

DEPARTMENT OF TAXATION

2013 Fiscal Impact Statement

1. **Patron** J. Randall Minchew

3. **Committee** House Finance

4. **Title** Land Preservation Tax Credits; Application
for Credits Prior to Any Donation

2. **Bill Number** HB 1694

House of Origin:

 X **Introduced**

 Substitute

 Engrossed

Second House:

 In Committee

 Substitute

 Enrolled

5. **Summary/Purpose:**

This bill would allow taxpayers to apply for conditional issuances of Land Preservation Tax Credits prior to the donation of land or an interest in land, and would remove the requirement that a taxpayer complete the conveyance of a donation in land or land interest prior to applying for Land Preservation Tax Credits. These provisions would apply to taxpayers requesting a credit of \$1 million or more that would require verification of the conservation value by the Department of Conservation and Recreation ("DCR").

To request the conditional issuance of Land Preservation Tax Credits, the taxpayer would be required to submit an application to the Department of Taxation ("the Department") and to DCR that clearly indicates that the application is for the conditional issuance of tax credits. The Tax Commissioner would be permitted to provide written notice to the taxpayer within 30 days after such application is filed that he has determined that a second qualified appraisal is warranted for purposes of determining the fair market value of the donation. If such notice is not provided, this bill would require that the Tax Commissioner conditionally issue any tax credits within 120 days of a complete application for tax credits. If a second qualified appraisal is prepared, the Tax Commissioner would be required to conditionally issue any tax credits within 180 days of notifying the donor, unless the donor has filed an appeal. The application would not be deemed complete until the fair market value of the donation is finally determined by the Tax Commissioner.

The Tax Commissioner's final determination would be required to conditionally issue the tax credits requested in whole or in part or deny the application for tax credits. If the Tax Commissioner denies any portion of the tax credits requested by the taxpayer, he would be required to include in the determination a finding of facts and the specific reasons for the denial.

If the taxpayer, upon receipt of the final written determination, completes the conveyance of the proposed donation, the taxpayer would be required to provide the Department with certified copies from the respective Virginia circuit court of the recorded deeds and instruments conveying the donation described in the taxpayer's application. The Department would be required to provide the taxpayer with written certification issuing the

tax credits that were conditionally issued within 60 days of receipt of such certified copies. In no case, however, would the Department be required to issue any tax credits if the conveyance of the land or interest in land does not conform to the proposed donation included in the taxpayer's application.

The provisions of this bill would be applicable to applications for tax credits first made to the Department of Taxation on or after January 1, 2014.

6. Budget amendment necessary: No.

7. Fiscal Impact Estimates are: Preliminary. (See Line 8.)

8. Fiscal implications:

Administrative Costs

To be able to provide preapproval for credit applications of \$1 million or more that require verification by DCR, the Department would incur administrative costs. Approximately 10 percent of total applications are for donations of easements valued at \$1 million or more. The Department's costs for reviewing such applications would be \$120,220 in Fiscal Year 2013 and \$228,640 annually in Fiscal Year 2014 and thereafter. These costs would include the costs of hiring one appraisal reviewer and one support person, as well as the costs associated with conducting second appraisals.

The Department currently recovers the costs that it incurs as a result of administering the Land Preservation Tax Credit from the two percent fee that is imposed on transfers of Land Preservation Tax Credits. However, Virginia law limits the amount that may be recovered to 50 percent of the total revenue generated by the fee, and this amount must be allocated between the Department and the Department of Conservation and Recreation. The remaining 50 percent is transferred to the Virginia Land Conservation Fund for distribution to the organizations that are responsible for enforcing conservation easements.

The costs that the Department routinely incurs for administering the credit are already close to the amount of funding currently available. Additionally, the amount of funding created by the transfer fee depends on the amount and timing of transfers, factors that are often unpredictable, and the number of transfers has been decreasing in recent years. As a result, the additional administrative costs that would result from this bill would increase the Department's costs above the amount of available funding and would require an appropriation of General Fund revenues.

Approximately 90 percent of the taxpayers that are required to submit applications to DCR already undergo this process. Accordingly, DCR would not incur significant administrative costs as a result of this bill.

Revenue Impact

This bill would have no revenue impact. However, in the absence of either the substitute discussed below or a budget amendment, the Department would not have enough

resources to address all transactions related to credits of \$1 million or more in the limited amount of time provided under this bill.

9. Specific agency or political subdivisions affected:

Department of Taxation
Department of Conservation and Recreation

10. Technical amendment necessary: Yes.

To avoid a negative impact on the General Fund, the Department recommends that a substitute be introduced to amend *Va. Code* § 58.1-513 to dictate that the Virginia Land Conservation Fund may only receive a portion of the transfer fee funding to the extent that additional funding is available after the Department and DCR have recovered all of their Land Preservation Tax Credit administrative costs. This change would likely provide enough funding to cover the costs of this bill. Without this change, the Department of Taxation would incur administrative costs that would require an appropriation of General Fund revenues to support the statutory requirements of a non-General Fund program.

Additionally, it is recommended that the following technical line amendments be incorporated into the suggested substitute:

Line 116, after verified
Insert: , or conditionally verified, respectively,

Line 148, after issued
Insert: , or conditionally issued,

11. Other comments:

Current Law

The Land Preservation Tax Credit is equal to forty percent of the fair market value of land or an interest in land located in Virginia which is conveyed for the purpose of agricultural and forestal use, open space, natural resource, and/or biodiversity conservation, or land, agricultural, watershed and/or historic preservation, as an unconditional donation by the taxpayer to a public or private conservation agency.

Beginning in calendar year 2007, the aggregate amount of Land Preservation Tax Credits that may be issued in any one year is subject to a cap. For 2007, the cap amount was \$100 million. Starting in calendar year 2008, the \$100 million cap must be indexed for inflation. For 2013, the cap is \$113,909,000. Taxpayers must apply to the Department of Taxation to receive Land Preservation Tax Credits and the credits are allocated on a first-come, first-served basis.

Pursuant to legislation passed during the 2011 General Assembly session, this credit cap must be increased by the amount of any credits previously issued but subsequently disallowed or invalidated by the Department. Such invalidated or disallowed credits must then be reissued in a subsequent calendar year.

The fair market value of qualified donations must be determined and substantiated by a qualified appraisal prepared by a qualified appraiser who is licensed in Virginia. Each appraisal must employ proper methodology and be appropriately supported by market evidence. As required by law, the Department has published guidelines for qualified appraisals that incorporate requirements under IRC § 170(h) and the Uniform Standards of Professional Appraisal Practice (USPAP). Among other requirements, USPAP and proposed federal regulations require that the appraisal be made within 60 days before the date of contribution.

To qualify for a tax credit, the qualified appraisal must be signed by the qualified appraiser and a copy of the appraisal must be submitted to the Department. Any appraisal that, upon audit by the Department, is determined to be false or fraudulent, may be disregarded by the Department in determining the fair market value of the property.

If the real property that is the subject of the donation was partitioned from or part of another parcel of land and any other portion of such parcel, or any land partitioned from such parcel of land, has been allowed a Land Preservation Tax Credit, or an application is pending for a Land Preservation Tax Credit, within three years of such donation and the tax credit that would otherwise be allowed to the donor is at least \$250,000, the conservation value must be verified by the Director of the Department of Conservation and Recreation ("DCR"). The Director must act on applications within 90 days of receipt of a complete application and must notify the taxpayer and the Department of Taxation of his action.

To receive a Land Preservation Tax Credits, taxpayers must apply after completing the donation by submitting forms prescribed by the Department in consultation with DCR. Credits must be issued in the order that each complete application is received. If more than one application is received at the same time, the credits with respect to those applications must be issued in the order that the conveyances were recorded in the appropriate Virginia circuit court. If a credit requires verification of the conservation value by DCR and such verification has not been received at the time the aggregate cap is reached for the calendar year, the credit shall be issued in the calendar year that the conservation value of the credit is verified.

During the 2011 session, the General Assembly passed legislation that clarifies that, if within 30 days after an application for tax credits has been filed, the Tax Commissioner provides written notice to the donor that the preparation of a second qualified appraisal is warranted, the application is not be deemed complete until the fair market value of the donation has been finally determined by the Tax Commissioner. The Tax Commissioner is required to make a final determination within 180 days of notifying the donor, unless the donor files an appeal. The donor has the right to appeal any decision in accordance with the Department's standard appeal process. Although the Department does occasionally request a second appraisal before issuing credits, in most cases the additional appraisal is requested in the course of an audit, administrative appeal, or litigation after the credit has been issued.

Proposed Legislation

This bill would remove the requirement that a taxpayer complete the conveyance of a donation in land or land interest prior to applying for Land Preservation Tax Credits for taxpayers requesting a credit of \$1 million or more that would require verification of the conservation value by the Department of Conservation and Recreation (“DCR”). Rather, such taxpayers would be permitted to apply for conditional issuance of Land Preservation Tax Credits prior to the donation of land or an interest in land.

To request the conditional issuance of Land Preservation Tax Credits, the taxpayer would be required to submit an application to the Department of Taxation (“the Department”) and to DCR that clearly indicates that the application is for the conditional issuance of tax credits. The Tax Commissioner would be permitted to provide written notice to the taxpayer within 30 days after such application is filed that he has determined that a second qualified appraisal is warranted for purposes of determining the fair market value of the donation. If such notice is not provided, this bill would require that the Tax Commissioner conditionally issue any tax credits within 120 days of a complete application for tax credits. If a second qualified appraisal is prepared, the Tax Commissioner would be required to conditionally issue any tax credits within 180 days of notifying the donor, unless the donor has filed an appeal. The application would not be deemed complete until the fair market value of the donation is finally determined by the Tax Commissioner.

The Tax Commissioner’s final determination would be required to conditionally issue the tax credits requested in whole or in part or deny the application for tax credits. If the Tax Commissioner denies any portion of the tax credits requested by the taxpayer, he would be required to include in the determination a finding of facts and the specific reasons for the denial.

If the taxpayer, upon receipt of the final written determination, completes the conveyance of the proposed donation, the taxpayer would be required to provide the Department with certified copies from the respective Virginia circuit court of the recorded deeds and instruments conveying the donation described in the taxpayer’s application. The Department would be required to provide the taxpayer with written certification issuing the tax credits that were conditionally issued within 60 days of receipt of such certified copies. In no case, however, would the Department be required to issue any tax credits if the conveyance of the land or interest in land does not conform to the proposed donation included in the taxpayer’s application.

The Department would be required to develop guidelines implementing the provisions of this bill. Such guidelines would be exempt from the Administrative Process Act.

The provisions of this bill would be applicable to applications for tax credits first made to the Department of Taxation on or after January 1, 2014.

Potential for Bargain Sale Consideration

The conditional issuance of a tax credit means that the taxpayer is assured of receiving a specific credit amount before he conveys the land or easement. The certainty of

receiving the credit under this bill may cause the credit to be characterized as consideration for the conveyance, which would cause the transaction to be characterized as a bargain sale for federal income tax purposes, i.e., partially a sale and partially a donation. In the case of a conservation easement, the transaction must qualify as a charitable donation under Internal Revenue Code § 170(h) in order to qualify for a Virginia Land Preservation Tax Credit. Therefore, only the portion of the transaction that is characterized as a donation for federal income tax purposes would qualify for the Virginia credit. The uncertainty about federal treatment of conditionally issued credits may complicate the process of conditionally issuing the credits and audit subsequent to the conveyance.

Similar Legislation

House Bill 1398 would require that, for any year that the Department has not received complete applications for enough Land Preservation Tax Credits to issue the maximum amount of credits allowed for that year, the remaining amount would be transferred to the Virginia Land Conservation Fund, the Civil War Site Preservation Fund, and the Virginia Farmland Preservation Fund.

House Bill 1462 would require the Department to assess additional taxes and penalties relation to Land Preservation Tax Credits within one year of the credit being claimed on an income tax return.

House Bill 1800 would increase the amount of the Land Preservation Tax Credit from 40 percent to 60 percent for any land that is conveyed for the purpose of a public park, public recreational facility, or public trail access easement, or for other public uses as identified by the Department of Conservation and Recreation.

House Bill 2034 would repeal the Land Preservation Tax Credit.

House Bill 2253 would repeal the Land Preservation Tax Credit and would make other significant changes to Virginia's tax structure.

cc : Secretary of Finance

Date: 1/17/2013 KLC
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