



## Aspen Valley Land Trust Landowner Information Series

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

(Revised October 2008)

#### **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 easements ever be terminated 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 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, and any condemnation proceeds are distributed between the landowner and the land trust.

Amendments to easements may be made to further the conservation purposes of the easement; to account for unforeseen circumstances; to correct typographical, clerical or factual errors; or to clarify language in the easement deed. No amendment may be made to confer private benefits onto the 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 C.R.S. Section 38-30.5-101, *et seq.*, or Section 170(h) of the Internal Revenue Code. Land trusts are under no obligation to amend an easement, and may decline to do so at their sole discretion.

#### **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 Colorado Revised Statutes 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 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. Most land trusts require a contribution to help cover the costs of ongoing monitoring and future defense of the easement, and the IRS requires that the donation be properly documented, including an appraisal, baseline inventory and geologist's report. 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, creating an easement may cost about \$20,000 (for a detailed accounting of this cost, please see AVLT's *Checklist for creating a conservation easement*). For those to whom this is an unreasonable burden, AVLT provides interest-free loans for qualifying expenses, which must be repaid by April 15 of the year following the transaction, whether the donation 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 income and estate tax benefits, 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 which cannot be funded through other means.

#### **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 in our service area competent 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, restrictions already in place, floodplain/survey information, access issues, additional property you 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 your completed appraisal, read it thoroughly and check for errors as well as consistency. 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 own in the area, and have they correctly listed the rights you wish to reserve (such as number of homesites)? This is the one document values your tax benefits and it is your responsibility to assure that it is 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,

- Partners, shareholders or members of pass-through entities (such as LLCs) which receive the credit from such entity, *regardless of whether those individuals are Colorado residents.*

The following restrictions apply:

- Joint tenancy, tenancy in common and pass-through entities such as a partnership, S corporation, or LLC, 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. Section 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](http://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?**

Income from the sale of conservation tax credits is taxable as ordinary income. In addition, the amount of your federal income tax deduction for a conservation easement must be added back to your state income; therefore, we recommend that you have a qualified tax advisor help forecast your tax situation as you may wish to retain part of your 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 re-transferred back to the donor. Unused credits survive death, and may be claimed or transferred by your estate.

#### **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 Internal Revenue Service (IRS) than regular tax returns. In addition, reports of some blatant abuses led the Colorado Department of Revenue (DOR) to invite the IRS to audit roughly 300 Colorado easement donations made in 2003 and 2004. Many of these donations deserve the scrutiny, as non-qualified land trusts

and over-inflated or fraudulent appraisals have resulted in poor deals that should not have received tax benefits. However, the IRS's wide net of suspicion has also ensnared many high-quality, legitimate easement donations now undergoing audit.

While we cannot estimate how long these audits will continue or their outcome, the land trust community, competently headed by the Land Trust Alliance and the Colorado Coalition of Land Trusts, is working closely with the DOR, the Colorado Division of Real Estate (DRE), the IRS and Colorado's Congressional delegation to reach a solution. Reforms enacted by the Colorado State Legislature in 2008 have resulted in increased requirements for appraisers and the requirement that all organizations which accept conservation easements for which a Colorado Conservation Tax Credit will be claimed, must be certified by the DRE. In addition, a Conservation Oversight Commission was formed to oversee the implementation and review of these reforms. The hope on all sides is that these legislative actions will root out the problems while supporting legitimate easement donors -- those who have worked with qualified land trusts and followed both letter and spirit of the law.

In the meantime, AVLTT does not discourage landowners from donating easements, but urges donors to work closely with their attorney and accountant to create a solid donation that will stand the test of time. It is notable that in the midst of the IRS audits, Congress has 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 read the January 2008 "AVLTT audit update letter" located under current news on our website [www.avltt.org](http://www.avltt.org).*

#### **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.