

Land Preservation Credit



Battling Abusive Conservation Easements

Virginia's Land Preservation Tax Credit

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In the beginning, there was a credit.

- ▪
- Effective 2000, *Virginia Land Conservation Incentives Act of 1999, Va. Code § 58.1-510 et seq.*
 - ◆ 50% of the fmv of any interest in land conveyed in perpetuity to a public or private conservation agency supported by a qualified appraisal
 - ◆ Capped: \$50k in 2000, \$75k in 2001 & \$100k in 2002 and thereafter
 - ◆ Five-year carry forward, thus, total of \$600,000
 - ◆ No transfer allowed

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... and the proponents of
the land preservation credit
saw that it was good.*

* For a while.

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Then there was light

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- In 2002, the legislature added twenty-five apparently innocent words to the statute:
Any taxpayer holding a credit under this article may transfer unused but otherwise allowable credit for use by another taxpayer on Virginia income tax returns.
- Effective retroactively to January 1, 2002

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... and the proponents of
the land preservation credit
saw that it was better.*

* Oh, oh.

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And then, later that same year, there was still more light . . .

- Opin. of the Va. Att’y Gen. 02-094, November 19, 2002
- Question: Whether “unused but otherwise allowable credit” that may be transferred refers to the limits applicable to each taxpayer (i.e., \$600,000), or to the total allowed amount of the tax credit (i.e., 50% of the fmv of the donation)
- Answer: The total allowed amount of the tax credit, i.e., there are no caps on transfers

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. . . and the proponents of the land preservation credit saw that it was terrific.*

*Better watch out now.

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... but the fruit of the tree of knowledge proved too much a temptation.

- The doors to the State Treasury were wide open
- Deals were there for the making and taking
- Promoters jumped at the opportunity
- Wealthy investors became donors for rich rewards
- Appraisers obliged their employers
- Potential tax credit transferees flocked to the bargain
- The LPC program really took off
- The LPC program suffered abuse
- The legislature began to stir, uncomfortably

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Donation History

- After the credits became transferable in 2002, the number of donations and the value of the easements increased dramatically.
- From 2000 to 2004:
 - ◆ The number of donations increased by 170% (from 84 to 146)
 - ◆ The value of the credits requested increased by 572% (from \$18.7 million to \$103.9 million)
- Through 2004, 504 easements have been donated on 92,876 acres with a credit value of \$241.3 million.



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Donation History

Tax Year	# of Credits	# of Acres	Credit Requests
2000	84	12,719	\$ 18,688,882
2001	40	3,973	\$ 9,536,229
2002	123	21,584	\$ 44,945,385
2003	111	23,453	\$ 64,292,132
2004	146	31,147	\$103,850,486
Grand Total	504	92,876	\$241,313,114



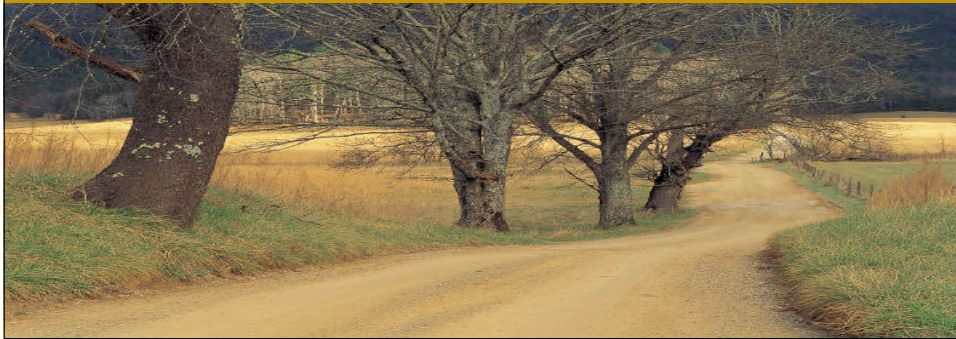
Large Donations (>\$600,000)

- 71 of 504 easement donations since 2000 have exceeded the \$600,000 maximum credit amount that can be claimed by an individual taxpayer.
 - ★ These “large donations” represent 14% of the easement donations but they represent 66% of the total credit value.
 - ★ For 2000, large donations represented 8% of the easement donations and 40% of the credit value.
 - ★ For 2004, large donations represented 22% of the easement donations and 75% of the credit value.



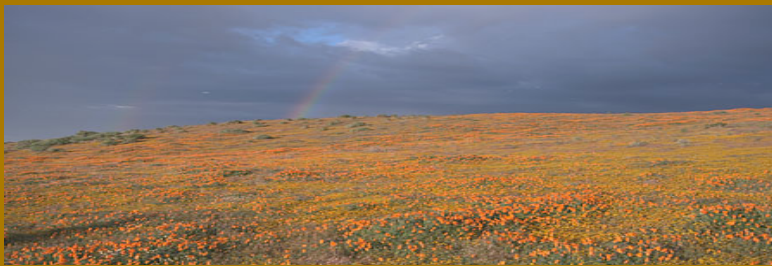
Large Donations (>\$600,000)

Tax Year	# of Credits	# of Acres	Credit Requests
2000	7	1,493	\$ 7,488,700
2001	3	404	\$ 2,363,250
2002	10	4,694	\$ 23,052,126
2003	19	8,713	\$ 49,037,057
2004	32	11,115	\$ 77,370,288
Grand Total	71	26,419	\$159,311,421



Breakdown of Large Donations

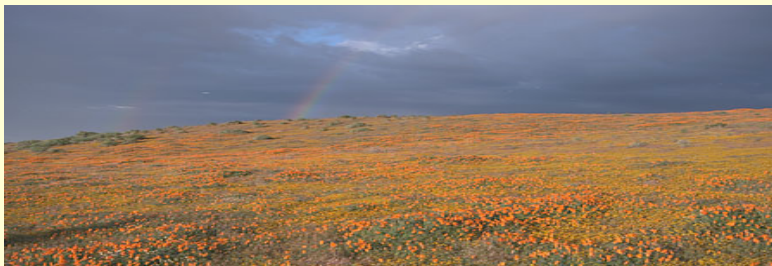
- More than one-half of the credit value of large donations is claimed by just 9 of the 71 donations.
- In the last two years, large donations have accounted for 75% or more of the credit value, while representing just over one-third of the acreage conserved.



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Breakdown of Large Donations

Appraised Value	# of Credits	# of Acres	Credit Req'd
\$1.2M – \$4.99M	58	19,803	\$62,791,930
\$5.0M-\$10.0 M	4	654	\$14,886,500
>\$10.0M	9	5,962	\$81,632,990
Total	71	26,419	\$159,311,421



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Breakdown of Large Donations cont'd

Tax Year	% of Credits	% of Acres	% of Credit Requested
2000	8%	12%	40%
2001	8%	10%	25%
2002	8%	22%	51%
2003	17%	37%	76%
2004	22%	36%	75%

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Comparative Donation Statistics

- The credit value per acre of these large easements (>\$600,000) is significantly higher than those below this threshold.
 - ◆ The average credit value for easements of \$600,000 or less is \$1,234 per acre.
 - ◆ The average credit value for easements over \$600,000 is \$6,030 per acre.



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Comparative Donation Statistics

- These per acre disparities are even greater for the largest easements.
 - ◆ The average credit value of easements from \$5-\$9.9 million is \$22,762 per acre.
 - ◆ The average credit value of easements over \$10 million is \$13,692 per acre.



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Comparative Donation Statistics

Type	# Credits	# Acres	Credits Req'd	Avg Credit	Avg/Acre
Large Donation	71	26,419	\$ 159,311,421	\$ 2,243,823	\$ 6,030
Small Donation	433	66,457	\$ 82,001,693	\$ 189,380	\$ 1,234
Grand Total	504	92,876	\$ 241,313,114	\$ 478,796	\$ 2,598



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Transfer History

- \$165 million (77%) of the credit value for easements donated in 2002-2004 has been transferred.
- While a small portion of these have been transferred to family members or related parties, most have been sold to third parties for less than face value.
- Although our data is not complete, it appears that credits are being transferred (sold) for 50-80% of their face value.



Transfer History

Tax Year	#of Credits	# of Recipients	Amt Transferred	% of Total
2002	95	1,366	\$ 32,052,263	71%
2003	81	1,110	\$ 54,157,695	84%
2004	111	1,358	\$ 78,796,099	76%
Grand Total	287	3,834	\$165,006,057	77%



LPC Claimed on Returns

- Through May 2005, \$61.9 million of Land Preservation Credits have been claimed on 3291 returns.
- Therefore, there are \$169 million in credits that are being carried over or transferred to be claimed in future years.



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LPC Claimed on Returns

Tax Year	# of Returns	Amount Claimed
2000	168	\$ 2,216,991
2001	247	\$ 3,501,694
2002	396	\$ 4,985,817
2003	1,253	\$ 30,503,024
*2004	1,227	\$ 20,709,385
Grand Total	3,291	\$ 61,916,911

* Thru May 2005



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Easement Value

The proportion of fair market value attributable to a conservation easement increases with the development potential of the property.

Many Virginia land trusts believe that a decline in value as a result of donating a conservation easement normally ranges from 30-40%.

- ◆ 49 easements with a credit value of \$48.7 million have a reduction in value ranging from 50-75%.
- ◆ 29 easements with a credit value of \$53.9 million, have a reduction in value greater than 76%.

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Easement Value Ratio

Reduction % Range	# of Donations	Credit Requested
0-25	55	\$ 20,365,373
26-50	188	\$ 69,949,436
51-75	69	\$ 48,667,887
76-100	29	\$ 53,932,677

*Does not include donations for 2000 & 2001 nor any gifts of land

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Who's Making Donations

- Individuals with large estate properties
- Business entities using LPC to generate capital for business development
- Speculators that broker structured deals through LLC's
- Real Estate Developers



Conservation Value vs Economic Benefit

- Partial easements on large tract developments
- Easements on land recently purchased for substantially less than easement value
- Donations by nonprofit entities where development potential is questionable



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Appraisal Issues

Quid pro quo

- Zoning consideration
- Enhancement of other property

Development Potential of Property

- Subdivision Development Method
- Rural Land

Current Zoning vs “What If”



Appraisal Issues

2005 Va. General Assembly, amendment to Code of Virginia § 58.1-512 B

- ◆ *“The value of the donated interest in land that qualifies for credit under this section, as determined in accordance with federal law and regulations, shall be subject to the limits established by U. S. Internal Revenue Code § 170 (e).”*

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Appraiser Penalties And Sanctions

IRS Notice 2004-41 (June 20, 2004)

- “[T]he Service intends to review promotions of transactions involving improper deductions for conservation easements. Promoters, appraisers and other persons involved in these transactions may be subject to penalties under §§ 6700, 6701, 6694.”



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Appraiser Penalties And Sanctions

- 2005 General Assembly, amendment to *Code of Virginia* § 58.1-512 B
 - ◆ *“In the event that any appraiser falsely or fraudulently overstates the value of the contributed property in an appraisal that the appraiser has signed, the Department may disallow further appraisals signed by the appraiser and shall refer the appraiser to the Real Estate Appraiser Board for appropriate disciplinary action pursuant to § 54.1-2013, which may include, but need not be limited to revocation of the appraiser’s license.”*

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FAÇADE EASEMENTS

- 2005 Va. General Assembly, Acts of Assembly Chap. 940 (Senate Bill 1139), second enactment clause
 - ◆ *“ No donation or portion of a donation of an easement on or other interest in an historic building or a functionally related complex of historic buildings made on or after January 1, 2005, but before July 1, 2006, shall qualify for a land preservation credit under this article unless the building or complex of buildings is individually designated as an historic landmark pursuant to §10.1-2206.1 for listing in the Virginia Landmarks Register and the easement or other interest imposes restrictions on all exterior surfaces of the building or buildings.”*

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The issue is joined . . .

- VaTAX questions one project, meets with representatives
 - ◆ Wealthy out-of-state H&W investors form LLC and purchase a large, rural Va. tract
 - ◆ LLC splits tract into two parcels and donates a conservation easement on one to Ducks Unlimited holding company
 - ◆ LLC retains appraiser who uses subdivision development method of appraisal
 - ◆ Investment broker creates an investment LLC and sells memberships
 - ◆ Investment LLC buys tax credits transferred from donor LLC
 - ◆ Investment LLC distributes tax credits to members and dissolves

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The issue is joined, cont'd

- VaTAX takes steps to challenge
 - ◆ Three appraisals conducted, two independent
 - ◆ Average of the three used as proper valuation
 - ◆ Issued 130+ notices to credit transferees of intention to devalue donation by 90%
 - ◆ Issued assessments for the difference to 120+ taxpayers who claimed devalued credits on their returns

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The issue is joined, cont'd

- Donor LLC takes steps to challenge VaTAX
 - ◆ Administrative appeals skipped
 - ◆ Appeal filed in court, seeking injunctive relief for immediate rescission of assessments
 - ★ *Ware Creek Preserve, LLC, et al. v. Virginia Dept. of Taxation, et al.*, Circuit Court of New Kent County, Chancery No. CH05000045-00
- Court responds to lawsuit
 - ◆ Sets a hearing promptly
 - ◆ Denies preliminary injunction to rescind assessments
 - ◆ Secures forbearance of collection by VaTAX
 - ◆ Directs plaintiff to bring 120+ taxpayers assessed into the case, or otherwise bind them to the result

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More to come . . .

- VaTAX challenges to other projects in the works
- General Assembly Joint Subcommittee to study the issues this summer and report
 - ◆ Unanimous concern to curb abuses
- IRS on the case; sharing information
- Public & private conservation organizations acting as donees are concerned about abuses and are cooperating with VaTAX
- Appraisal professionals concerned about abuses
- Legitimate promoters are condemning abuses
- The press, on its own, is covering some projects as abuses of the public fisc

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**. . . and the Tax
Commissioner saw that it
was good, but it could be
better.**

The End

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Federal Moves in the Works

Senate Finance Committee hearing June 8, 2005

- Eliminate deduction for donors who continue to live on the property; reduce to 33% of value of rights given up for owners who do not live on land
- Limit deductions to price originally paid for the property
- Require appraisers to be certified in tax valuation
- Set uniform standards for appraisals
- Impose penalties for inflated appraisals
- Require second opinions on very large donations
- Restrict changes to property use after donation
- Crack down on land trusts for failure to monitor and enforce
- Enhance transparency of reporting

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IRS Moves in the Works

Senate Finance Committee hearing June 8, 2005

- Must be exclusively for conservation purposes
- Must be visual access to property
- Values cannot be fanciful
 - ◆ Cannot value on basis of development that will never happen
 - ◆ Cannot assume major zoning change
 - ◆ Cannot assume low development costs
- Must be public access
- Property cannot be ordinary in character
- Sanctions against land trusts for failure to enforce
- Appraisal standards should be developed

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