Conservation Easements: A Rapidly Developing Legal & Regulatory Landscape

Recent Developments in Colorado

Overview

Following the passage of House Bill 11-1300, the Conservation Easement Tax Credit Unit, in the Colorado Attorney General's Office was created to represent the Department of Revenue (DOR) in litigation over denied conservation easement tax credits.

Thompson

In the first conservation easement tax credit case to go to trial, *Thompson v. Brohl*, Otero County District Court Case No. 11CV95, the court invalidated the taxpayer's tax credit.

Thompson

In an Order issued January 22, 2013, the trial court held that the taxpayers failed to comply with the filing and recordkeeping requirements of the federal and state tax codes.

Thompson

"The purpose of the substantiation requirements is to bring to the attention of the taxing authorities information that is pertinent in weighing the contents of the conservation easement tax credit claims against the statutory requirements."

Thompson

Although the taxpayer provided information to the DOR, "the information provided by her was not in a form easy for DOR to evaluate and it contained various deficiencies when compared to the substantiation requirements."

Though the easement donation did "not violate the perpetuity requirements, the Court determines that cumulative defects exist in Plaintiff's filing and recordkeeping." The court concluded that the Plaintiff failed to substantiate her eligibility for a tax credit.

Farm Deals

In *Farm Deals, LLLP v. State of Colo.*, Bent County District Court Case No. 2011CV24, on April 16, the court invalidated four tax credits.

Farm Deals

Plaintiffs argued that an extinguishment clause contained in the Conservation Easement deeds allowing termination of the easement upon mutual consent fulfilled the perpetuity requirement because any associated proceeds would nonetheless go to the donee.

Farm Deals

DOR noted that the language in these conservation easement deeds was the very same language used in the easement deeds that were at the heart of *Carpenter v. C.I.R.*, T.C. Memo 2012-1 *8 (2012).

The court also looked to *Belk v. C.I.R.*, 140 T.C. 1 *4-7(2013) which held that a contribution of real property was not subject to a use restriction granted in perpetuity where the restriction on development was trumped by a specific provision permitting the parties, by mutual consent to substitute portions of property subject to the easement.

Farm Deals

“[A] restriction on the ‘use which be made of real property’, and its ‘conservation purposes’, is not sufficiently granted in perpetuity if a deed permits termination of the restrictions solely upon mutual consent of interested parties.”

Farm Deals

Plaintiffs also argued that notwithstanding the extinguishment language of the conservation easement deeds, Colorado's *cy pres* doctrine protected the easement purposes in perpetuity by requiring the donee or the Attorney General for the State of Colorado to file suit and reform the instrument to ensure the perpetuity of the gift.

Farm Deals

Applying Colorado's charitable trust doctrine, the court noted that the law was unclear as to the holder's duty to inform the Attorney General that the parties were seeking extinguishment upon mutual agreement.

The court cited to *Walter v. Otero County Land Trust*, 05-CV-96 Order (Otero County District Court, June 21, 2005)noting the Attorney General was not provided notice in that matter dealing with the extinguishment of a conservation easement.

Farm Deals

The conservation deed itself was not silent on the extinguishment of the easement.

The court declined to apply the *cy pres* doctrine to reform the deed and remove the ability to extinguish the deed by mutual consent, where the very language of the deed clearly expressed the (contrary) intent of the parties.

Farm Deals

Plaintiffs also argued that the provision under section 39-22-522(6), C.R.S., limiting a taxpayer to a single claim of credit per taxable year only applied on the entity level for a pass-through entity, and not to the partners owning the entity.

In this case a property was subdivided into four parcels. Four pass through entities (LLLPs) each received a parcel, donated a conservation easement and claimed a tax credit. The same two taxpayers were the general partners for all four entities.

Farm Deals

The court found that Plaintiffs as the general partners were individually liable for the taxes of the LLLP and were also jointly subject to the same limitations under section 39-22-522(6), C.R.S. Plaintiff's interpretation allowed taxpayers to improperly bypass the mandatory aggregate tax credit limitations.

Atherton

In *Atherton v. Brohl*, Jefferson County District Court Case No. 2011CV4124, the Department argued, that the underlying appraisals were not "qualified appraisals" and lacked substantive methodological requirements set forth in the U.S. Treasury Regulations.

Atherton

The court found the appraisal for the later donation (2005) did not provide an objective assessment of the highest and best use of the property pursuant to Treas. Reg. § 1.170A-14(h)(3) and did not set forth a sufficient method or specific bases of valuation under Treas. Reg. § 1.170A-13(c)(3)(ii)(J)-(K).

Atherton

The court found that the appraisal lacked adequate support for its feasibility analysis and for its conclusion that the subject property has a high probability of being rezoned.

The court also found that the culmination of the appraisal's deficiencies made the valuation analysis difficult to follow and burdensome to evaluate for whether overvaluation may have occurred. The qualified appraisal regulations' purpose was not achieved because the cumulative effect of the defects deprived the DOR of sufficient information to evaluated the tax credits.

Legislative update

Senate Bill 13-221 and House Bill 13-1183 were signed into law on May 23, 2013. These bills provide several changes to Colorado's conservation easement tax credit program. These legislative changes are effective January 1, 2014.

Legislative update

House Bill 13-1183 extends the existing tax credit cap beyond 2013 and increases the annual cap to $45 million. Therefore, if a credit is claimed in 2013 after the $34 million cap is met, the credit will be waitlisted and a certificate will be issued for the 2014 tax year.

Legislative Update

Under Senate Bill 13-221 the Division of Real Estate (DRE) will be responsible for approving a conservation easement donation and the tax credit associated with that donation. The DOR will no longer be involved in the conservation review process. DOR will still have the authority, for good cause shown, to review, accept or reject in whole or part the use of the credit, except where the authority lies with DRE. Missing, inaccurate or incomplete tax filings will be challenged by DOR.

Status of CE Tax Credit Cases – AG's Office (December 31, 2013)				
	Region 1	Region 2	Region 3	Total
Cases Filed in State District Courts	38	121	12	171
Cases Settled or Resolved in Principle	18	104	9	131
Remaining Cases	20	17	3	40

Orphaned Easements

State Auditor's recommendation – October 2012.

Evaluate options for protecting the State's investment of public resources in tax-credit-generating conservation easements when the conservation easement holder is no longer certified. Report back to the Legislative Audit Committee and the House and Senate Finance Committees by July 1, 2013, on viable options and pursue statutory and/or regulatory change, as appropriate. At a minimum, options that should be considered include (a) strengthening DRE's ability to investigate complaints against conservation easement holders that hold tax-credit-generating conservation easements, regardless of whether or not the holder is certified and (b) utilizing assignment clauses in the deeds for tax-credit-generating conservation easements that reserve the State's right to require the transfer of the easement to another certified conservation easement holder when the original holder ceases to exist; is no longer certified; or is unwilling, unable, or unqualified to enforce the terms and provisions of the easement.