



CONSERVATION EASEMENT TAX CREDIT

Performance Audit, September 2012

Report Highlights



Dianne E. Ray, CPA
State Auditor

Department of Revenue
Division of Real Estate

PURPOSE

To determine whether there are effective internal controls in place at the Department of Revenue (DOR) and the Division of Real Estate (DRE) to ensure that conservation easement tax credits being claimed and used by taxpayers are valid.

BACKGROUND

- A conservation easement is an interest in real property with the purpose of promoting land conservation. The restrictions on development and other land uses imposed by a conservation easement are intended to maintain the property in a relatively undeveloped state.
- Taxpayers may claim a state income tax credit for all or part of a conservation easement that is donated to a certified governmental entity or nonprofit organization.
- As of 2009, nearly \$640 million in tax credits had been claimed for about 3,200 conservation easements. In return, landowners restricted development rights and other land uses on about 925,000 acres of land.

OUR RECOMMENDATIONS

- DOR should strengthen its conservation easement tax credit claim review process and improve its information management practices.
- DRE should strengthen its processes for reviewing conservation easement appraisals and certifying conservation easement holders.
- DOR, DRE, and the Conservation Easement Oversight Commission (CEOC) should ensure that the CEOC consultation process furthers the State's ability to determine the validity of conservation easement tax credit claims.
- DOR and DRE should evaluate options to better protect the State's investment of public resources in tax-credit-generating conservation easements.
- DOR, DRE, and the CEOC should work together to design a pre-approval process for reviewing and approving conservation easement tax credits.

DOR, DRE, and the CEOC agreed with our recommendations.

AUDIT CONCERN

The State foregoes a significant amount of annual tax revenues to incentivize land conservation. House Bill 08-1353 was intended to try to curb historical abuses of the tax credit and help ensure the validity and proper valuation of tax-credit-generating conservation easements. However, our audit demonstrates that more changes need to be made to strengthen the administration of Colorado's conservation easement tax credit to ensure that tax credits being claimed and used by taxpayers are valid.

KEY FACTS AND FINDINGS

- DOR's process for reviewing conservation easement tax credit claims and uses does not ensure coverage of a key requirement—the easement's conservation purpose—and other relevant risk factors.
- DOR's tax examiners do not sufficiently document their reviews of conservation easement tax credit claims and uses. Review documentation held little information about judgments made and conclusions reached.
- The CEOC consultation process is limited in its ability to help inform and facilitate DOR's decision making to allow or disallow tax credit claims. The CEOC tends to take a substantive compliance approach when reviewing conservation easement transactions that DOR refers for consultation, and the CEOC's deliberations tend to take on a landowner-centered perspective.
- DRE's appraisal review process is not sufficient to ensure that all appraisals of tax-credit-generating conservation easements undergo a desk review or that potential problems with appraisals are identified and referred for further investigation.
- DRE's certification process does not ensure that governmental entities and nonprofit organizations holding tax-credit-generating conservation easements continue to meet the minimum certification requirements.
- The State lacks adequate protections when governmental entities and nonprofit organizations that hold tax-credit-generating conservation easements are no longer certified.
- The State's current approach to administering the conservation easement tax credit creates uncertainty for the taxpayer and does not align review and decision-making responsibilities with those with the most appropriate and relevant expertise.
- Measuring the public cost of the conservation easement tax credit is generally straightforward. However, measuring the benefits the public has received in return is more difficult and limited because of a lack of available data.