distributive shares of income or ownership percentage in such entity or group.
- *A single-member LLC will generally be disregarded* for federal tax purposes (I.R.S. Regulation 301.7701-3) as well as state tax purposes, and does not qualify for the conservation easement tax credit unless the member is a Colorado resident.
- Individuals who are *not residents* of Colorado cannot claim the conservation easement tax credit. *Part-year residents may claim the credit only if they make the donation while they are Colorado residents.* Nonresident owners included in a joint tenancy, tenancy in common, and similar groups cannot claim the conservation easement tax credit. Only a credit apportioned to nonresident members of a pass-through entity can be claimed by nonresidents.

Additional restrictions may also apply. For more information, please see C.R.S. Regulation 39-22-522, and the State of Colorado Taxpayer Service Division’s **FYI 39** regarding the Gross Conservation Easement Tax Credit (in your Landowner Information Packet or available online at www.revenue.state.co.us/fyi/html/income39.html.)

8. If I sell my conservation tax credits for cash, how will this affect my income taxes?

The sale of conservation tax credits creates taxable income. A recent 2011 partial summary judgment by the US Tax Court of the Tempel case implies that the proceeds from the sale of Colorado conservation easement tax credits are capital gains with a basis of \$0. Credits sold within a year of being granted create short-term capital gain, while credits held for at least a year after they were granted, and then sold, would be classified as long-term capital gain. This is not a final ruling and not all issues surrounding this judgment have been settled. For more information and discussion, please see the Conservation Resource Center 2011 Tax Credit Update (available from AVL T) or the full Temple opinion at www.ustaxcourt.gov/InOpHistoric/Temple.TC.WPD.pdf.

Also, remember that the amount of you deduct annually from your federal income as a result of a conservation easement donation must be added back to your state income – this is called a federal add back. You may wish to have a qualified tax advisor help forecast your tax liability so that you can retain part of your state credit to offset your state liability.

Income from the sale of a tax credit may not be considered income derived from farming or ranching, which could affect your status as a “qualified farmer or rancher” under USC Section 2032A(e)(5) for the year in which you receive payment for your tax credit. If you qualify as a farmer or rancher for tax purposes, discuss this point with your tax advisor, as this one-time influx of non-ranch income may change the percentage of your adjusted gross income that is tax-deductible through a conservation easement.

Finally, remember that easement donors cannot qualify for another Colorado conservation tax credit until their current credit has been completely used by either the donor or the buyer of the credit. Credits can only be transferred once, and may not be transferred back to the original donor. Unused credits survive death, and may be claimed or transferred by your estate.

The actual impact of conservation easement tax deductions and tax credits depends on the individual's financial situation. As always, discuss the tax consequences with an accountant or tax advisor before making a decision.

9. Will donating a conservation easement increase my chances of being audited?

Large, one-time donations claiming significant tax deductions have always been subject to a higher level of attention from the IRS than regular tax returns, but the State of Colorado and the conservation community have taken strong measures in recent years to strengthen the oversight of land trusts and prevent the abuses that led the IRS to audit roughly 290 tax returns in Colorado for easement donations made in 2003 and 2004. Many of these donations deserve the scrutiny, but the IRS's wide net of suspicion also ensnared many high-quality, legitimate easement donations.

The land trust community, competently headed by the national Land Trust Alliance and the Colorado Coalition of Land Trusts, has worked closely with the Colorado Department of Revenue, the Colorado Division of Real Estate (DRE), the IRS, and Colorado's Congressional delegation to provide a framework for review and regulation of conservation easements. Reforms enacted by the Colorado State Legislature in 2008 and 2010 have resulted in increased requirements for appraisers and a requirement that all organizations that accept conservation easements for which a Colorado conservation tax credit is claimed be certified by the DRE.

In 2008, the Governor also appointed the Colorado Conservation Easement Oversight Commission to oversee the implementation and review of these reforms. State officials and the conservation community are confident that these measures have stopped the problems and are helping to support the legitimate donations of easements to certified land trusts working within both the letter and spirit of the law.

AVLT urges donors to work closely with their land trust, attorney, and accountant to create a documented, quality donation that will stand the test of time. It is notable that in the midst of the IRS audits, federal and state legislators have given the land trust community a resounding vote of confidence by expanding the tax benefits for easements on both the state and federal level, speaking to the importance of conservation easements in protecting valuable open space.

For more information, please contact AVLT.

10. Will the IRS tell me in advance if my easement donation qualifies for tax benefits?

In the past the IRS has, for approximately \$5,000-10,000, issued a private letter ruling for an individual conservation easement donation that determines whether the donation qualifies for tax benefits based on the stated case and circumstances at the time. The IRS will NOT rule as to

the easement's value or pre-approve an appraisal. Private letter rulings should not be relied upon by or extrapolated to other cases or circumstances not under review.

11. Can conservation easements be granted in conjunction with development approvals, and are there tax incentives for doing so?

Yes and no. A special vote of AVLT's board of directors is required for easements being offered in conjunction with development approvals. Generally this will involve an assessment of the conservation values of the property in question, and of the potential impacts to those values that may result from proposed or neighboring development. *Conservation easements required by government contract or as a condition of development approval are not recognized by the IRS or the State of Colorado as tax-deductible gifts.*

If a conservation easement is granted *before* the landowner applies for development or subdivision approval, it *may* qualify for tax benefits; however, *the land under conservation easement may not be later used toward housing density calculations or to fulfill open space requirements* if it has also been used to claim state or federal tax benefits as a voluntary conservation donation. (This is in part because the deed of conservation easement transfers the development rights on the conserved property to the land trust to hold in perpetuity, and the easement appraisal value is based largely upon "giving up" these rights. Development rights cannot then later be moved to a different part of the property for use by the landowner, unless the landowner forgoes the tax benefits associated with giving away those rights.)

12. Can I "phase" a conservation easement across my property over multiple years?

Phasing of conservation easements across large or particularly valuable pieces of land is a common strategy among Colorado landowners who wish to maximize conservation tax incentives or who require extra time and flexibility for estate or land planning purposes. As with any donation, each phased conservation easement must *stand alone* and have sufficient conservation purpose and public benefit to qualify by itself as a deductible easement. AVLT will accept phased easement projects after working with landowners to develop a *non-binding phasing plan* reviewed by the AVLT board. Our phasing policy describes the process, fees, and requirements for using the latest AVLT model easement document, and can be found in your landowner packet or on our website (or by request). Keep in mind that each donor is limited to one conservation easement donation per year (unless tax benefits are not to be claimed), and state tax credits resulting from an easement donation must be used or extinguished before a donor can qualify for additional conservation tax credits.

If you have any questions or concerns about these or other issues, please call or email the AVLT office at 970-963-8440 or avlt@avlt.org and we will gladly meet with you or direct you to an advisor that can help you find the answer.