



CONSERVATION EASEMENT CREDIT

EVALUATION SUMMARY | APRIL 2022 | 2022-TE24

| | | | |
|------------------------|--------|-------------------------|----------------|
| TAX TYPE | Income | REVENUE (TAX YEAR 2018) | \$23.9 million |
| YEAR ENACTED | 1999 | NUMBER OF TAXPAYERS | 362 |
| REPEAL/EXPIRATION DATE | None | NUMBER OF LANDOWNERS | 40 |

KEY CONCLUSION: The credit is meeting its purpose because it provides a substantial financial incentive for landowners to establish and donate conservation easements, and it has generally had a significant influence on landowners' decisions.

WHAT DOES THE TAX EXPENDITURE DO?

The Conservation Easement Credit is available to landowners who create a perpetual conservation easement and donate part or all of the easement's value to a certified land conservation organization. For easements donated on or after January 1, 2021, the credit is equal to 90 percent of the donated easement's fair market value.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute states that "Colorado's conservation easement tax credit program was designed to give landowners an incentive to conserve and preserve their land in a predominantly natural, scenic, or open condition."

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

The General Assembly may want to establish performance measures for the Conservation Easement Credit.



CONSERVATION EASEMENT CREDIT

EVALUATION RESULTS

WHAT IS THE TAX EXPENDITURE?

Conservation easements are legally binding agreements that impose limitations or prohibitions on a piece of land in order to fulfill specific conservation purposes. These agreements are created between the landowner and the designated holder of the conservation easement, which is typically a land trust or governmental entity. The easement holder is responsible for monitoring the property to ensure that the limitations imposed by the easement are upheld. Statute [Section 38-30.5-102, C.R.S.] provides that the limitations established under a conservation easement must be imposed for the purpose of maintaining the property predominantly:

- In a natural, scenic, or open condition,
- For wildlife habitat,
- For agricultural, horticultural, wetlands, recreational, forest, or other uses or conditions consistent with the protection of open land, environmental quality, or life-sustaining ecological diversity, or
- For other uses or conditions appropriate to the conservation and preservation of buildings, sites, or structures having historical, architectural, or cultural interest or value.

Under statute [Section 38-30.5-103(3), C.R.S.], conservation easements are perpetual by default, meaning that the property on which an easement is established will be subject to the easement's restrictions in perpetuity, even when the land is sold to or inherited by a new landowner. Although landowners give up certain rights with respect to

their land, such as development rights and surface mining rights, they continue to own the land and retain the right to use the property in any way that is not inconsistent with the easement. For example, a farmer or rancher may create a conservation easement to preserve the agricultural productivity of their land. Depending on the terms of the easement, this landowner may be able to make certain changes to the land in the future, such as planting different crops or building a new barn. However, other uses of this land may be inconsistent with the goal of preserving agricultural land, such as building multiple residential homes or subdividing the land into smaller parcels for sale.

Since the landowner permanently gives up certain rights with respect to the property's treatment, the property value of the land decreases as a result of the easement. The fair market value of a conservation easement is defined as the amount of property value lost as the result of establishing the easement, which is calculated as the difference between the property's value before the easement is established and the value after the easement is established, as determined by an appraisal. This fair market value is considered to have been donated and/or sold to the easement holder once the easement has been established. The landowner has effectively donated the entire fair market value to the easement holder if the holder does not provide the landowner with any compensation in exchange for the easement agreement. Alternatively, the landowner has sold the entire easement to the easement holder if the holder compensates the landowner for the entire fair market value. Landowners may also complete a bargain sale, in which the landowner receives payment for a portion of the easement's value and donates the remaining value.

The Conservation Easement Credit [Section 39-22-522(2)(b), C.R.S.] is available to landowners who create a perpetual conservation easement and donate part or all of the easement's value to a certified governmental entity or charitable organization, which serves as the easement holder. In order to qualify, the conservation easement donation must meet the requirements for claiming the federal deduction for qualified conservation contributions, as established in 26 U.S. Code,

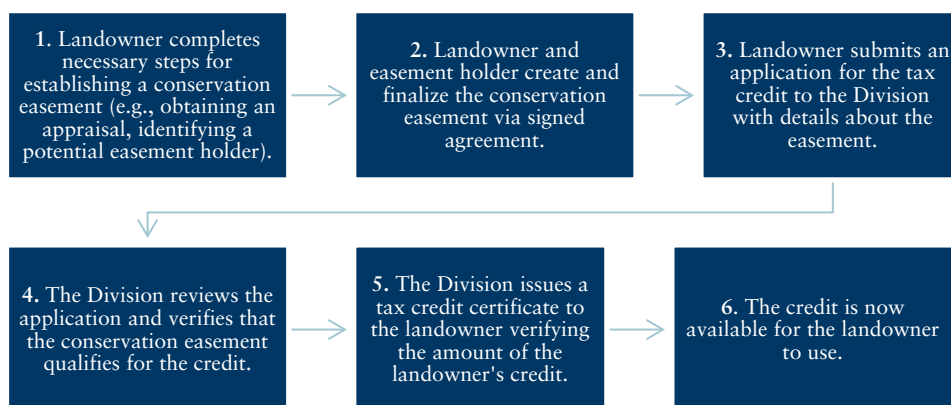
Section 170, and its related regulations. Among other things, this section of federal statute generally requires that a conservation easement:

- Be substantiated by a qualified appraisal. The appraisal must be conducted in accordance with generally accepted appraisal standards by a recognized professional appraiser who has verifiable education and experience in valuing conservation easements.
- Be donated to a qualified organization, which includes governmental organizations and most nonprofit organizations.
- Be donated exclusively for conservation purposes and be expected to yield a significant public benefit.
- Be perpetual.
- Not allow for surface mining.

For income tax years prior to 2021, the credit was available to most taxpayers, including resident individuals, corporations, pass-through entities and their co-owners, and estates and trusts. In 2021, the General Assembly broadened the definition of a taxpayer for purposes of the credit to include any person or entity filing a state income tax return; nonprofit entities; and irrigation districts, water conservation districts, and ditch and reservoir companies. Entities that are exempt from Colorado income tax receive a “transferrable expense amount” in lieu of the credit. Per statute [Section 39-22-522(7.5)(a), C.R.S.], this amount “shall be treated in all manners as a tax credit...including provisions governing the amount, valuation, and transfer of a tax credit; except that the transferable expense amount may only be transferred to a transferee to be claimed by the transferee...” The entity may receive payment from the transferee in exchange for the transferred amount, but statute does not require that this be the case in order for the transfer to occur.

The Division of Conservation (Division), housed within the Department of Regulatory Agencies, handles the majority of the credit's administration, including certifying conservation easement holders for purposes of the credit, reviewing various aspects of a conservation easement donation to verify that the donation qualifies for the credit, and issuing tax credit certificates to landowners who have submitted applications for a qualified donation. The Department of Revenue (Department) administers taxpayer claims of the credit. A high-level overview of this process is presented in EXHIBIT 1, and additional details about the administration of the credit are discussed later in this report.

EXHIBIT 1. OVERVIEW OF THE CONSERVATION EASEMENT CREDIT PROCESS



SOURCE: Office of the State Auditor analysis of Sections 12-15-106(3), (5), and (10), C.R.S., and Division of Conservation documentation.

The credit amount is calculated as a percentage of the donated portion of the easement's fair market value when the easement was created. For conservation easements donated between January 1, 2015, and December 31, 2020, the credit is equal to 75 percent of the first \$100,000 of the donated portion's value and 50 percent of the remaining donated value. For conservation easements donated on or after January 1, 2021, the credit is equal to 90 percent of the donated value. The credit is capped at \$5 million per donation for all donors of a given easement, including the aggregate amounts of two individuals (either married filing jointly or married filing separately) and the

individual co-owners of a single pass-through entity, such as partnerships and S corporations. Additionally, no more than \$1.5 million of a credit for a given donation may be certified in a given year. For credits exceeding \$1.5 million, the Division provides tax credit certificates in increments of no more than \$1.5 million per year over multiple years. For example, for a conservation easement donated in 2019 that generates a \$2.5 million credit, the Division would generally issue a \$1.5 million tax credit certificate for 2019 and a \$1 million certificate for 2020. There is also a \$45 million cap on the cumulative credits that may be certified by the Division for each calendar year. The Division uses the year in which a conservation easement was donated to track credit amounts for purposes of the annual cumulative credit cap. For example, if a taxpayer donated a conservation easement in 2017 but submitted the tax credit application in 2019, the credit generated counts toward the 2017 cumulative cap. Taxpayers may apply for a credit at any point after they have donated a conservation easement. Any applications for tax credit certificates exceeding the cumulative cap for a given calendar year are placed on a waitlist in the order submitted for the next calendar year for which the cap has not been met. No more than \$15 million in credits may be waitlisted for any given calendar year.

After the Division issues the tax credit certificate to the landowner, the landowner has four potential options for utilizing their credit:

- **THEY MAY OFFSET THEIR INCOME TAX LIABILITY WITH THE CREDIT.** If the landowner has sufficient income tax liability to claim the entire credit, they may do so.
- **THEY MAY CARRY THE CREDIT FORWARD.** If the amount of the credit exceeds the landowner's income tax liability for a single year, the remaining credit amount may be carried forward and claimed for up to 20 income tax years after the year for which the credit was certified.

- **THEY MAY TRANSFER THEIR CREDIT TO ANOTHER TAXPAYER.** Landowners may choose to transfer part or all of the credit to one or more other taxpayers, who may then claim the transferred credit amounts. Landowners with significant tax credits but low income tax liabilities may not have enough tax liability to claim their full credit amount, so they may choose to sell some or all of their credit at a discount to taxpayers with higher income tax liabilities. Optionally, landowners can use a tax credit broker to facilitate this process in exchange for a fee.

- **IN CERTAIN YEARS, THEY MAY ELECT TO HAVE A PORTION OF THE CREDIT REFUNDED.** If the amount of total state revenue exceeds the TABOR revenue limit [Colorado Constitution, Article X, Section 20(7)(a)] for the fiscal year ending in the income tax year for which the credit is claimed, and if voters have not authorized the State to retain all of the excess funds, landowners may claim part or all of their credit as a refund. The combined amount of the credit claimed and the amount refunded for all taxpayers that claim the credit for a single donation may not exceed \$50,000, excluding amounts transferred to or used by a transferee. Taxpayers may carry forward any unclaimed amounts that remain after the credit and refund are claimed. The TABOR refund option is not available to transferees.

Statute [Section 39-22-522(6), C.R.S.] provides that landowners may only receive the credit for one conservation easement donated in any given income tax year. If the landowner donates more than one qualified conservation easement in a tax year, they will only be certified for the credit and receive a tax credit certificate for one donation. However, they may claim credit amounts carried forward from previous donations with no restrictions, and they may also claim a new credit for a conservation easement donated in a subsequent tax year. Unlike the original donors of the conservation easement, transferees may hold credits from more than one conservation easement donation occurring in a given year.

Additionally, a tax credit held by an individual either directly or as a result of a donation by a pass-through entity may survive the death of the individual and be passed on to the individual's estate to be claimed or transferred. Credits held by a deceased transferee may be used to offset income tax owed by the transferee's estate but may not be transferred to other taxpayers.

Both credit amounts claimed and amounts paid to the landowner in exchange for transferring the credit to another taxpayer are subject to federal and state income tax. As discussed below, taxpayers may claim a federal income tax deduction for the fair market value of qualified conservation easement contributions. However, Internal Revenue Service (IRS) regulations [26 CFR 1.170A-1(h)(3)] require that taxpayers reduce their federal deduction by the amount of any state credit received that exceeds 15 percent of the donated value of the easement. Additionally, in *Tempel v. Comm'r (2011)*, the U.S. Tax Court ruled that Colorado Conservation Easement Credits are capital assets for federal income tax purposes. Therefore, the amount paid by a transferee to the transferor in exchange for the credit is taxable as a capital gain on the transferor's federal and Colorado income tax returns.

ADMINISTRATION: THE DIVISION OF CONSERVATION

In 2008, the General Assembly tasked the Division of Real Estate with establishing and administering a certification program for qualified conservation easement holders. Subsequent years added additional administrative requirements related to the Conservation Easement Credit, and in 2018, the General Assembly created the Division of Conservation and transferred all tasks related to the credit to the new Division, with the exception of administering taxpayer credit claims and transfers. The Division of Conservation administers the following aspects of the credit:

CERTIFICATION OF CONSERVATION EASEMENT HOLDERS. In order for a conservation easement donation to qualify for the credit, the

governmental entity or charitable organization to which the easement is donated must apply to become a certified conservation easement holder with the Division. Under statute [Section 12-15-104(1), C.R.S.], the purposes of this certification program are to (1) establish minimum qualifications for certifying organizations that hold conservation easements to encourage professionalism and stability and (2) identify fraudulent or unqualified applicants to prevent them from becoming certified. Entities must pay an initial application fee and an additional renewal fee for each year in which they are certified thereafter. The initial fee ranges from \$500 to \$2,000, and the renewal fee ranges from \$250 to \$1,000, depending on whether the entity is (1) accredited with a national land certification organization or not and (2) obtaining full certification, which allows them to accept new donated easements, or stewardship-only certification, which allows them to oversee previously donated easements but does not permit them to accept new donations for purposes of the credit.

APPLICATION FOR TAX CREDIT CERTIFICATES. Landowners must submit an application to the Division in order to receive a tax credit certificate, which documents the amount of the credit certified and allows the landowner to claim the credit with the Department. Statute [Section 12-15-106(2)(a), C.R.S.] establishes that the purpose of this application process is to determine whether a conservation easement donation (1) is a contribution of a qualified real property interest to a qualified organization to be used exclusively for a conservation purpose, (2) is substantiated with a qualified appraisal, and (3) meets the other statutory requirements for the donation to qualify for the credit. Landowners' applications must include, among other things, the final conservation easement appraisal, the recorded deed granting the conservation easement, documentation supporting the easement's conservation purpose, and an application fee of \$2,400. The Division approves an application for a tax credit certificate if the conservation easement meets the statutory requirements for qualified conservation easement donations and is substantiated by a qualified appraisal that the Division determines to be credible. The Division may deny applications that do not meet these requirements but must allow

landowners an opportunity to address any potential deficiencies in their applications prior to making a final determination.

Before donating an easement and applying for the credit, landowners may also choose to submit a proposed conservation easement donation to the Division to obtain an optional preliminary advisory opinion for a fee of \$2,000 or \$10,000, depending on the topic of the opinion. This opinion may address the proposed deed of conservation easement, the appraisal, the conservation purpose, or other relevant aspects of the transaction.

CREDIT CAP AND ISSUANCE OF TAX CREDIT CERTIFICATES. The Division issues tax credit certificates for approved applications in the order in which they were submitted. As previously discussed, there are several limitations imposed on the certification of credits—the \$5 million per-donation cap, the \$1.5 million annual cap on amounts certified for any donation that generates a total credit of more than \$1.5 million, and the \$45 million annual cumulative cap. The Division is responsible for managing these caps either through the issuance of tax credit certificates in specific amounts or by tracking the total amount of credits certified for conservation easements donated in each calendar year. For any given calendar year, the Division issues tax credit certificates first for previously approved applications that must be issued in multi-year increments (i.e., credits greater than \$1.5 million), then for waitlisted credit applications, and finally for new applications.

CREDIT TRANSFERS. Once landowners have received their tax credit certificates from the Division, they may choose to transfer part or all of the credit to one or more other taxpayers. The transferor and transferee must jointly file a copy of the written transfer agreement with the Division, which then issues new tax credit certificates in the appropriate amounts.

ADMINISTRATION: THE DEPARTMENT OF REVENUE

The Department administers taxpayer claims of the Conservation Easement Credit. Taxpayers claim the credit on their respective income tax returns:

- Individuals claim the credit on Line 25 of the 2020 Colorado Individual Income Tax Return (Form DR 0104).
- Corporations claim the credit on Line 29 of the 2020 Colorado C Corporation Income Tax Return (Form DR 0112).
- Pass-through entities, such as S corporations and partnerships, report the credit on Line 16 of the 2020 Colorado Partnership and S Corporation and Composite Nonresident Income Tax Return (Form DR 0106). Pass-through entities must allocate the amount of the credit to individual co-owners in proportion to their ownership percentage in the entity. Separate co-owners of pass-through entities may claim their separate shares of the credit on their respective income tax returns, or, if the individual co-owners are nonresidents, the pass-through entity may claim the credit on the co-owners' behalf on Form DR 0106.
- Fiduciaries claim the credit on Line 21 of the 2020 Colorado Fiduciary Income Tax Return (Form DR 0105).

Department regulations [1 CCR 201-2, Rule 39-22-522(7)(b)] require all donors claiming the credit to file a copy of the tax credit certificate provided by the Division and an IRS Form 8283 with a summary of the qualified appraisal. Taxpayers must also file all schedules that are specific to the credit and relevant to the taxpayer, which includes one or more of the following:

- GROSS CONSERVATION EASEMENT DONOR SCHEDULE (FORM DR 1305). Taxpayers use this form to calculate the amount of credit available to them, including factors such as percent interest in the easement and credit amounts transferred or carried forward by either

the taxpayer themselves or a pass-through entity on the taxpayer's behalf. This form must be filed by conservation easement donors who are claiming the credit for the first time, transferring the credit, or, in the case of pass-through entities, are passing the credit to individual co-owners. Taxpayers who are claiming a transferred credit or who are claiming a credit carried forward from previous years are not required to file this form.

- GROSS CONSERVATION EASEMENT CREDIT TRANSFER SCHEDULE (FORM DR 1305E). Donors of conservation easements use this form to report credit amounts transferred to other taxpayers.
- GROSS CONSERVATION EASEMENT CREDIT PASS-THROUGH SCHEDULE (FORM DR 1305F). Pass-through entities must use this form to report how the credit is passed through to their co-owners.
- GROSS CONSERVATION EASEMENT CREDIT USE SCHEDULE (FORM DR 1305G). Taxpayers, including both donors and transferees, may use this form in order to claim the credit and/or carry forward the credit to future tax years.

LEGISLATIVE HISTORY

The Conservation Easement Credit was enacted in 1999 by House Bill 99-1155. Since then, the General Assembly has frequently enacted substantive changes to the credit, including:

- INCREASED CREDIT CAP PER DONATION. When the credit was enacted, the maximum credit amount that could be claimed for a conservation easement donation was \$100,000. For most taxpayers, this was increased to \$260,000 in 2001; \$375,000 in 2006; \$1.5 million in 2015; and \$5 million in 2019.
- CHANGED CREDIT AMOUNT. The value of the credit has varied between 40 percent and 100 percent of the conservation easement's fair market value, subject to the per-donation caps discussed above.

Between 2006 and 2021, the credit's value increased from 50 percent to 90 percent of the fair market value.

- **IMPOSED ANNUAL CAP ON CUMULATIVE CREDIT AMOUNTS CERTIFIED.** When the credit was enacted, statute did not limit the total amount of credits that could be issued or claimed by taxpayers in a given year. In 2010, the General Assembly imposed a \$26 million limit on total annual credits that could be certified by the Division. Subsequent years saw varied annual limits until 2013, when the General Assembly imposed a permanent \$45 million limit per year for 2014 and beyond.
- **ADDED CERTIFICATION AND FILING REQUIREMENTS FOR TAXPAYERS.** Initially, taxpayers were required to file a qualified appraisal along with their income tax returns to claim the credit. Various bills required taxpayers to file an increasing amount of information with the Department, such as affidavits from appraisers and easement holders. Starting in 2010, taxpayers were required to file documentation to apply for a tax credit certificate, first with the Division of Real Estate, which previously administered tax credit certificate applications, and then, starting in 2018, with the Division of Conservation.
- **ADDED CERTIFICATION REQUIREMENTS FOR EASEMENT HOLDERS.** When the credit was enacted, statute did not impose any limitations on the governmental entities and charitable organizations permitted to hold a conservation easement for purposes of the credit. Between 2007 and 2008, the General Assembly added reporting and application requirements for these entities, all of which appear to have been designed to ensure that the holder of a conservation easement will be a good custodian of the property and the easement's conservation purpose.
- **CREATED THE CONSERVATION EASEMENT OVERSIGHT COMMISSION.** The General Assembly created the Conservation Easement Oversight Commission (Commission) in 2008 for the purpose of advising the

Division of Real Estate (later, the Division of Conservation) and the Department on issues related to conservation easements and the credit itself.

- **ADDED DISPUTE RESOLUTION PROCESSES.** In 2011, with the goal of providing for the equitable and expedited resolution of hundreds of then-existing credit disputes, the General Assembly created new dispute resolution procedures for credit claims that had been denied by the Department prior to May 2011. Landowners with disputed credits could elect to bypass an administrative hearing with the Department and appeal directly to a district court instead. The bill (House Bill 11-1300) also directed the Commission to review each of the disputed credits and provide an initial recommendation to the Department regarding whether the credit should be allowed or denied.

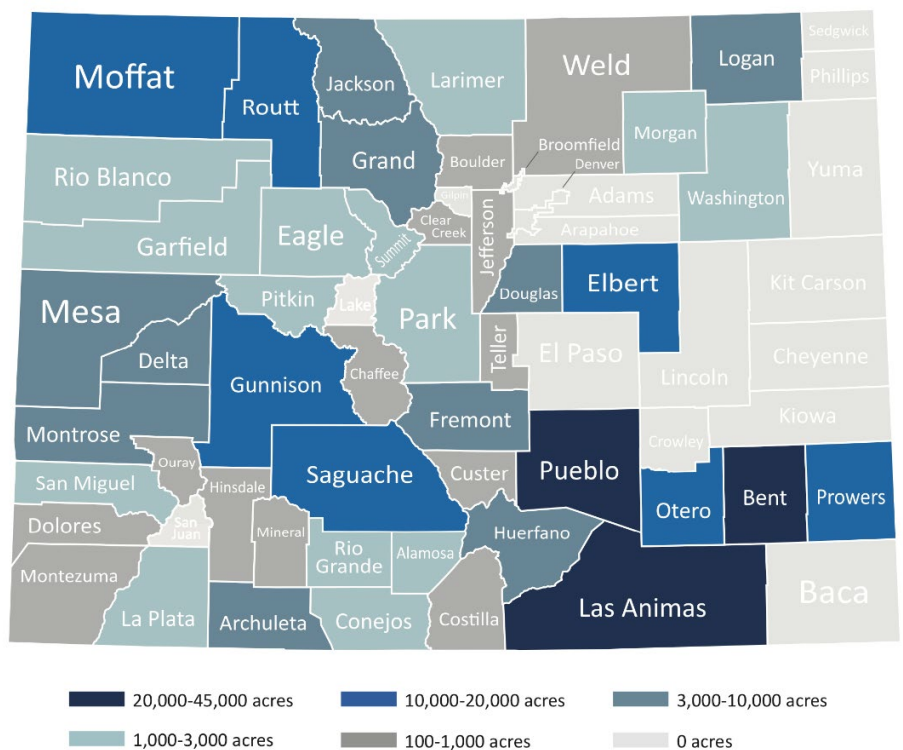
WHO ARE THE INTENDED BENEFICIARIES OF THE TAX EXPENDITURE?

Statutes [Sections 12-15-101(1)(c) and 39-22-522(2)(b), C.R.S.] provide that the Conservation Easement Credit is intended to benefit landowners who establish conservation easements on their property and donate some or all of the easements' value to a certified land conservation organization. Additionally, statute [Section 12-15-101(1)(a), C.R.S.] states that the credit has “allowed many farmers and ranchers the opportunity to donate their development rights to preserve a legacy of open spaces in Colorado for wildlife, agriculture, and ranching.” To the extent that the credit incentivizes landowners to conserve their property, the credit was also likely intended to benefit certified land conservation organizations, which may receive increased conservation easement donations, and Colorado residents, who may indirectly benefit from increased quality of life due to the conservation of land in the state.

The Land Trust Alliance estimated that Colorado landowners placed about 491,000 acres of land under conservation easements held by land trusts between 2015 and 2020. Additionally, Division data indicates

that landowners established conservation easements for which the credit was certified on about 288,000 acres of property in Colorado between 2016 and 2020. EXHIBIT 2 summarizes the acreage of these conserved properties by county. Finally, a 2017 study published by Colorado State University (CSU) estimated that almost 6 percent of privately owned land in Colorado has been protected by a conservation easement.

EXHIBIT 2. ACREAGE OF CONSERVATION EASEMENTS¹ DONATED BETWEEN 2016 AND 2020 THAT GENERATED CONSERVATION EASEMENT CREDITS BY COUNTY²



SOURCE: Office of the State Auditor analysis of Division of Conservation data.
¹Conservation easements may be established on properties of any size. Therefore, the total acreage protected by conservation easements in a given county is not necessarily reflective of the number of conservation easements established in the county.
²The acreages of conservation easements that span county lines have been divided evenly between the counties.

WHAT IS THE PURPOSE OF THE TAX EXPENDITURE?

Statute [Section 12-15-101(1)(c), C.R.S.] states that “Colorado’s conservation easement tax credit program was designed to give landowners an incentive to conserve and preserve their land in a predominantly natural, scenic, or open condition.”

IS THE TAX EXPENDITURE MEETING ITS PURPOSE AND WHAT PERFORMANCE MEASURES WERE USED TO MAKE THIS DETERMINATION?

We determined that the Conservation Easement Credit is meeting its purpose because it provides a substantial financial incentive for landowners to establish and donate conservation easements, and landowners and representatives of the land conservation field generally reported that the credit has had a significant influence on landowners’ decisions.

Statute does not provide quantifiable performance measures for this credit. Therefore, we created and applied the following performance measure to determine the extent to which the credit is meeting its purpose:

PERFORMANCE MEASURE: To what extent has the Conservation Easement Credit encouraged landowners to protect their land by establishing conservation easements?

RESULT:

In order to assess the Conservation Easement Credit’s effectiveness, we analyzed Division data on certified credits, examined academic studies, and conducted two surveys: One for landowners who donated conservation easements between 2014 and 2021 and were certified for the credit (receiving a total of 108 responses) and another for certified land conservation organizations (26 responses). We determined that the credit reimburses landowners for a significant portion of their lost property value and serves as a strong financial incentive for landowners to establish conservation easements. However, landowners generally

reported that personal values and environmental concerns were the most influential factors in their decisions to create a conservation easement.

As discussed, establishing a conservation easement on a property generally results in a permanent reduction to the property value because the landowner gives up certain rights with respect to the property, such as development and surface mining rights. Therefore, mechanisms that reimburse the landowner for some of this lost property value make conservation easements a more financially viable option for many landowners. EXHIBIT 3 provides the estimated percentage of a conservation easement's fair market value that a landowner may have retained after establishing the easement, which varies depending on whether the landowner completed a bargain sale and whether they were certified for the credit. As demonstrated, we estimated that the typical landowner donating a conservation easement between 2016 and 2020 would have received a certified credit amount between 28 percent (with a bargain sale) and 55 percent (without a bargain sale) of the fair market value of their easement. Since the value of the credit is calculated based on the donated value rather than the total value, landowners who complete a bargain sale would receive a lower credit amount than landowners who donate the entire value of the easement. Based on information from a representative of the land conservation field, we assumed that a landowner completing a bargain sale would have received a payment of 50 percent of the easement's value. For the amount of the credit, we used the average credit amount certified for easements donated between 2016 and 2020 as a percentage of the easements' donated value (55 percent). Since House Bill 21-1233 increased the value of the credit to 90 percent of the donated value for donations occurring in 2021 onward, the percentages of a conservation easement's fair market value that the landowner retains will increase in the future from those provided in EXHIBIT 3. Additionally, bargain sales may become less common due to the increase in the credit's value.

**EXHIBIT 3. ESTIMATED PERCENTAGE
OF CONSERVATION EASEMENT'S FAIR MARKET
VALUE RETAINED BY LANDOWNER BASED
ON BARGAIN SALE AND CREDIT USAGE**

| Bargain sale completed? | Value of bargain sale | Easement certified for credit? | Value of certified credit ¹ | Total value retained |
|-------------------------|-----------------------|--------------------------------|--|----------------------|
| Yes | 50% | Yes | 28% | 78% |
| | | No | 0% | 50% |
| No | 0% | Yes | 55% | 55% |
| | | No | 0% | 0% |

SOURCE: Office of the State Auditor analysis of Division of Conservation data.

¹These values are calculated based on the average credit amount certified for conservation easements donated between 2016 and 2020, as a percentage of the donated portion of the easements' fair market value.

EXHIBIT 3 does not account for the additional expenses that landowners typically incur during the conservation easement process, such as legal fees, appraisal fees, and tax credit certificate application fees. As discussed, landowners may also be liable for federal and state income tax on the claimed amount of their credit and the payments received from other taxpayers in exchange for transferring the credit. These fees and income taxes would decrease the net value that landowners retain after creating the easement and claiming the credit.

Additionally, landowners who transfer part or all of their credit to other taxpayers do not receive the full value of their certified credit. Representatives of the land conservation community stated that landowners who sell their credits to other taxpayers typically receive about 85 percent of the credits' value in exchange for transferring the credits. In comparison, landowners who have sufficient income tax liability to claim their entire credit amount, whether in a single tax year or across multiple tax years, retain the entire value of their credit amount. Landowners who combine these two approaches, claiming a portion of their credit and transferring the remainder, would retain between 85 percent and 100 percent of their total credit amount. Despite the lost value resulting from the sale and transfer of the credit, 71 percent of landowners who responded to the relevant survey

question reported that they had transferred or planned to transfer some portion of their credit to one or more other taxpayers, and another 71 percent stated that the credit's transferability had increased their level of interest in the credit. This may be because landowners with low income tax liabilities may have no other way of using their entire credit, since the credit is only refundable in years when the TABOR revenue limit has been exceeded, and only up to a certain amount. In recent years, state revenue exceeded the TABOR limit in Fiscal Years 2015, 2018, 2019, and 2021.

Our survey of landowners who were certified for the credit indicated that the credit generally had a substantial impact on landowners' decisions to establish conservation easements. For example, 70 percent of respondents stated that the credit was either important or very important in their decision, and only 14 percent stated that the credit was either not important at all or minorly important in their decision. Several landowners also stated that they planned to use the funds from the credit to establish more conservation easements or to acquire neighboring properties for conservation purposes.

We also asked landowners to rate the importance of 10 factors that may have influenced their decision to establish a conservation easement. As demonstrated in EXHIBIT 4, personal values and environmental concerns tended to be the most motivating factors for landowners on average. However, among the five financial motivations listed, landowners reported that the Conservation Easement Credit was the most important factor in their decision. Certified easement holders provided similar responses as landowners, also indicating that the credit was generally the most important financial factor in landowners' decisions. It is important to note that our survey of landowners did not include landowners who have established conservation easements, but were not certified for the credit or who considered establishing a conservation easement, but decided against doing so. Therefore, these results may overstate the importance of the credit with respect to all landowners' decisions to an unknown extent.

EXHIBIT 4. FACTORS IN LANDOWNERS' DECISIONS TO ESTABLISH CONSERVATION EASEMENTS, RANKED IN ORDER OF IMPORTANCE

| | | |
|--|---|--|
| 1 | Concern about whether the land would continue to be protected under future inheritors or landowners | <p>Most Important</p> <p>Least Important</p> |
| 2 | Desire to protect family legacy and/or provide natural spaces for future generations | |
| 3 | Interest in protecting the land as a habitat for native species | |
| 4 | Interest in protecting the land's scenic or recreational value | |
| 5 | The Conservation Easement Credit | |
| 6 | Interest in maintaining the land's productive agricultural value | |
| 7 | Federal tax benefits | |
| 8 | To improve my or my family's financial wellbeing | |
| 9 | Concern about my financial ability to continue to own and/or maintain the land | |
| 10 | Interest in reducing my local property taxes | |
| <p>SOURCE: Office of the State Auditor analysis of survey results from landowners who were certified for the credit for at least one conservation easement that was donated between 2014 and 2021.</p> | | |

These results are supported by several academic studies of conservation easement donors, which generally found that the most motivating factors for landowners' decisions to donate conservation easements are personal values, including strong personal attachment to the land, concern about the long-term stewardship of the property, environmental motivations, and social motivations. Financial incentives were generally found to be less motivating factors, but most studies reported that they have some effect on stimulating conservation easements, with one survey indicating that up to 29 percent of

landowners would not have established conservation easements without financial incentives.

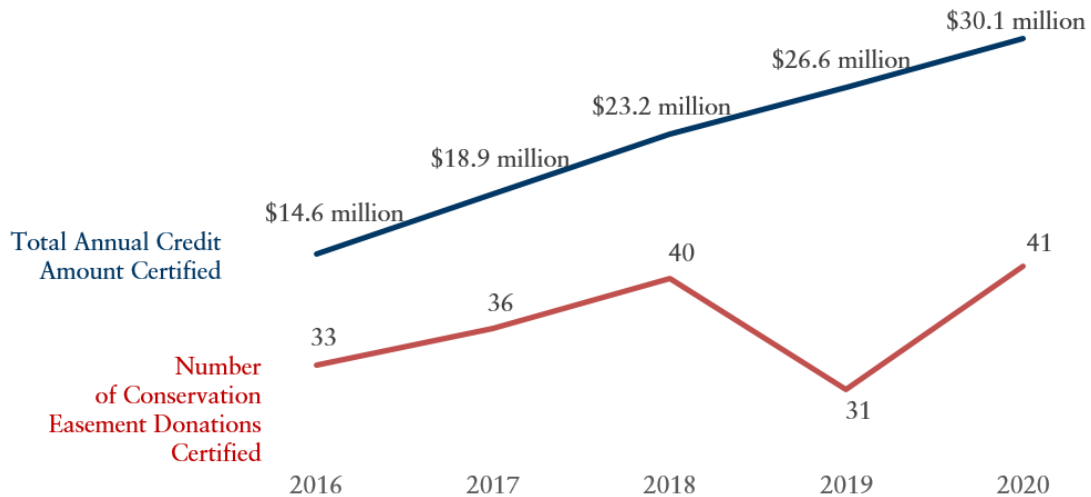
In addition to the credit, we also identified several other mechanisms that reimburse landowners for some of the property value lost as a result of establishing conservation easements. These include bargain sales; grant funding from various sources; and the federal income tax deduction for qualified conservation easement contributions. To the extent that a landowner benefits from each of these mechanisms, they may all have an effect on the landowner's decision to establish a conservation easement. However, we were unable to quantify the extent to which each mechanism may influence landowner decisions.

Finally, although conservation easements that are eligible for the credit generally protect a property's natural state in perpetuity, the creation of a conservation easement does not necessarily indicate that the property was at immediate risk for development or other land uses that may have threatened the property's natural state. However, we were unable to assess the extent to which the credit may have prevented land from being developed in the immediate future because there is no way to definitively determine what may have happened to any given parcel of land if the landowner had not established a conservation easement.

WHAT ARE THE ECONOMIC COSTS AND BENEFITS OF THE TAX EXPENDITURE?

According to Department data, the Conservation Easement Credit resulted in a total of \$23.9 million in forgone revenue to the State in Tax Year 2018. Additionally, as demonstrated in EXHIBIT 5, the Division has certified between \$14.6 million and \$30.1 million in credits per calendar year between 2016 and 2020, and the annual amount has increased from one year to the next. Since the Division is funded entirely by application fees from landowners and certified conservation easement holders, there are no appropriations from the General Fund for the Division's administration of the credit.

EXHIBIT 5. CONSERVATION EASEMENT CREDITS CERTIFIED BY CALENDAR YEAR (2016-2020)



SOURCE: Office of the State Auditor analysis of Division of Conservation data.

On average, the conservation easement donations that were certified for the credits had a total annual fair market value of \$63.8 million. Importantly, the fair market value of a conservation easement is calculated by subtracting the appraised value of the property with the restrictions imposed by the easement from the appraised value of the property without the easement’s restrictions. Therefore, the fair market value of a conservation easement does not reflect the value of the public benefits received from conserving the property; it simply reflects the estimated amount of property value lost to the landowner as a result of establishing the easement. We were unable to accurately quantify the benefits provided by the conserved land for which the credit has been certified because such calculations involve a large degree of uncertainty, and the total estimated benefit can vary substantially depending on the values used for different variables.

One study, published by CSU in 2017, provided an estimate of the benefits of conserved land in Colorado by holding some of these values fixed. The researchers used the concept of “ecosystem services” to estimate the return on investment of two Colorado conservation

programs: Great Outdoors Colorado (GOCO) and the Conservation Easement Credit. Different types of ecosystems provide different ecosystem services—including things like flood control, air pollution removal, carbon sequestration, water quality protection, erosion control, and pollination services—and multiple studies have estimated the annual value of services provided per acre of various ecosystem types. The CSU study used this concept to estimate that the Colorado conservation easements that had received GOCO funds or been certified for the credit would provide between \$4 and \$12 in public benefits by 2024 for every dollar of revenue forgone by the State. However, these numbers do not reflect the total benefit induced by the credit for a number of reasons, including:

- The study captures the benefits of conservation easements that received funds from GOCO but were not certified for the credit.
- For most conservation easements, the researchers did not have data to determine whether the easement had been certified for the credit.
- The researchers' calculations capture a broader range of benefits than those directly induced by the credit. For example, the calculations assume that all of the conservation easements had provided ecosystem benefits and that these benefits began to accrue the year each easement was established. However, in reality, the ecosystem services provided by a conserved property can only be directly attributed to the credit if the property would not have been conserved without the credit. For example, if a landowner would have created a conservation easement on their property regardless of the credit's availability, the conservation of the property did not occur as a result of the credit. This is also the case if a landowner created a conservation easement on their property but used the property in the same way with the easement as they would have without the easement because the property would have continued to provide ecosystem services for an unknown period of time regardless of the easement's existence. As previously discussed, we were unable to

determine the extent to which the credit may have prevented land from being developed.

- The analysis period for the study ended in 2024. In reality, the ecosystem services provided by conserved land would continue to provide value far beyond 2024, and it becomes increasingly difficult to estimate that value as time goes on.

In addition to ecosystem services, land conservation provides other benefits that are very difficult to quantify, such as biodiversity, health benefits, and reducing the impact of climate change. Although these benefits cannot be valued, they nevertheless have an economic impact on Colorado.

Finally, the higher credit amount established in House Bill 21-1233, which is available for conservation easements donated in 2021 or later, will likely change the credit's economic costs and benefits. For example, in February 2022, the Division reported that it had already reserved the full \$45 million in certified credits for 2021 donations, and the total annual value of credits certified for future calendar years will continue to be higher than it has been in the past. Once the total amount certified reaches \$45 million for a given calendar year, the Division will begin waitlisting credits for certification in the next available calendar year, as established in statute. The total number of conservation easements may also increase, since the higher credit amount provides a stronger incentive for landowners to establish conservation easements. The credit's revenue impact per tax year is also likely to increase from that reported by the Department for Tax Year 2018, since landowners will be certified for higher credit amounts than they would have received in previous years.

WHAT IMPACT WOULD ELIMINATING THE TAX EXPENDITURE HAVE ON BENEFICIARIES?

Eliminating the Conservation Easement Credit would remove the tax benefit that landowners currently receive for establishing conservation easements and donating part or all of the easements' value to land

conservation organizations. On average, about 36 landowners donated a conservation easement and were certified for the credit each calendar year between 2016 and 2020, with an average credit value of about \$626,000. Based on Division data, we estimated that most landowners (81 percent) were certified for tax credits between \$125,000 and \$1.4 million. As a result of the recent increase in the amount of the credit to 90 percent of an easement's fair market value, the average credit amounts certified will increase in the future.

Additionally, Department data indicates that 362 taxpayers claimed the credit in Tax Year 2018, with most taxpayers (72 percent) claiming between \$1,000 and \$53,000 and a small number of taxpayers claiming much larger credits. There are a number of possible reasons why there are so many credit claimants in comparison with the average annual number of landowners that are certified for the credit, including:

- Landowners may be pass-through entities such as partnerships, as opposed to a single individual. Statute [Section 39-22-522(4)(b)(I), C.R.S.] requires that the amount of the credit be allocated to individual co-owners of pass-through entities in proportion to their ownership percentage in the entity. Therefore, when a landowner that is a pass-through entity is certified for the credit with the Division, this credit is divided among each of the property's co-owners, resulting in more than one potential claimant of the credit for a single conservation easement donation.
- A landowner may transfer portions of their credit to multiple taxpayers, again resulting in multiple potential credit claimants for a single conservation easement donation.
- The credit may be carried forward for up to 20 years following the year of the conservation easement's donation. As a result, landowners who donated a conservation easement at any point during the previous 20 years may still be claiming the credit for the current tax year, provided that they have unused credit amounts remaining. For example, if all 174 landowners who donated a

conservation easement between 2016 and 2020 still had unused credit amounts left, they could all claim the credit in Tax Year 2021.

Several questions in our surveys pertained to the effects that the credit has had on stakeholders. On the landowner survey, 38 percent of landowners indicated that they would not have established a conservation easement on their property if the credit had not been available, and 80 percent reported that their land was likely to have been developed in the future if they had not established a conservation easement. However, only 10 percent stated that they would have sold part or all of their property if the credit had not been available, which suggests that most properties were not under threat of imminent development. When asked what may have happened to their property if they had not established a conservation easement, many landowners stated that their property would likely have been subdivided for sale or otherwise developed, and a few stated that their land may have been stripped of water or used for solar array projects. Two-thirds (67 percent) of respondents who were considering establishing or planning to establish additional conservation easements in the future reported that the credit's repeal would have a significant impact on the likelihood that they would establish another conservation easement. Some of these landowners stated that without the credit, conservation easements would be less financially viable and, in some cases, would result in the landowner selling their land out of financial necessity.

Certified conservation easement holders also generally reported that the credit is an important conservation tool. Sixty percent of these land conservation organizations reported that the credit has had a moderate or significant impact on their ability to fulfill their mission statement or other goals, and 69 percent stated that the credit's repeal would have a moderate or significant impact on their organization. Some respondents also provided additional comments about the credit's effects, including:

- The credit has expanded the number of landowners interested in establishing an easement and has helped the organizations to increase the number of land conservation projects and the number of acres conserved.
- Repealing the credit would reduce the pace of land conservation in Colorado.
- The quality of conservation easements may decline without the credit because landowners establishing new easements may want to keep more of their development rights, since they lose a larger amount of land value with higher restrictions on development rights.

ARE THERE SIMILAR TAX EXPENDITURES IN OTHER STATES?

We identified 11 other states that offer an income tax credit for land conservation donations. Although some states restrict the availability of their credits to conservation easement donations, other states allow for alternative methods of land conservation, such as the donation of an entire property for conservation purposes. Most of the 11 states require that land conservation donations meet the requirements of the federal deduction for qualified conservation contributions (seven states, or 64 percent) and have some level of review or application process in place in order for taxpayers to receive their credits (nine states, or 82 percent). The only other state that allows its credit to result in a refund is Massachusetts, and the remaining states all allow their credits to be carried forward for a specified number of years. Finally, only three other states (27 percent) explicitly establish that their credits may be transferred from the original donor to other taxpayers: New Mexico, South Carolina, and Virginia.

EXHIBIT 6 compares the value of land conservation credits available in the United States, including Colorado's credit. As demonstrated, the credits available in Colorado, California, and Connecticut provide the most value to taxpayers; although California and Connecticut calculate their credits as a smaller percentage of the donated value than Colorado's credit (55 percent and 50 percent, respectively), they do not

cap the amount of the credit that taxpayers can receive for a donation. The land conservation credits available in other states are much more modest in comparison because most of them are capped between \$50,000 and \$250,000 per donation, with the exception of Virginia's credit, which has a cap of \$550,000. The one other state with no credit cap is Mississippi. However, Mississippi is unique because it calculates the credit amount on a per-dollar, per-acre basis; because of the low amount per acre, it is unlikely to provide a credit amount that exceeds the \$50,000 to \$250,000 range.

EXHIBIT 6. COMPARISON OF CONSERVATION CREDIT AMOUNTS IN COLORADO AND OTHER STATES¹ (LARGEST CREDITS HIGHLIGHTED)

| State | Credit Amount as Percentage of Donated Value | Credit Cap Per Donation |
|----------------|--|-------------------------|
| Arkansas | 50% | \$50,000 |
| California | 55% | No cap |
| Colorado | 90% | \$5 million |
| Connecticut | 50% | No cap |
| Delaware | 40% | \$50,000 |
| Iowa | 50% | \$100,000 |
| Maryland | 100% | \$80,000 ² |
| Massachusetts | 50% | \$75,000 |
| New Mexico | 50% | \$250,000 |
| South Carolina | 25% | \$250 per acre |
| Virginia | 40% | \$550,000 ³ |

SOURCE: Office of the State Auditor analysis of Bloomberg Law resources and other states' statutes.

¹Mississippi's credit is calculated at \$5.50 per acre of land rather than as a percentage of fair market value, so we did not include this credit in the chart.

²Maryland limits the credit amount claimed per year to \$5,000 and allows these credits to be carried forward for up to 15 tax years after the year in which the credit was approved. Therefore, taxpayers are generally limited to \$80,000 in total credit amounts.

³Virginia limits the credit amount claimed per year for conservation easement donations to \$50,000 and allows these credits to be carried forward for up to 10 tax years after the year in which the credit originated. Therefore, taxpayers are generally limited to \$550,000 in total credit amounts.

ARE THERE OTHER TAX EXPENDITURES OR PROGRAMS WITH A SIMILAR PURPOSE AVAILABLE IN THE STATE?

We identified several tax expenditures and programs in Colorado that are similar to the Conservation Easement Credit because they reimburse landowners for some of the property value lost as a result of establishing a conservation easement. Like the Conservation Easement Credit, the federal deduction is a noncompetitive source of funding in that any landowner may benefit from the deduction provided that all of the deduction's requirements are met. The remaining funding sources listed below are competitive in that funds are issued on a preferential basis for select land conservation projects.

FEDERAL INCOME TAX DEDUCTION FOR QUALIFIED CONSERVATION CONTRIBUTIONS [26 U.S. CODE SECTION 170(h)]. Taxpayers may be able to claim a federal income tax deduction for conservation easement donations or donations of land for conservation purposes, which are considered to be charitable contributions under federal law for income tax purposes. As discussed, conservation easements must meet certain requirements in order to be eligible for this deduction, including having been substantiated by a qualified appraisal and donated exclusively for certain specified conservation purposes. Farmers and ranchers can generally deduct up to 100 percent of their adjusted gross income. For other taxpayers, individuals can deduct up to 50 percent of their adjusted gross income, and corporations can deduct up to 10 percent of their taxable income. Contribution amounts that exceed these limits may be carried forward to the 15 succeeding tax years, but the deduction is subject to the same percentage limitations in all tax years.

If a taxpayer has received the Conservation Easement Credit, they cannot receive the benefit of the federal deduction on their state income tax return because statutes [Sections 39-22-104(3)(g) and 304(2)(f), C.R.S.] require that the amount of the conservation easement's value that was deducted for federal income tax purposes be added back to the taxpayer's income when calculating Colorado taxable income. Under Department rule [1 CCR 201-2, Rule 39-22-104(3)(g)(1)], this addition

must be made regardless of whether the credit is waitlisted, carried forward, transferred, and/or issued incrementally.

Finally, under federal regulations [26 CFR 1.170A-1(h)(3)], taxpayers who claim a federal deduction for a charitable contribution must reduce the deduction by the amount of any state tax credits they expect to receive that are over 15 percent of the value of the contribution. Since the Conservation Easement Credit is greater than 15 percent of a conservation easement donation's fair market value, taxpayers who donate a conservation easement and claim the federal deduction for this donation must adjust the amount of their federal deduction accordingly.

U.S. NATURAL RESOURCES CONSERVATION SERVICE AGRICULTURAL CONSERVATION EASEMENT PROGRAM. The Agricultural Conservation Easement Program is administered by the U.S. Natural Resources Conservation Service, which is housed within the U.S. Department of Agriculture (USDA). There are two separate components to this program:

- AGRICULTURAL LAND EASEMENTS (ALE). ALE funding is available to state and local governments, Indian tribes, and certain non-governmental conservation organizations, which must apply for funding a proposed conservation easement on a specific property with the landowner's approval. ALE funds will cover up to 50 percent of the fair market value of the easement, or up to 75 percent for an easement protecting grasslands of special environmental significance.
- WETLAND RESERVE EASEMENTS (WRE). WRE funding is available to landowners with farmed or converted wetland that can be successfully restored. For perpetual conservation easements, WRE funds will cover up to 100 percent of the easement's value, in addition to restoration costs and administrative costs such as recording fees and appraisal fees.

U.S. FOREST SERVICE FOREST LEGACY PROGRAM. The Forest Legacy Program is funded by the Land and Water Conservation Fund and is

administered jointly by the U.S. Forest Service, which is housed within the USDA, and the Colorado State Forest Service (CSFS). Participating landowners may either sell their property outright or establish a conservation easement, with a state conservation agency serving as the purchaser or easement holder. The program provides up to 75 percent of the funds needed for an approved conservation project, with at least 25 percent of funds coming from state, local, or private sources. The program is competitive, and submissions for projects in all states are pooled into one application pool. According to CSFS, larger conservation projects that encompass 1,000 acres or more have typically been most successful at receiving funding. Since the beginning of Colorado's participation in 2002, the program has provided \$29.6 million to fund nine conservation projects. In recent years, one Colorado conservation project has received \$7 million in funding through this program.

GREAT OUTDOORS COLORADO TRUST FUND. In 1992, Colorado voters approved a constitutional amendment to create the Great Outdoors Colorado Trust Fund (GOCO), which is funded by proceeds from the Colorado Lottery. GOCO's mission is "To help preserve, protect, enhance, and manage the state's wildlife, park, river, trail, and open space heritage." GOCO invests some of its funds in land acquisition grants with the goal of increasing the number of protected lands in Colorado that reflect significant conservation values. Only certain specified entities may apply for GOCO land acquisition grants, including Colorado municipalities and counties, Colorado Parks and Wildlife, and nonprofit land conservation organizations. Although landowners cannot apply directly for the grants, eligible entities may apply for funding to obtain a conservation easement from a landowner via bargain sale. GOCO's spending plan indicates that they may invest up to \$7.7 million in land acquisition in Fiscal Year 2022.

COLORADO PARKS AND WILDLIFE COLORADO WILDLIFE HABITAT PROGRAM. Colorado Parks and Wildlife (CPW) is a state agency that manages Colorado's state parks and wildlife. CPW also administers the Colorado Wildlife Habitat Program, which provides funding for

landowners seeking to establish a conservation easement on their property or sell their property to CPW. Landowners may submit funding proposals themselves, or a land conservation organization can submit a proposal on landowners' behalfs. Between 2006 and 2020, funds from this program helped to secure conservation easements on over 250,000 acres.

WHAT DATA CONSTRAINTS IMPACTED OUR ABILITY TO EVALUATE THE TAX EXPENDITURE?

We did not identify any data constraints during our evaluation of the credit.

WHAT POLICY CONSIDERATIONS DID THE EVALUATION IDENTIFY?

THE GENERAL ASSEMBLY MAY WANT TO CONSIDER AMENDING STATUTE TO ESTABLISH PERFORMANCE MEASURES FOR THE CONSERVATION EASEMENT CREDIT. As discussed, statute does not provide performance measures for evaluating the credit's effectiveness. Therefore, for the purposes of our evaluation, we used the following performance measure to assess the extent to which the credit is meeting its purpose: *To what extent has the credit encouraged landowners to protect their land by establishing conservation easements?* We found that the credit provides a substantial financial incentive for landowners to establish and donate conservation easements, and landowners and representatives of the land conservation field generally reported that the credit has had a significant influence on landowners' decisions. However, the General Assembly may want to clarify its intent for the credit by providing performance measure(s) in statute. This would allow our office to more definitively assess the extent to which the credit is accomplishing its intended goal(s).