



# Colorado Legislative Council Staff

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## MEMORANDUM

August 28, 2017

**TO:** Interested Persons

**FROM:** Kate Watkins, Senior Economist, 303-866-3446

**SUBJECT:** Colorado Conservation Easement Tax Credit Program

### Summary

Since 2000, Colorado has offered a state income tax credit for conservation easements donated to government entities or qualifying charitable organizations. This memorandum provides information on the tax credit program, including how the credit is structured and claimed, as well as state budget impacts, recent audit findings, and a legislative history of the program.

### Background

A **conservation easement** is a voluntary legal agreement that permanently preserves land for certain public benefits, such as scenic or agricultural open space, natural habitat, recreational areas, or historical sites. These agreements can be individually tailored to preserve specific qualities of a property for specific purposes, allowing landowners to retain ownership while land use is restricted for conservation. For example, an agreement may preserve traditional land uses, such as family ranching or farming, and may or may not allow public access to the property protected by the easement.

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The federal government and many states offer tax incentives intended to encourage landowners to donate conservation easements to charitable organizations or government entities that manage the permanent preservation of the land. Federal and Colorado state tax incentives are detailed below.

**Federal income tax deduction.** Federal law allows taxpayers to claim an income tax deduction for the charitable donation of qualifying conservation easements. An income tax **deduction** reduces the amount of income that is taxed, thereby reducing the amount of tax owed. To qualify for the deduction, federal law requires that conservation easements meet a conservation purpose such as:

- preservation of land areas for outdoor recreation of the general public;
- protection of a relatively natural habitat for fish, wildlife, plants, or similar ecosystem;
- preservation of open space, including farmland and forest land; or
- preservation of a historically important land area or structure.<sup>1</sup>

The deduction amount is based on the fair market value of the conservation easement, as determined by a qualified appraisal prepared and signed by a qualified appraiser. The deduction amount that may be claimed is limited and based on the type of the property donated, type of organization receiving the donation, and taxpayer status. In general, deductions may not exceed 50 percent of the contribution made for individual income tax filers. Though, an individual who is a qualified farmer or rancher may deduct up to 100 percent of the contribution in certain circumstances. For any given year, the maximum deduction is generally limited to 10 percent of the corporation's taxable income. Both individual and corporate taxpayers can carry over unused contributions for up to 15 years.<sup>2</sup>

**Colorado income tax credit.** Colorado has offered a state income tax credit for the donation of conservation easements since 2000. Federal requirements for charitable contributions are used to determine eligibility for the state income tax credit. Donations must be made to a government entity or a 501(c)(3) charitable organization in perpetuity. State law defines a conservation easement as a right of the owner of the easement to prohibit certain acts with respect to the property in order to preserve its value for recreation, education, habitat, open space, or historical importance.<sup>3</sup> The remainder of this memorandum provides additional information about the Colorado conservation easement tax credit program.

## Tax Credit Structure

The following provides an overview of the conservation easement tax credit tax structure, including how the credit is calculated, and the partial refundability and transferability of the credit — two uncommon characteristics among state tax credits in Colorado.

**Allowable credit amounts.** A Colorado taxpayer can claim a state income tax credit beginning in the tax year in which the easement is donated (e.g., a donation made in 2017 may be claimed beginning in tax year 2017). In most years, the tax credit is **nonrefundable**, meaning that the amount of credit claimed is limited by a taxpayer's income tax liability. Any remaining credit amount may be carried forward and claimed on future tax returns for up to 20 years.

As shown in Table 1, the maximum tax credit per donation has increased over time. Under current law, a taxpayer can claim 75 percent of the first \$100,000 of the fair market value of the donation, and 50 percent of any donation amount above \$100,000, with a maximum credit amount per donation of \$1.5 million. Property holdings may be parceled and donated as separate tracts of land if a property exceeds the statutory maximum. However, limits on multiple donations may apply.<sup>4</sup>

<sup>1</sup>26 U.S.C. § 170 (h)(4)(A).

<sup>2</sup>For more information on the federal deduction, visit: <http://www.irs.gov/businesses/small-businesses-self-employed/conservation-easement-audit-techniques-guide>.

<sup>3</sup>Section 38-30.5-102, C.R.S.

<sup>4</sup>For more information, see the Colorado Department of Revenue "FY1 Income 39: Gross Conservation Easement Credit," available at: <http://www.colorado.gov/pacific/sites/default/files/Income39.pdf>.

**Table 1**  
**Allowable Colorado Conservation Easement Tax Credit Amounts**

| Tax Years     | Credit Amount as a Share<br>of the Donation's Fair Market Value |                 | Maximum<br>Credit<br>Per Donation | Aggregate<br>Credit Cap | Legislative<br>Changes |
|---------------|-----------------------------------------------------------------|-----------------|-----------------------------------|-------------------------|------------------------|
|               | First \$100,000                                                 | Above \$100,000 |                                   |                         |                        |
| 2000 to 2002  | 100%                                                            | N/A             | \$100,000                         | N/A                     | HB 99-1155             |
| 2003 to 2006  | 100%                                                            | 40%             | \$260,000                         | N/A                     | HB 01-1090             |
| 2007 to 2014  | 50%                                                             | 50%             | \$375,000                         | Varies*                 | HB 06-1354             |
| 2015 or After | 75%                                                             | 50%             | \$1.5 million                     | \$45 million            | SB 15-206              |

Source: Legislative Council Staff analysis of the Colorado Revised Statutes.

N/A = Not applicable.

\*House Bill 10-1197 capped credits to \$26 million for tax years 2011, 2012, and 2013. House Bill 11-1300 lowered the cap to \$22 million for 2011 and 2012, and increased the cap to \$34 million for 2013. A \$45 million cap was imposed beginning in tax year 2014 under House Bill 13-1183.

**Partial refundability.** In tax years in which the state refunds a TABOR surplus,<sup>5</sup> the conservation easement tax credit becomes partially **refundable**, meaning qualifying taxpayers may receive a tax refund if the credit exceeds the taxpayer's income tax liability.<sup>6</sup> However, the total amount of the credit claimed (including both refundable and nonrefundable portions of the credit) may not exceed \$50,000. For example, a taxpayer with a \$150,000 credit and a 2015 income tax liability of \$20,000 could claim \$20,000 in nonrefundable credits (the amount of his or her tax liability) plus up to \$30,000 in refundable credits, totaling \$50,000 in credits claimed in 2015. The taxpayer then would have \$100,000 in credits remaining that could be claimed in future tax years.

The conservation easement tax credit was made partially refundable in tax years 2001, 2005, and 2015 following TABOR surpluses in FY 2000-01, FY 2004-05, and FY 2014-15, respectively. The June 2017 Legislative Council Staff economic and revenue forecast does not anticipate another TABOR surplus through at least FY 2018-19. If this forecast is correct, under current law partial refundability of the tax credit will not be available through at least tax year 2019.

**Transferability.** The conservation easement tax credit is transferable, meaning that a donor may transfer (or sell) a credit, in whole or in part, to another taxpayer.<sup>7</sup> Transferability allows a donor to realize the financial benefit of the credit more quickly if he or she can find a transferee willing to purchase the credit. To transfer a credit, both the donor and the transferee must file written statements with their income tax returns specifying the amount of credit that has been transferred. A transferee may use a transferred credit to offset his or her income tax liability, but may not use the credit to obtain a refund even after the state incurs a TABOR refund situation. The donor of the easement serves as the "tax matters representative" in disputes between the state and all taxpayers, including transferees.<sup>8</sup>

<sup>5</sup>The state incurs a TABOR surplus when state revenue exceeds the limit on state revenue in the Taxpayer's Bill of Rights (TABOR) (Colo. Const. art. X, § 20 (7)(a)). For a primer on TABOR, see page 7 of "Understanding the State Budget" information paper, available at: <http://leg.colorado.gov/publications/understanding-state-budget-information-paper>.

<sup>6</sup>Section 39-22-522 (5)(b)(II), C.R.S.

<sup>7</sup>Section 39-22-522 (7), C.R.S.

<sup>8</sup>Section 39-22-522 (7) (i), C.R.S.

## Program Administration

The Colorado conservation easement tax credit program is administered by three state agencies: the Division of Real Estate (division) within the Department of Regulatory Agencies; the Conservation Easement Oversight Commission (commission) within the Division of Real Estate; and the Department of Revenue (DOR). Since 2000, legislative measures have shifted credit verification and certification of the program from DOR to the Division of Real Estate. Under current law, the division and commission certify eligible conservation easement donations, while DOR processes tax returns and issues the tax credit to taxpayers.

The commission was created in 2008 to assist the division in certifying credit eligibility.<sup>9</sup> The commission has nine members, including three permanent members from state agencies and six members appointed by the Governor for three-year terms. Commission meetings are open to the public and held at least quarterly. Effective July 1, 2018. The commission is subject to repeal and will undergo sunset by October 15, 2017.<sup>10</sup> Additional information about the commission can be found [online](#).<sup>11</sup>

## Claiming the Credit

To claim the Colorado conservation easement income tax credit, qualifying taxpayers must donate their land as a perpetual conservation easement to a qualified holder, have the land appraised, and receive a tax credit certificate from the Division of Real Estate certifying eligibility and the amount of the tax credit that may be claimed. The credit certificate must be provided to DOR with the taxpayer's income tax return. Additionally, an annual cap limits the total amount of credits that may be awarded to taxpayers each year. The process of claiming the tax credit is described in greater detail below.

**Qualified holders.** Donations must be made to a qualified state agency or nonprofit land trust (or "holder") that is certified by the division at the time of the donation. Qualified holders must renew their certification each year and are subject to compliance reviews.<sup>12</sup> A current list of certified holders and holder applications are available on the division's [website](#).<sup>13</sup>

**Qualified appraisal.** To claim the tax credit, taxpayers must have their conservation easement donation appraised. The tax credit amount is based on the fair market value of the donation as determined in a qualified appraisal. Conservation easement appraisals must be performed by a certified general appraiser who is compliant with all state licensure and continuing education requirements and who completed an annual conservation easement update course.<sup>14</sup> The appraisal must also be performed in accordance with Uniform Standards of Professional Appraisal Practice.<sup>15</sup> Federal regulations require the appraisal to be completed no more than 60 days prior to the donation and prior to filing an income tax return for the year of the donation.<sup>16</sup>

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<sup>9</sup>House Bill 08-1353.

<sup>10</sup>Sections 24-34-104 (5)(b) and (14)(a)(II), C.R.S.

<sup>11</sup>Visit: <http://www.colorado.gov/pacific/dora/division-boards-commissions-and-programs>.

<sup>12</sup>Section 12-61-724, C.R.S., and 4 CCR 725-4.

<sup>13</sup>Available under the "Find Certified Holders" link at: <http://www.colorado.gov/pacific/dora/node/91516>.

<sup>14</sup>4 CCR 725-4 (4.1)(E)(1).

<sup>15</sup>Section 12-61-727 (2)(a)(II), C.R.S.

<sup>16</sup>26 CFR 1.170A-13(c)(3)(A).

**Credit certification.** Once the appraisal is complete, the taxpayer must apply for a tax credit certificate from the Division of Real Estate.<sup>17</sup> Application forms and instructions can be found on the division [website](#).<sup>18</sup> If approved, the tax credit certificate specifies the amount that the landowner can claim for a particular tax year, which may differ from the qualified appraisal. Taxpayers may request a preliminary advisory opinion from the commission and division on an easement's stated conservation purpose and an appraisal's credibility prior to completing a donation transaction and recording the easement.<sup>19</sup> If issues are identified with the application, the commission and division follow the following processes:

- **Conservation purpose issues.** When an issue with the conservation purpose of a donation is identified, the application and a division staff report and recommendations are sent to the commission, who then votes to either approve the tax credit certificate, issue a deficiency letter to the landowner, or issue a favorable or non-favorable preliminary advisory opinion.
- **Appraisal issues.** When an issue with an appraisal is identified, the division director reviews staff reports and recommendations and decides whether or not an appraisal is credible. If significant problems are identified, the director may request a second appraisal or issue a non-favorable opinion.
- **Issue resolution or denial.** If the landowner resolves issues identified to the satisfaction of the commission and the division director, a tax credit certificate is issued. Otherwise, the division sends the landowner a letter of denial.

The credit certification process is subject to repeal effective July 1, 2018.

**Filing taxes and claiming the credit.** After receiving the tax credit certificate from the division, the taxpayer must submit the certificate to DOR with his or her state income tax return, including any required forms and other documentation, to claim the credit. If the landowner receives the certificate after the filing deadline for a specific tax year, the landowner may have to submit an amended return to claim the credit. For additional information on filing, see state income tax form [instructions](#) or visit the DOR website for [informational documents](#) specific to the credit.<sup>20</sup>

**Credit cap.** Since tax year 2011, state law has capped the aggregate value of credit certificates that can be issued each year. Notably, the cap only applies to the credits *issued* per year, not the amount of credits *claimed* by taxpayers on their tax return for that year. Under current law, the cap is set at \$45 million for 2014 and all subsequent tax years.<sup>21</sup> The division may process applications for credit certificates after the \$45 million cap has been reached; however, approved certificates are not issued until the following tax year when the cap has reset. The division is responsible for notifying DOR of certificates issued each year. The status of the number of credits requested relative to the cap is available on the division [website](#).<sup>22</sup> Figure 1 summarizes credit amounts issued and requested relative to the cap since it was first enacted.

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<sup>17</sup>Section 12-61-724, C.R.S.

<sup>18</sup>Available at: <http://www.colorado.gov/pacific/dora/node/91516>.

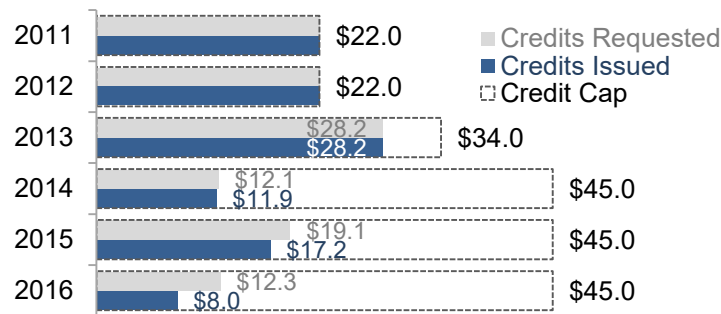
<sup>19</sup>Section 12-61-727(14), C.R.S.

<sup>20</sup>For more information on filing for the credit, see the Colorado Department of Revenue "FYI Income 39: Gross Conservation Easement Credit," available at: <http://www.colorado.gov/pacific/sites/default/files/Income39.pdf>.

<sup>21</sup>Section 39-22-522 (2.5), C.R.S.

<sup>22</sup>Available under the "Find Tax Credit Cap Status" link at: <http://www.colorado.gov/pacific/dora/node/91516>.

**Figure 1**  
**Aggregate Conservation Easement Tax Credit Cap,  
Total Credits Requested, and Total Credits Issued**



*Source: Colorado Department of Regulatory Agencies, Division of Real Estate.*

## Dispute and Appeal Processes

If a state or federal income tax audit results in the disallowance of a credit, the taxpayers claiming the credit, including transferees, are liable for the amount of the credit claimed plus interest and penalties.<sup>23</sup> If a disallowance occurs, the easement donor serves as the tax matters representative for the purpose of resolving the credit.<sup>24</sup> A transferee may not dispute the disallowance of a credit.

The general statute of limitations for the conservation easement tax credit is four years,<sup>25</sup> meaning DOR has four years to notify a taxpayer of a disallowed tax credit from the first time the credit is claimed on a tax return by either the donor or the transferee. The following provides a brief overview of the process for disputing a disallowed credit. For additional details about this dispute process, visit DOR's [website](#).<sup>26</sup>

**Administrative hearing.** If an easement donor is notified of a disallowance, he or she has 30 days to request an administrative hearing by filing a written protest to the executive director of DOR. Alternatively, the easement donor may file a written brief and request that the executive director reconsider the deficiency without a hearing. Within 60 days of the administrative hearing or after review of a written brief, DOR is required to issue a final determination based on the evidence and arguments presented during the hearing or provided in the written brief. The final determination may be extended by 60-day increments.<sup>27</sup>

The final determination may approve a refund, or either require or modify the tax, penalties, and interest amounts stated in the notification of disallowance. Payment is due within 30 days of the mailing of the final determination, unless the easement donor appeals the determination.

**Appeal process.** To appeal the final determination, an easement donor must file a notice of appeal with the clerk of the district court of the county in which the easement donor resides. Nonresidents of Colorado should file with the City and County of Denver. The notice of appeal

<sup>23</sup>Section 39-22-522 (9), C.R.S.

<sup>24</sup>Section 39-22-522 (7) (i), C.R.S.

<sup>25</sup>Section 39-21-107 (2), C.R.S. The federal statute of limitations is three years, and DOR is allowed one additional year after the federal limitation. If a taxpayer waives the statute of limitations on a credit contested, the statute of limitations may be extended.

<sup>26</sup><http://www.colorado.gov/pacific/tax/conferee-taxation-disputes>.

<sup>27</sup>Section 39-21-103, C.R.S., and Section 39-22-522 (7) (i), C.R.S. See also, *Markus v. Brohl*, 2014 COA 146 and *Medved v. State* 2016, COA 157.

must be filed within 30 days of the mailing of the final determination. Like the administrative hearing, the burden of proof rests on the taxpayer. The district court may affirm, modify, or reverse the final determination of DOR. If the easement donor or DOR is dissatisfied with this ruling, either may appeal further. After all appeals are exhausted, the taxpayer must pay any amounts the court determines are owed.<sup>28</sup>

***Expedited process for credits disallowed on or before May 1, 2011.*** In response to a backlog in administrative hearings for disputed claims over gross conservation easement tax credits, House Bill 11-1300 created a mechanism to expedite the resolution of credits disallowed on or before May 1, 2011. The bill allowed donors to forego an administrative hearing and proceed to resolve the matter in a district court.

## State Budget Impacts

***Revenue impacts.*** The conservation easement tax credit reduces the amount of state income tax revenue collected. Income tax revenue is collected in the state's General Fund and is used for various state programs, including K-12 education, higher education, health care, and human services programs. Figure 2 summarizes the amount of credits claimed, number of taxpayers claiming credits, and the average credit claimed by taxpayers since the credit was first enacted. The amount of credits issued over the past 16 years exceeds \$1 billion, while the amount of credits actually claimed on tax returns totaled \$695.3 million. Unclaimed credits may still be claimed on future tax returns as a carry forward, which could result in significant variance in the amount of credits claimed in any given year depending on taxpayer behavior and whether or not the credit is partially refundable.

***Expenditure impacts.*** For each year from FY 2013-14 to FY 2016-17, the division was appropriated 5.8 full-time equivalent (FTE) staff to administer the conservation easement program. The division and commission's administration of the program is funded by application fee revenue from landowners applying for tax credits or preliminary advisory opinions, and from entities applying to become certified conservation easement holders. Historically, fee revenue has not been sufficient to cover all administration costs in some years, resulting in an increase in fees over time. As of the date of this memo, holders are charged a \$6,967 renewal fee, and credit applicants are charged a \$12,350 credit certificate fee.<sup>29</sup> Table 2 summarizes program revenue from fees and expenditures on program administration for the past four fiscal years.

**Table 2**  
**Conservation Easement Program Revenue and Expenditures**

|                     | <b>FY 2013-14</b> | <b>FY 2014-15</b> | <b>FY 2015-16</b> | <b>FY 2016-17</b> |
|---------------------|-------------------|-------------------|-------------------|-------------------|
| <b>Revenue*</b>     | \$268,240         | \$266,389         | \$398,776         | \$645,046         |
| <b>Expenditures</b> | 198,763           | 349,105           | 429,626           | 530,601           |

*Source: Colorado Department of Regulatory Agencies.*

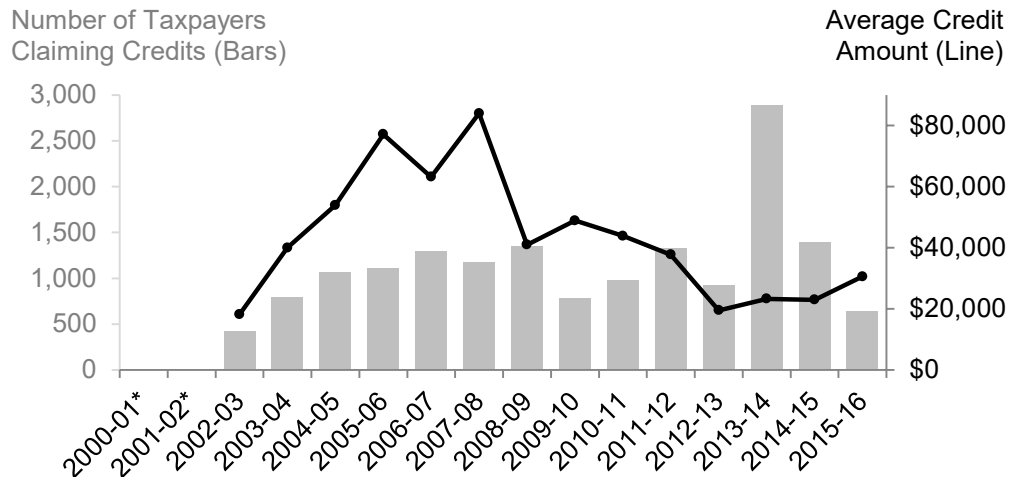
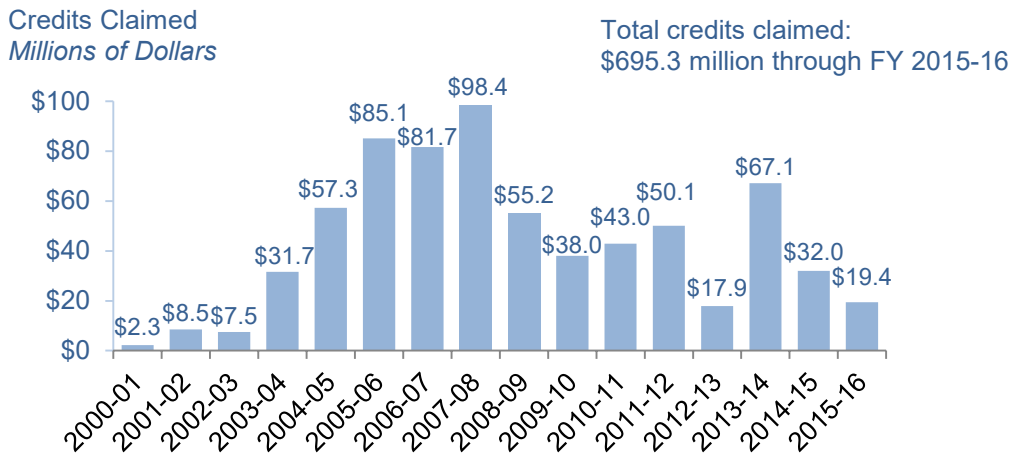
\*Includes fee revenue to the Conservation Easement Holders Fund and Conservation Easement Tax Credit Certificate Fund.

<sup>28</sup>Section 39-21-105, C.R.S.

<sup>29</sup>A schedule of fees can be found at: <http://www.colorado.gov/pacific/dora/node/96096>.



**Figure 2**  
**Conservation Easement Tax Credits Claimed on Tax Returns**



Source: Colorado Department of Revenue, annual reports.

Note: data are shown on a fiscal year basis.

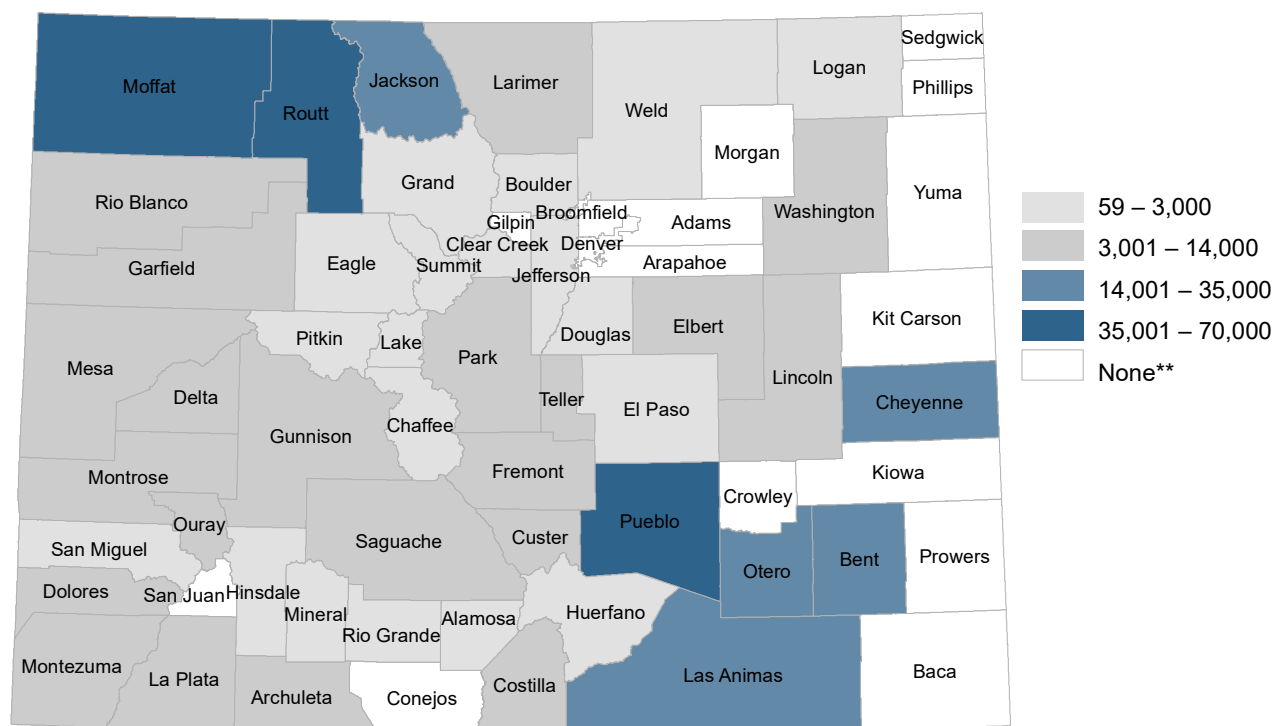
\*Data for the number of taxpayers are not available for FY 2000-01 or FY 2001-02.

### Regional Distribution of Credits

Figure 3 summarizes the acreage of conservation easements by county for which tax credits were awarded to date since 2011. Because the program dates back to 2000, the total acreage held in conservation easements is significantly greater than that shown. Data prior to 2011 are not available.



**Figure 3**  
**Acreage of Conservation Easement Tax Credit Awards by County, 2011 to 2017\***



Source: Colorado Department of Regulatory Agencies, Division of Real Estate.

Note: Data for 2016 and 2017 are preliminary; data prior to 2011 are not available.

\*Acreage data for easements spanning multiple counties are shown for the larger of the two counties.

\*\*Baca County includes one easement shared with Las Animas County.

## Recent Audit Findings and Recommendations

Since its inception, the conservation easement program has undergone several audits that prompted changes in the program. Audits include those performed by the Colorado Department of Revenue and the Internal Revenue Service on taxpayers claiming the tax credit, as well as audits on the conservation easement program itself. Tables 3 and 4 summarize findings and recommendations from the two most recent audits conducted by the Office of the State Auditor (OSA), which were published in 2012 and 2016, respectively. For both audits, affected agencies agreed with all of OSA's recommendations.

**Legislative outcomes.** Many of the findings and recommendations of the 2012 audit were addressed by Senate Bill 13-221, which created a tax credit application and certification process and clarifies the roles of the division, DOR, and the commission in administering the conservation easement program. State agencies have made changes to practices to address the 2016 audit concerns; legislative changes related to the 2016 audit have been limited to date. Colorado State University published a study in July 2017 on the program's "return on investment," which addresses one of OSA's 2016 audit recommendations for reporting on the program's benefits.<sup>30</sup>

<sup>30</sup>The study was funded by a private donation and is available at:  
[http://warnercnr.colostate.edu/wp-content/uploads/sites/2/2017/07/ColoradoStateU\\_CE-ROI-study\\_web.pdf](http://warnercnr.colostate.edu/wp-content/uploads/sites/2/2017/07/ColoradoStateU_CE-ROI-study_web.pdf).

**Table 3**  
**Summary of 2012 Audit Findings and Recommendations**

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

**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, the 2012 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.

| Findings                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                             | Recommendations                                                                                                                                                           |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>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.</li> <li>DOR's tax examiners do not sufficiently document their reviews of tax credit claims and uses. Review documentation held little information about judgments made and conclusions reached.</li> </ul>                                                                                              | DOR should strengthen its tax credit claim review process and improve its information management practices.                                                               |
| <ul style="list-style-type: none"> <li>The division'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.</li> <li>The division'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.</li> </ul> | The division should strengthen its processes for reviewing appraisals and certifying conservation easement holders.                                                       |
| <ul style="list-style-type: none"> <li>The commission's consultation process is limited in its ability to help inform and facilitate DOR's decision making to allow or disallow tax credit claims. The commission's tends to take a substantive compliance approach when reviewing conservation easement transactions that DOR refers for consultation, and the commission's deliberations tend to take on a landowner-centered perspective.</li> </ul>                                                                                              | DOR, the division, and the commission should ensure that the commission consultation process furthers the state's ability to determine the validity of tax credit claims. |
| <ul style="list-style-type: none"> <li>The state lacks adequate protections when governmental entities and nonprofit organizations that hold tax credit-generating conservation easements are no longer certified.</li> <li>Measuring the public cost of the 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.</li> </ul>                                                                                                | DOR and the division should evaluate options to better protect the state's investment of public resources in tax credit generating conservation easements.                |
| <ul style="list-style-type: none"> <li>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.</li> </ul>                                                                                                                                                                                                                                                | DOR, the division, and the commission should work together to design a pre-approval process for reviewing and approving conservation easement tax credits.                |

Source: Office of the State Auditor. Report available at:  
<http://leg.colorado.gov/audits/conservation-easement-tax-credit>.

**Table 4**  
**Summary of 2016 Audit Findings and Recommendations**

**Audit concern.** The Division of Real Estate should improve its administration of the conservation easement tax credit program by reviewing tax credit applications faster, improving its management of program fees and resources, and implementing strategies to help reduce the incidence of problems in conservation easement appraisals.

| <b>Findings</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | <b>Recommendations</b>                                                                                                                        |
|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>The division spent an average of 133 days on its initial reviews of tax credit applications from January 2015 to June 2016, which exceeded the statutory 120-day average time frame. Lengthy reviews are an inefficient use of the division's resources and increase costs for some landowners.</li> </ul>                                                                                                                                                                                                                   | <p>The division should implement timeliness goals and strategies to reduce the time it takes to review applications and issue decisions.</p>  |
| <ul style="list-style-type: none"> <li>In an effort to increase cash flow in 2014, the division created a placeholder process to encourage landowners and non-landowners to prepay fees for preliminary advisory opinions in exchange for discounted fees on future tax credit applications. The division improperly recorded 63 such prepayments and spent the money before receiving applications for the preliminary advisory opinions, resulting in unfunded liabilities through 2016. As of September 2016, about \$48,000 in liabilities remained.</li> </ul> | <p>The division should address the problems created by its placeholder process by either issuing refunds or continuing to track usage.</p>    |
| <ul style="list-style-type: none"> <li>The division has not collected sufficient revenue from application fees to cover its expenses associated with reviewing applications, partly due to flaws in its fee-setting methodology. Consequently, the division has had difficulty funding program staff positions and has a backlog of applications waiting to be reviewed.</li> </ul>                                                                                                                                                                                 | <p>The division should improve its fee-setting methods to ensure revenues are sufficient to cover the program's administrative costs.</p>     |
| <ul style="list-style-type: none"> <li>The division identified problems with most conservation easement appraisals from January 2014 to June 2016, indicating the division could improve its communication to help appraisers understand how to meet applicable standards.</li> </ul>                                                                                                                                                                                                                                                                               | <p>The division should better communicate review standards to appraisers and give landowners information on finding competent appraisers.</p> |
| <ul style="list-style-type: none"> <li>Currently, no state agency reports on the types of lands, wildlife, or habitats being conserved by the program, making it difficult for the public and policymakers to determine the benefits that the state has received from the program in return for forgone tax revenue.</li> <li>The division may need authority from the General Assembly or legal guidance to set program policies or direct outcomes, which would help ensure the program addresses the state's conservation needs effectively.</li> </ul>          | <p>The division should expand its public reporting on the specific conservation benefits the state receives from the program.</p>             |

Source: Office of the State Auditor. Report available at:

[http://leg.colorado.gov/sites/default/files/documents/audits/1561p\\_conservation\\_easement\\_tax\\_credit\\_program.pdf](http://leg.colorado.gov/sites/default/files/documents/audits/1561p_conservation_easement_tax_credit_program.pdf).

## Legislative History

Table 5 summarizes the legislative measures passed by the General Assembly that impacted the Colorado gross conservation easement tax credit since its inception.

**Table 5**  
**Enacted Legislation Impacting the Gross Conservation Easement Tax Credit**

| Bill Number | Major Provisions                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
|-------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| HB 99-1155  | <ul style="list-style-type: none"><li>Beginning in tax year 2000, establishes the conservation easement tax credit as a nonrefundable income tax credit for individuals and corporations who donate all or part of a perpetual conservation easement in gross to a governmental entity or to a 501(c)(3) charitable organization.</li><li>In order to qualify, the taxpayer must file all appraisals that were prepared when the conservation easement was created with DOR at the time the tax return is filed seeking the tax credit. The amount of the credit is equal to the fair market value of the conservation easement when it was created.</li><li>The credit may be carried forward and applied against the income tax due for up to 20 succeeding income tax years.</li><li>The credit may not exceed \$100,000 per donation over one or more tax years.</li></ul> |
| HB 00-1348  | <ul style="list-style-type: none"><li>Allows the tax credit to be transferrable.</li><li>Allows partial refundability of the credit if the state issues a TABOR refund. Transferees are not eligible for a refundable credit.</li><li>In TABOR refund years, limits the total credit amount (including nonrefundable and refundable credits) that may be claimed per tax year per taxpayer to \$20,000.</li><li>Allows partnerships, S corporations, or other pass-through entities that donate a conservation easement to allocate the credit to partners or shareholders in proportion to the partners' or shareholders' distributive shares of income from the entity.</li></ul>                                                                                                                                                                                            |
| HB 01-1082  | <ul style="list-style-type: none"><li>Specifies that the execution of a tax deed by a county treasurer to the purchaser of a tax lien shall not affect the existence of any conservation easement claimed or existing prior to the execution of the deed.</li></ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            |
| HB 01-1090  | <ul style="list-style-type: none"><li>Authorizes the tax credit for a partnership, S corporation, or other pass-through entity, estate, or trust that donates a conservation easement.</li><li>Raises the maximum available credit from \$100,000 to 100 percent of the first \$100,000, plus 40 percent of the value of the donation that is in excess of \$100,000, with a maximum credit value of \$260,000 per donation.</li><li>In years in which there is a TABOR refund, raises the limit on the total amount of credits claimed to \$50,000 per year beginning in tax year 2003.</li><li>Allows taxpayers to transfer a pro-rated portion of the tax credit and eliminates the \$20,000 minimum provision for transfers.</li></ul>                                                                                                                                     |
| HB 02-1098  | <ul style="list-style-type: none"><li>Clarifies the definition of a qualified conservation easement eligible for the tax credit to be consistent with qualification requirements under the federal tax code.</li></ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
| HB 05-1244  | <ul style="list-style-type: none"><li>Gives power to the Executive Director of DOR to review and evaluate the appraisal value of the easement, and the amount and validity of the credit. Furthermore, any dispute resolutions regarding a credit are binding on any transferees. Transferees are liable for disallowed credits and only the easement donor may engage in a legal dispute regarding the credit.</li><li>Requires that any transferee purchase the credit prior to the filing deadline for the transferee's income tax return. For credit holders that pass away prior to fully using all credits, the bill states that any remaining credits be transferred to the estate and may be claimed or transferred by the estate.</li></ul>                                                                                                                           |
| HB 06-1354  | <ul style="list-style-type: none"><li>Beginning with tax year 2007, changes the allowable tax credit to 50 percent of the value of the donated easement, with a maximum amount of \$375,000 per taxpayer per tax year.</li></ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |

**Table 5 (Cont.)**  
**Enacted Legislation Impacting the Gross Conservation Easement Tax Credit**

| <b>Bill Number</b> | <b>Major Provisions</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|--------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| HB 07-1361         | <ul style="list-style-type: none"> <li>• Sets forth additional requirements to verify the validity of state income tax credits claimed by a taxpayer for donating a conservation easement in the state: <ul style="list-style-type: none"> <li>– Taxpayers claiming the credit must file a statement with DOR reflecting the specific nature, location, and value of the easement and the amount of the credit claimed;</li> <li>– Organizations that accept a conservation easement for which a credit is claimed must submit certain information to the DOR, the Department of Agriculture, and the Department of Natural Resources; and</li> <li>– Appraisers valuing conservation easements must submit an affidavit specifying certain information related to the easement, such as the value of the easement and the manner in which the appraisal was conducted.</li> </ul> </li> <li>• Conservation easements must be valued by licensed appraisers in accordance with specified provisions of federal law and uniform standards for professional appraisal practice and a second appraisal may be required at the taxpayer's expense if the initial appraisal appears to represent a gross valuation misstatement.</li> <li>• DOR must create a publicly accessible report on any conservation easement for which an income tax credit is granted.</li> </ul> |
| HB 08-1353         | <ul style="list-style-type: none"> <li>• The Internal Revenue Service identified possible abuses by Colorado taxpayers of the conservation easement tax benefits. The most common problems identified were violations of appraisal practice standards and overvalued land, which allowed landowners to claim a larger tax credit. The conservation purpose of some easements was also questioned.</li> <li>• The bill provides additional requirements to verify the validity of a state income tax credit claimed by a taxpayer for donating a conservation easement, including the following: <ul style="list-style-type: none"> <li>– creates the Conservation Easement Oversight Commission within the Division of Real Estate;</li> <li>– creates a certification program for conservation easement holders to be implemented by the division; and</li> <li>– requires a fee to cover the cost of administering the conservation easement appraisal review process.</li> </ul> </li> </ul>                                                                                                                                                                                                                                                                                                                                                                        |
| HB 10-1197         | <ul style="list-style-type: none"> <li>• Caps at \$22 million annually the total amount of conservation easement income tax credits that may be claimed for tax years 2011, 2012, and 2013.</li> <li>• Requires the division to issue a certificate for the claims received in the order that they are submitted. The division is authorized to promulgate rules for the issuance of certificates.</li> <li>• Requires the DOR to make quarterly reports to the General Assembly regarding the quarterly and cumulative net revenue gain to the state resulting from enactment of the bill.</li> <li>• Specifies that land used for residential purposes would continue to be valued as agricultural land unless it is used for nonagricultural residential purposes.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       |

**Table 5 (Cont.)**  
**Enacted Legislation Impacting the Gross Conservation Easement Tax Credit**

| <b>Bill Number</b> | <b>Major Provisions</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
|--------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| HB 11-1300         | <ul style="list-style-type: none"> <li>• Authorizes a new expedited method for resolving disputed claims over conservation easement state income tax credits for credits disallowed on or before May 1, 2011 by allowing the following options: <ul style="list-style-type: none"> <li>– <i>Option 1: Waive the administrative hearing.</i> The easement donor must mail a signed notice of appeal on or before October 1, 2011, to DOR and the district court of the decision to waive an administrative hearing and to resolve the tax credit dispute before the district court. Interest and penalties still accrue while the case is on appeal before the court, and no surety bond or other deposit is required in connection with the appeal.</li> <li>– <i>Option 2: Request an expedited administrative hearing.</i> The easement donor must mail a written request to DOR on or before October 1, 2011. DOR is then required to hold a hearing and issue a final determination on or before July 1, 2014, unless the easement donor and DOR mutually agree to an extended date.</li> <li>– <i>Option 3: Make no decision.</i> If no election is made by October 1, 2011, DOR must hold a hearing and issue a final determination on or before July 1, 2016. If DOR fails to issue a final determination by this date, DOR is required to allow the full amount of the credit in dispute and waive any interest and penalties assessed on any amount owed.</li> </ul> </li> <li>• For purposes of resolving claims in the district courts, this bill: <ul style="list-style-type: none"> <li>– establishes venue for the appeals in a manner that allows cases to be consolidated regionally;</li> <li>– provides procedures for the administrative process;</li> <li>– establishes a process for courts to publish notices to taxpayers who cannot be located;</li> <li>– allows claims to be consolidated and settled, and allows additional parties to intervene at the discretion of the court; and</li> <li>– specifies procedures related to discovery, case management conferences, the disclosure of information by the parties, trial management orders, and the phasing of issues to be resolved by the court.</li> </ul> </li> </ul> |
| HB 13-1183         | <ul style="list-style-type: none"> <li>• <i>Recommended by the Joint Budget Committee.</i></li> <li>• Caps, at \$45 million annually, the total amount of conservation easement income tax credits beginning in tax year 2014. Claims for tax credits are made in the order in which they are submitted. Any claims for tax credits that exceed the limit are placed on a wait list and given credit in a future year when the limitation has not been exceeded, except that no more than \$15 million in claims can be placed on the wait list in any given calendar year.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |

**Table 5 (Cont.)**  
**Enacted Legislation Impacting the Gross Conservation Easement Tax Credit**

| Bill Number | Major Provisions                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
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| SB 13-221   | <ul style="list-style-type: none"> <li>• <i>Recommended by the Legislative Audit Committee.</i></li> <li>• Requires the division to create an application and certification process for landowners seeking to claim an income tax credit for a conservation easement. Beginning with income tax year 2014, a claim for the tax credit must be pre-certified by the division. The certification process will determine if the easement is a qualified contribution to an authorized entity, is substantiated by a credible appraisal, and conforms to all other legal requirements. Landowners may also seek a preliminary advisory opinion on an application.</li> <li>• Allows the division to charge fees for applications and advisory opinions. Effective January 1, 2014, the authority to charge appraisers a fee for submitting conservation easement appraisals for review is repealed, and any balance remaining in the Conservation Easement Appraisal Review Fund is transferred to the newly created Conservation Easement Tax Credit Certificate Review Fund.</li> <li>• Authorizes a General Fund loan to the division to provide start-up funding for the new process, to be repaid as fee revenue becomes available as of January 2014. The director of the division must promulgate rules to implement the new program and prepare an annual report to the public.</li> <li>• Modifies the composition of the commission and authorizes it as a type 2 agency under the control of the division. The authority to review and advise concerning conservation easement transactions, applications, and related documents was repealed, as were reporting requirements. The commission retains the authority to determine whether a conservation easement donation qualifies as a conservation contribution pursuant to federal tax regulations.</li> <li>• Landowners may address deficiencies found in an application and are provided an appeals process if an application is denied. If neither the division nor the commission identifies deficiencies with an application, the landowner is issued a tax credit certificate which may then be used to claim the income tax credit from DOR.</li> <li>• Clarifies that the DOR does not have the authority to disallow a claimed tax credit based on the pre-certification requirements under the jurisdiction of the division and the commission.</li> </ul> |
| SB 14-117   | <ul style="list-style-type: none"> <li>• Corrects an oversight from SB 13-155 and extends the repeal date of the Board of Real Estate Appraisers in the Department of Regulatory Agencies (DORA) through September 1, 2022.</li> <li>• Reenacts the provisions from SB 13-155, allowing the board to continue to implement DORA's recommendations from the 2012 real estate appraisers' sunset report.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
| SB 15-206   | <ul style="list-style-type: none"> <li>• Increases the amount of credit allowed from 50 percent to 75 percent for the first \$100,000 of easement fair market value and increases the total amount of credit that can be awarded for a single easement from \$375,000 to \$1.5 million.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |
| SB 17-215   | <ul style="list-style-type: none"> <li>• Closes the Conservation Easement Holders Fund and Conservation Easement Tax Credit Fund and transfers all money left over to the Division of Real Estate Cash Fund.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |

*Source: Legislative Council Staff fiscal notes and analyses of the Colorado Revised Statutes.*