

Annual Report

Conservation Easement Tax Credit Certificates

Applications Submitted in Calendar Year 2018

Effective as of February 21, 2019



COLORADO

**Department of
Regulatory Agencies**

Division of Conservation



The Colorado Division of Conservation protects the public

We ensure the soundness of the state income tax credits issued to landowners who donate conservation easements

- by determining the credibility of appraisals,
- by assuring that the deeds of conservation easement protect conservation purposes in perpetuity, and
- by certifying non-profit and government organizations to hold conservation easements where their donors will seek a tax credit.

This 2018 annual report, as required at section 12-61-1106(13)(a), C.R.S., includes aggregate information about conservation easement tax credit applications deemed complete after December 31, 2017 and before January 1, 2019. The information is current as of February 21, 2019.

I. Introduction

History

Between 2000 and the end of 2008, the conservation easement income tax credit program was administered by the Department of Revenue (DOR). Between then and the end of 2013, parts of the program's administration remained within the DOR, and the Division of Real Estate (DRE) within the Department of Regulatory Agencies (DORA) began to assume a larger role. From January 1, 2014 through May 29, 2018, the program was administered entirely within the DRE, although the DOR continued its pre-2014 examination and enforcement activities.

On May 29, 2018, House Bill 18-1291 was signed into law. It created the new Division of Conservation (Division) within DORA, and moved administration of the tax credit, certification of conservation easement holders, and the Conservation Easement Oversight Commission (Commission) out of the DRE into this new division. This was done to keep a firewall between the disciplinary activity in the DRE and the professional evaluation activity in the Division. It also allowed landowners to exercise their private property rights while protecting taxpayers from the fraud and abuse that existed in the tax credit program prior to 2009.

Accordingly, this 2018 annual report summarizes activity that occurred in the DRE from January 1, 2018 through May 29, 2018, and in the new Division thereafter.

Program Process

The Commission and the Division Director approve or deny an application for a tax credit. The Commission has the authority and responsibility to determine whether the conservation easement donation associated with the application is a "qualified conservation contribution" under section 170(h) of the Internal Revenue Code and any federal regulations promulgated in connection with this section. The Director determines whether the donation is supported with

a credible appraisal prepared by a qualified appraiser. Applications that meet both requirements are approved, and applicants receive tax credit certificates.

Division staff assists the Commission and the Director by reviewing each application for compliance with relevant state statute, federal law, and associated rules and regulations. Specifically, the Division staff examines the appraisal, the conservation easement deed, and other aspects of the donation using objective compliance checklists.

The Division also administers the tax credit cap, an annual aggregate limit on the total dollar amount of conservation easement tax credits available for a given year. For calendar year 2014 and thereafter, the statutory tax credit cap is \$45 million.

In general, the amount of the income tax credit a taxpayer (landowner) can use is limited to the landowner's net tax liability. If the amount of conservation easement tax credit exceeds the landowner's state income tax liability, the excess credit may be carried forward for up to 20 years after the first year it was eligible to be claimed. This means that the Division may continue to receive tax credit applications for conservation easements recorded in prior years, so long as the cap for that prior year has not been met. For example, in 2017, the DRE received applications for easements contributed to certified holders in 2015 through 2017.

In 2018, DORA's two divisions received applications for easements contributed to certified holders in 2015 through 2018. Also, as a result of settlement of potential litigation, the DOR issued one tax credit in 2018 against the 2013 cap for an easement contributed to a holder in 2011.

Conservation easement tax credit certificates also may be transferred, in full or in part, to other Colorado income tax payers and, in TABOR surplus years, the state must issue refunds to tax credit certificate holders.

Pursuant to sections 12-61-1106(7)(a) and (10), effective May 29, 2018, the Division must complete its review of all tax credit applications within 120 days, either by issuing the tax credit or sending the landowner a notice identifying potential deficiencies with the application (a Request for Additional Information, or RFAI¹). Prior to this date, these actions were required to have been completed within an average of 120 days after the date the application was deemed complete.

¹ Since the DRE began administering the program in 2014, this statutory notice has had different names. Irrespective, it offers the landowner 60 days, not counting extensions, to provide the Division with more information about the application. Often, this information consists of a new appraisal. Less often, it consists of a correction to the deed of conservation easement. This process allows the landowner sufficient time to clarify or correct the tax credit application.

Report contents

Section 12-61-1106(13)(c), C.R.S., requires the annual report to contain the following aggregate information for 2018:

- I. Total number of tax credit applications received, approved and denied, along with average processing times;
- II. For approved applications:
 - A. Total acreage under easement summarized by allowable conservation purpose;
 - B. Total appraised value of the easements;
 - C. Total donated value of the easements;
 - D. Total dollar amount of tax credits issued;

As provided for in statute, the annual report also may include additional easement-specific information that would otherwise be publicly available. Accordingly, this report includes information about the number of tax credit applications received, approved and denied, as well as those where a RFAI has been issued.

The report also shows, by county, the number of acres protected by easements associated with applications deemed complete in 2018. Prior year annual reports included information about the optional Preliminary Advisory Opinions, but none were submitted in 2018.

HB 18-1291 also authorized the Director, after consultation with the Commission, "to share publicly-available information regarding conservation easements with a third-party vendor for the purpose of developing and maintaining a registry of conservation easements in the state with a corresponding map displaying the boundaries of each easement..." section 12-61-1106(13)(c), C.R.S.

As of the effective date of this annual report, while the Division is collecting and retaining such information, pursuant to the Commission's request, no such information has been shared with any third-party vendor. First, no such vendor has requested any information. Second, section 12-61-1106(16) prohibits "public inspection of any documentation... obtained as part of an individual landowner's application..."

II. Tax Credit Certificate Applications Received in 2018

The two divisions received and deemed complete 42 tax credit applications related to conservation easement donations made in three separate calendar years, representing a 20% increase in 2018 applications over 2017:

<u>Year of Conservation Easement Donation</u>	<u>No. of Applications received in 2017</u>	<u>No. of Applications received in 2018</u>
2015	3	5
2016	17	3
2017	15	20
2018	<u>N/A</u>	<u>14</u>
Total tax credit applications received	35	42

Of the 42 applications deemed complete in 2018, 19 were submitted to the DRE prior to May 29, and 23 were submitted to the Division after May 29, 2018.

Outcomes and Application Processing Times as of February 21, 2019

No applications were denied in 2018.

Of the 42 applications deemed complete in 2018, examinations of 38 are complete; 36 applicants received state income tax credits, and two are preparing additional information to submit to the Division in response to an RFAI. The four remaining applications were received in November and December. Processing times for these four will not be known until the examinations have been completed.

As of the effective date of this report, the Division has issued three RFAIs for applications received in 2018. Concerns with one examination (appraisal-related) have been resolved and, as noted above, the applicant received a tax credit. The remaining two RFAIs were issued because the conservation easements may not have protected conservation purposes in perpetuity; both applicants are taking steps to address this concern and it is expected they will be resolved.

The average time to complete the examination of these 38 applications and issue either tax credit or an RFAI is 111 days, within the statutorily required period.²

In the 35 applications that had no issues, the average processing time to issue the tax credit certificates TCC was 110 days. In all but two cases, the credits were issued within 120 days of the applications having been deemed complete. In the case of the two applications where

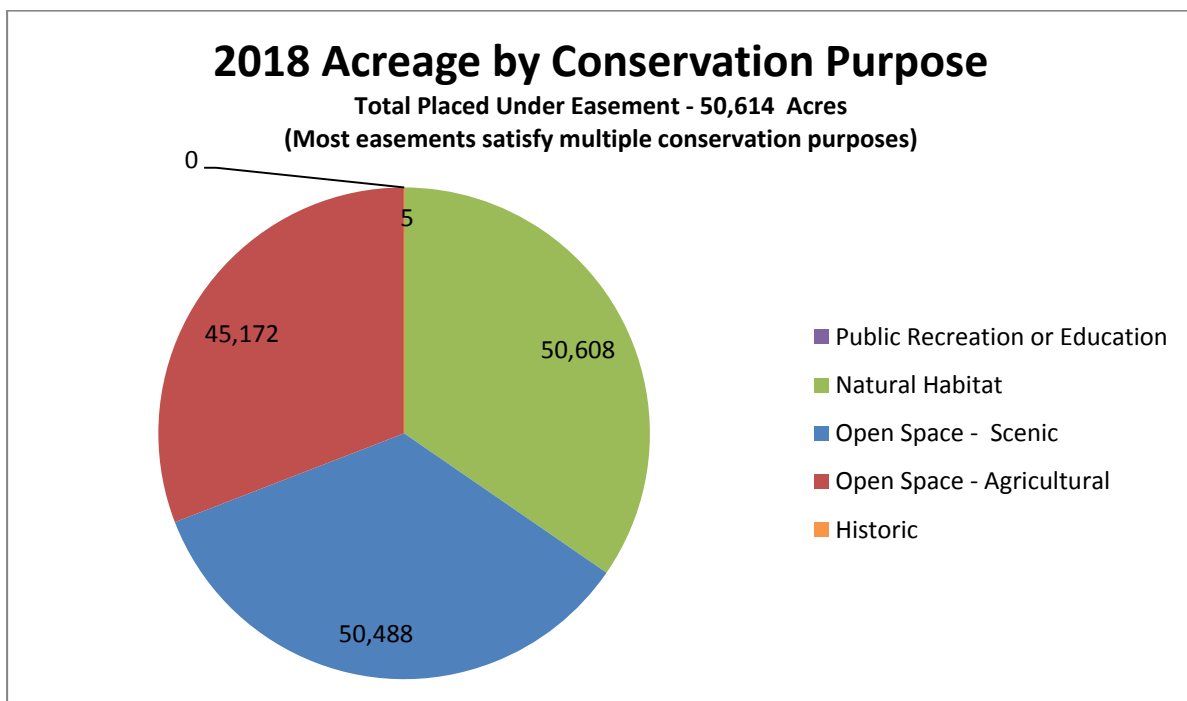
² Following separation of the tax credit program from the DRE, staffing decreased. From May 30 through December 31, 2018, continuing through the effective date of this report, the new Division's staff consisted of just two persons, the Director and one application examiner. During the time the program was administered in the DRE, program staff consisted of one program manager, two to four staff examiners, occasional independent appraisal examiner contractors, and general administrative support.

time to issue the credit exceeded 120 days, both applications had been deemed complete well prior to May 29, 2018; the 120-day average still applied.

Total acreage under easement summarized by allowable conservation purpose

(For the 36 Applications Deemed Complete in 2018 for which tax credits have been issued, as of February 21, 2019)

Since most easements satisfy more than one conservation purpose, the gross encumbered acreage, 146,273 acres, exceeds the 50,614 acres of net land area encumbered by easements:



Section 170(h)(4)(a) of the Internal Revenue Code sets forth the four allowable conservation purposes. To qualify for a tax credit, the conservation easement must satisfy at least one of these purposes, in perpetuity:

1. Preservation of land area for outdoor recreation by, or the education of, the general public (*five acres*)
2. Protection of relatively natural habitat of fish, wildlife, or plants, or similar ecosystem (*50,608 acres*)
3. Preservation of open space,
 - a. for scenic enjoyment (*50,488 acres*)
 - b. farmland and forest land - agriculture (*45,172 acres*)
4. Preservation of an historically important land area or a certified historic structure (*no such conservation easements in 2018*)

Easement Valuation and Amount of Tax Credits Issued

(For the 36 Applications Deemed Complete in 2018 for which tax credits have been issued, as of February 21, 2019)

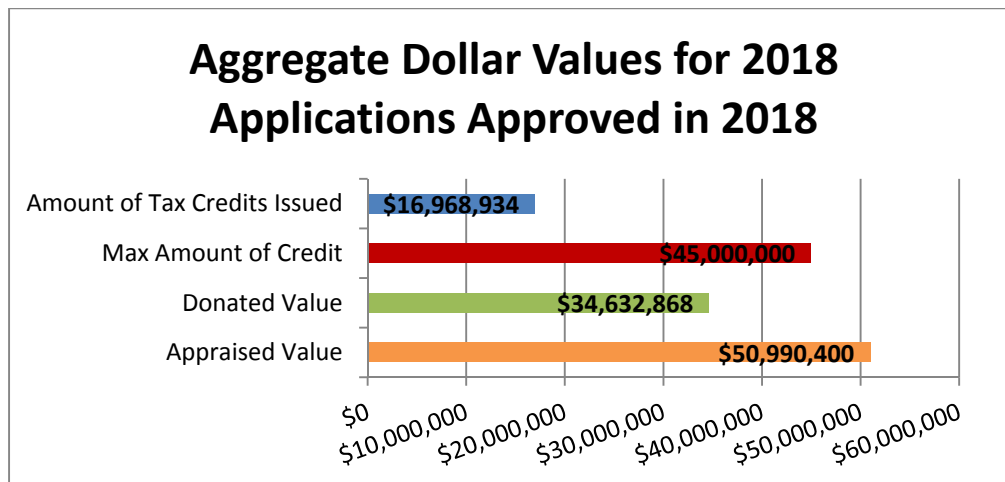
The qualified appraisal submitted with each tax credit application sets forth the appraiser's opinion of the fair market value of the conservation easement. This value opinion is the basis for calculating the amount of the applicant's Colorado income tax credit.

State and federal statutes allows landowners to

- donate a conservation easement outright to a certified holder (full donation),
- donate a portion of the easement's value and be compensated, in cash or other valuable consideration, for a portion of its value (bargain sale), or
- be compensated (paid) the full value of the easement.

For a conservation easement to qualify for a tax credit, it must have a charitable component, either a full donation or a bargain sale; this is sometimes referred to as donative intent.³ Easements where a landowner receives full value in exchange for the easement do not qualify for a Colorado income tax credit.

For bargain sale easements, an applicant must deduct the amount of its proceeds from the appraised value of the easement before calculating the allowed amount of the tax credit. In addition, applicants who have donated an easement within one year of the date when they purchased the property are subject to other limitations on the amount of appraised easement value that can be used to calculate the tax credit.

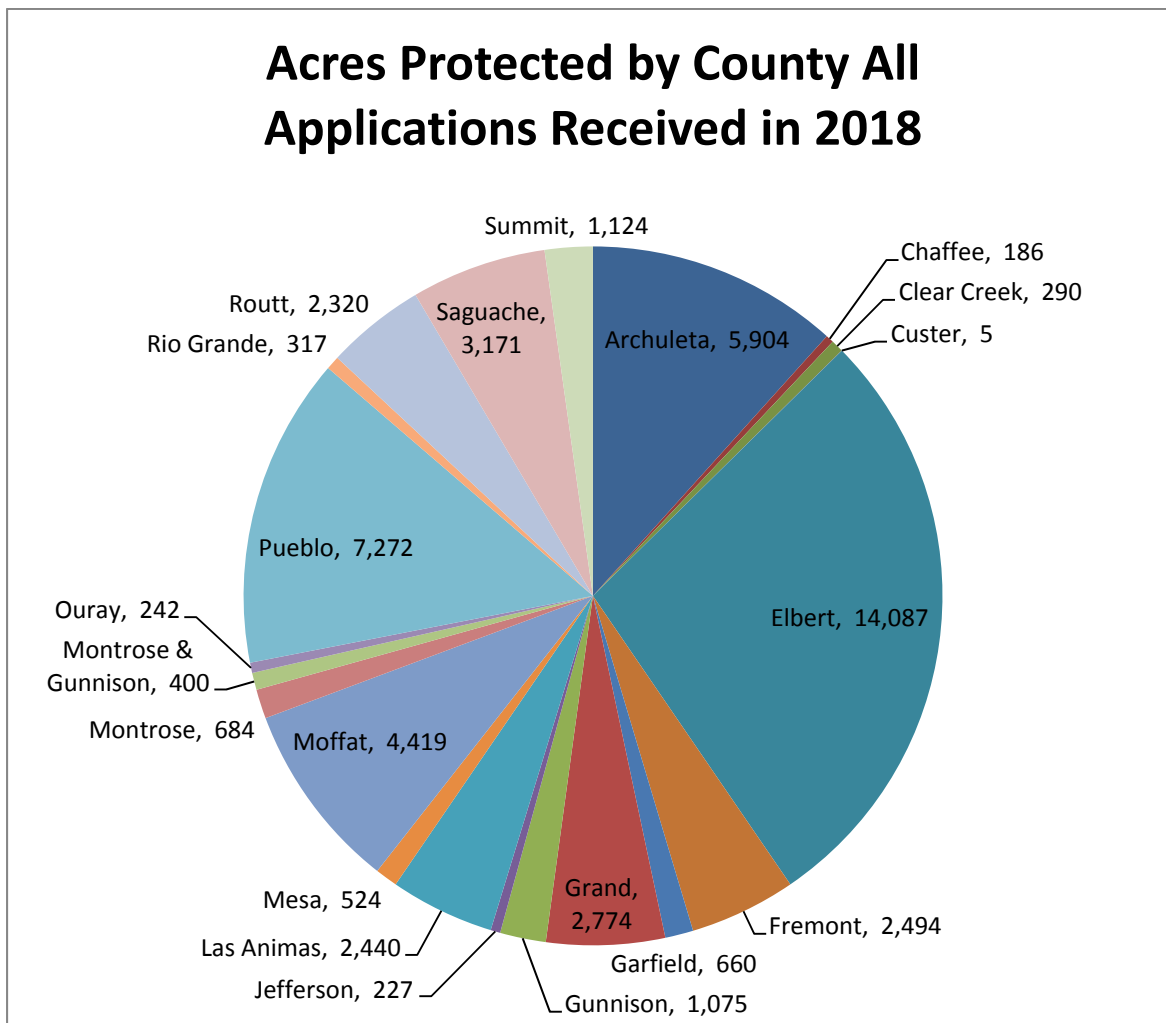


³ Section 12-61-1106(1)(a) requires compliance with section 170(h) of the Internal Revenue Code and any federal regulations promulgated in connection with this code section. The landowner's "qualified appraisal" must comply with section 170(f) of the Internal Revenue code and any federal regulations promulgated in connection with this code section. Section 39-22-522(2)(B), C.R.S. specifies that a "...credit shall only be allowed for a donation that meets the requirements of section 170 of the federal "Internal Revenue Code of 1986", as amended, and any federal regulations promulgated in accordance with such section. The amount of the credit shall not include the value of any portion of an easement on real property located in another state."

Additional Information Otherwise Publicly Available

(For the 36 Applications Deemed Complete in 2018 for which tax credits have been issued, as of February 21, 2019)

Conservation easements encumbered properties in 20 of Colorado's 64 counties:



III. Preliminary Advisory Opinions

The Division also offers an optional Preliminary Advisory Opinion, informing an applicant whether the anticipated donation is likely to be approved for a tax credit. PAOs may be requested for a proposed donation's conservation purpose, appraisal, or other relevant aspect of the transaction. Pursuant to section 12-61-1106(14)(b), C.R.S., the Division, Director and Commission shall issue "favorable" or "unfavorable" opinions.

In 2018, the Division received no applications for preliminary advisory opinions.

For more information regarding conservation easement tax credit certificates, please contact the Division at 303-894-2305.