

# Conservation Easements and Income Tax Credits

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# Why are we here?

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- Generous state and federal tax benefits are available to people who voluntarily preserve their land and water with a conservation easement donation
- The transactions must meet certain qualifications to be done properly
- State tax benefits can be as much as \$250,000 depending on the value of the donation
- Tax credits are available for donations of land in fee or conservation easements
- Landowners can sell their tax benefits for cash
- Taxpayers can save 11-13% on their state tax bill by purchasing tax credits.

# What are Tax Credits?

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- Used against state taxes dollar for dollar
- Similar to a 'gift certificate'
- More valuable than deductions



# What are Conservation Easements?

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- Voluntary legal agreement between landowner and qualified organization
- Permanently restrict use of land
- Preserve land and water rights
- Protect Conservation Values



# How do Conservation Easements Work?

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- Run with the land
- Donated development rights have monetary value
- Landowner Rights:
  - Remains owner of property
  - Manages property
  - Retains all rights not conveyed in easement
  - Public access not generally required
  - Land may be sold, leased or mortgaged
- Grantee's Rights and Obligations:
  - Monitoring obligations
  - Enforces restrictions of easement over time
  - Has all rights granted in the easement

# Requirements for a Donation to Qualify for Tax Benefits:

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Federal requirements for donated conservation easements:

- Qualified Conservation Contribution
  - Contribution of a Qualified Conservation easement
  - To a Qualified Organization (501)(c)(3) or government
  - Exclusively for Conservation Purposes

# Requirements for a Donation to Qualify for Tax Benefits (cont'd)

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- Recognized Conservation Purposes are:
  - Outdoor recreation or education of the public
  - Protection of a relatively natural habitat
  - Preservation of open space where such preservation is:
    - For scenic enjoyment with public benefit, or
    - Pursuant to a clearly delineated governmental conservation policy with public benefit
  - The preservation of an historically important land area or certified historic structure

# Requirements for a Donation to Qualify for Tax Benefits (cont'd)

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- Donative intent
- Conservation Easement must be perpetual
- Probability of surface mining so remote as to be negligible
- Mortgages must be subordinated
- Qualified Appraisal required to substantiate value
- Baseline Inventory identifying condition of property



# Requirements for a Donation to Qualify for a Tax Credit under New Mexico Statutes

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- Donor must be a United States taxpayer
- Donors are limited to one credit-generating donation per year
- If public recreation or education, the conservation easement must allow the public to use the property regularly
- Dedications of land or conservation easement for open space to fulfill density requirements to obtain a subdivision or building permit do not qualify

# Requirements for a Donation to Qualify for a Tax Credit under New Mexico Statutes (cont'd)

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- Landowner must apply to Energy, Minerals, Natural Resources Department (EMNRD)
- Two-Step Application Process
  1. Assessment
  2. Certification of Eligibility

# Requirements for a Donation to Qualify for a Tax Credit under New Mexico Statutes (cont'd)

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## Assessment Application Process:

- Submit Donation Assessment Report
- Review by EMNRD Secretary and Natural Lands Protection Committee for Conservation Purposes
- EMNRD will either:
  1. Approve (Applicant can proceed)
  2. Denied (Applicant may re-submit)

# Requirements for a Donation to Qualify for a Tax Credit under New Mexico Statutes (cont'd)

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## Certification of Eligibility Application Process

- Record Conservation Easement
- Complete Qualified Appraisal
- Legal descriptions for other properties owned within a 10 mile radius of conserved property
- EMNRD submits Qualified Appraisal for review by Taxation and Revenue Department
- EMNRD either:
  1. Approves (issues Certificate of Eligibility)
  2. Denies (re-submit Certification of Eligibility Application)



# Requirements for a Donation to Qualify for a Tax Credit under New Mexico Statutes (cont'd)

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- Submit Certificate of Eligibility to Taxation and Revenue (RPD-41335)
- Taxation and Revenue authorizes the amount of tax credits and assigns a tax credit number



# How Conservation Easement Income Tax Credits are Valued

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- Appraisal determines conservation easement value
- Qualified Appraisal Requirements:
  - Entire contiguous parcel owned by donor or family must be appraised
  - Enhancement to nearby unprotected land owned by donor or related persons must be examined
  - Dated no earlier than 60 days prior to donation date
  - Completed before federal income tax return is filed (can extend to 10/15)

# How Conservation Easement Income Tax Credits are Valued (cont'd)

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- Appraisal Requirements, cont'd
  - Comparable Sales must be used to determine value
    - Look at properties similar to easement
    - Use 'Before and After Valuation'

Example:

$$\begin{array}{r} \$1,000,000 \text{ 'Before'} \\ - \$600,000 \text{ 'After'} \\ \hline = \$400,000 \text{ 'Conservation Easement Value'} \end{array}$$

(if full donation, this is also the 'Donation Value')

# How Conservation Easement Income Tax Credits are Valued (cont'd)

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- Bargain Sales
  - When a portion of the conservation easement value is purchased or grant-funded
  - Affect donation value

Example:

\$400,000	Conservation easement value
- <u>\$100,000</u>	Purchase price for conservation easement
= \$300,000	Donation value



# How Conservation Easement Income Tax Credits are Valued (cont'd)

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- Tax credits are available for donations of land in fee or conservation easements
- Tax credits are calculated based on donation value
- FORMULA = 50% of donation value, up to a total credit of \$250,000

Example:

\$400,000 donation value

$50\% \times \$400,000 = \underline{\$200,000 \text{ tax credit}}$

# How Conservation Easement Income Tax Credits are Valued (cont'd)

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Husband and Wife:

- May each receive a tax credit worth the lesser of \$250,000 or his or her proportionate share of 50% of the donated land or conservation easement

Example:

\$1,000,000 CE donated by Husband and Wife

X 50%

\$500,000 Tax Credit

Husband and Wife each receive \$250,000 tax credit because both own the land

# How Conservation Easement Income Tax Credits are Valued (cont'd)

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More than one taxpayer owns an interest in the land:

- Total tax credits cannot exceed 50% of the donated land or conservation easement value

Example:

\$2,000,000 CE donated by 10 individual owners

$\times \quad 50\%$

\$1,000,000 Tax Credit

\$1,000,000 / 10 individual owners = \$100,000 Tax Credit each

# How Donors Can Use their Conservation Easement Income Tax Credits

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- Use credit against their own tax liability for up to 20 years
- Transfer some or all of credit to another taxpayer for approx 82% of face value

Example:

\$200,000 Value of Tax Credit  
X 82% Sold to Buyer  
= \$164,000 CASH





# How Donors Can Use their Conservation Easement Income Tax Credits (cont'd)

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## Rules regarding the sale of tax credits

- Credits can be sold up to December 31st for use against the buyer's tax liability for that year

Example:

Donation is made October 31, 2018, the credits can be sold up to December 31, 2018 and the buyer can use them for 2018 taxes

- Can sell all of their credits, or just sell some and keep the rest for use against their own tax bill
- Credits must be sold in increments of \$10,000 or greater
- Credits must be transferred by Qualified Intermediary
- Qualified Intermediary notifies Taxation and Revenue within 10 days of transfer (RPD- 41336)

# Requirements for a Donation to Qualify for a Tax Credit under New Mexico Statutes

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Qualified Intermediary cannot be:

- Previously convicted of a felony
- Persons with a revoked professional license
- Engaged in practice under Public Accountancy Act
- A real estate broker or salesman
- An entity owned wholly or in part or employing any of the above persons

# Provisions of Tax Credit Purchase Agreement

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- Seller's Representations and Warranties
- Buyer's Representations and Warranties
- Seller indemnifies Buyer
- Buyer and Seller will share information

# Benefits to Taxpayers for Purchasing Tax Credits

- Purchase tax credits at a discount (rate varies based on time of year)
- Credits can be applied towards taxes dollar for dollar

Plan ahead: no quarterly payments

Example:

\$100,000	Tax Credit
<u>x 87%</u>	June rate
= \$87,000	Purchase price

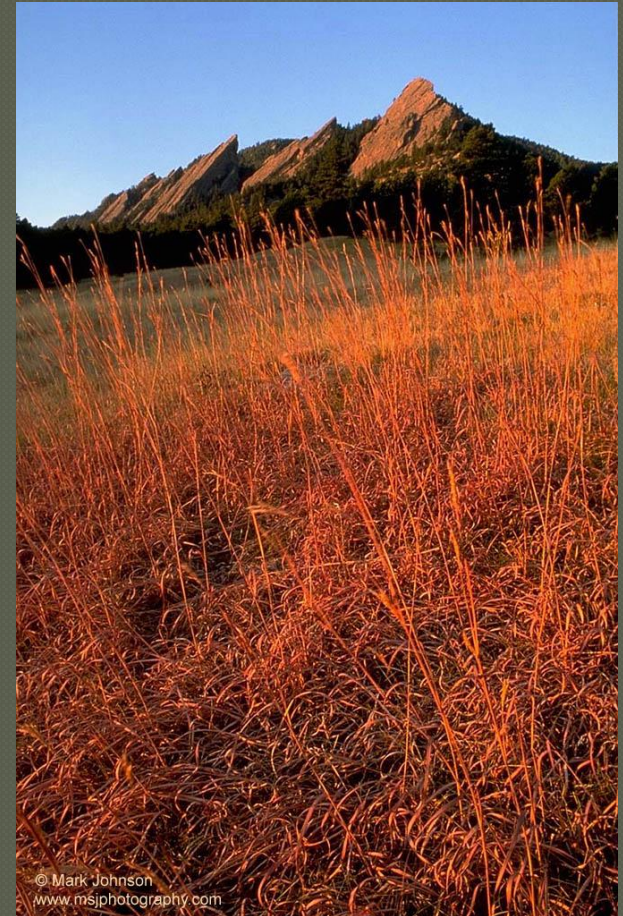
Taxpayer saves \$13,000 on their tax bill





# Benefits of Working with a Qualified Intermediary

- Qualified Intermediaries will review and correct:
  - Appraisal
  - Deed of Conservation Easement
  - Title work
  - Baseline Report
  - Tax forms (8283, RPD 41335, RPD 41336, RPD 41282)
  - Supporting documents as needed
- Assist with EMNRD Application Process
- Qualified Intermediaries guide buyers and sellers through process and take care of details



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# Federal Tax Benefits of Donating a Conservation Easement

- Federal Income Tax Deduction = Donation Value of the Conservation Easement



Example:

\$400,000 donation value

\$400,000 Federal income  
tax deduction available

# Federal Tax Benefits of Donating a Conservation Easement (cont'd)

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## Federal Deductions

- Deduct 50% of AGI and carry forward 15 years

Example:

\$100,000 AGI

- Deduct \$50,000/yr X 8 years = \$400,000 of deduction used with time to spare

# Federal Tax Benefits of Donating a Conservation Easement (cont'd)

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- Qualified Farmers and Ranchers receive more benefits
- Can deduct 100% of AGI if qualified
- Qualified farmer/rancher is one who receives at least 50% of **gross income** from agricultural or livestock production
- Gross income is before all of the farm expenses are taken out, so even if donor has a second job, he/she may still qualify
- Agricultural corporations also qualify if closely held

# Federal Income Tax Liability for Sale of State Tax Credits

- If a landowner sells their tax credits, they will have to pay federal tax on that income
- IRS has not determined whether the income is treated as ordinary income or capital gains income, although they are arguing it is ordinary income in individual audits
- Recent Tax Court Opinion has a different take on it

# Federal Income Tax Liability for Sale of State Tax Credits– *Tempel* case

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- ◉ A recent Tax Court Case
- ◉ Holding: State Income Tax Credits = Capital Assets
- ◉ Credits held less than a year generate a short-term capital gain.
- ◉ Tax credit holding period begins at the time the credits are granted and ends when the credits are sold.



# Additional Tax Benefits Possible for Conservation Easement Donation

## ◉ Property Tax Benefits

- Assessed on 'After value'
- Not much benefit if property is already taxed at agricultural rate

## ◉ Estate tax benefits

- Conservation Easement reduces value of the estate



# Is a conservation easement right for me?

## Questions to consider:

- Do you want to continue living/working on the land?
- Do you want to pass the land down to heirs?
- Is it important for you to know that land will stay as is?
- Do you want to get the greatest return on your property?





# Recap

- Extremely generous tools are available for donors of qualified conservation easements
- Donors can receive state tax credits, which can be converted into cash



# Questions?

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