

# FYI – For Your Information

## Gross Conservation Easement Credit

### OVERVIEW

An income tax credit is available for tax years beginning on or after January 1, 2000, for the donation of a perpetual conservation easement in gross on real property located in Colorado. The credit is based on the fair market value (FMV) of the easement. [§39-22-522, C.R.S.]. The donation must be made to a governmental entity or a charitable organization that is exempt under section 501(c)(3) of the Internal Revenue Code of 1954, as amended, and created at least two years prior to receipt of the easement. [§38-30.5-104(2), C.R.S.] The donation must also qualify as a charitable contribution for federal income tax purposes [Internal Revenue Code section 170(h)].

### DEFINITION

Conservation easement in gross is a right of the owner of the easement to prohibit certain acts with respect to the property in order to maintain the property in a manner that will preserve its value for recreation, education, habitat, open space, or historical importance. See, §38-30.5-102, C.R.S. for a complete definition.

### WHO CAN CLAIM THE CREDIT

Taxpayers qualified to claim the gross conservation easement credit (including transferees of these credits) are:

- Colorado resident individuals,
- C Corporations,
- trusts,
- estates,
- members of pass-through entities who receive the credit from such entity, regardless of whether such members are Colorado residents.

A limited liability company with only one member will generally be disregarded for federal tax purposes (I.R.S. Regulation §301.7701-3) as well as state tax purposes. [§39-22-104 (1), C.R.S.] Therefore, a sole member is not a "member of a pass-through entity" and does not qualify as a "taxpayer," for the conservation easement credit unless the member can otherwise satisfy the definition of a "taxpayer" (i.e., as a Colorado resident individual, C corporation, trust, or estate).

### CREDIT COMPUTATION

- For donations made on or after January 1, 2007, the credit cannot exceed \$375,000 (50% of the first \$750,000 FMV of the donation).
- For donations made on or after January 1, 2003 through December 2006, the credit cannot exceed \$260,000 (100% of the first \$100,000 FMV, plus 40% of the next \$400,000 FMV of the donation).
- For donations made on or after January 1, 2000 through December 31, 2002, the credit cannot exceed \$100,000 (100% of the first \$100,000 FMV).

The total amount of credit claimed by:

- A married couple, regardless of whether they file jointly or separately,
  - All members of a pass-through entity, which makes a donation,
  - All tenants in common, joint tenants, or other similar ownership groups that donate a gross conservation easement on jointly owned land
- is limited to the \$375,000, \$260,000 \$100,000 amounts above.



Colorado Department of Revenue  
Taxpayer Service Division  
1375 Sherman St.  
Denver, Colorado 80261

Forms and other services:  
(303) 238-FAST (3278)  
Assistance:  
(303) 238-SERV (7378)

[www.taxcolorado.com](http://www.taxcolorado.com)

## **ANNUAL LIMITS ON CREDIT**

### **General Rule**

In general, the credit a taxpayer can claim is limited to the net tax liability reported during the tax year. Excess credits may be carried forward for a maximum of twenty years from the year the credit is originally claimed. The credit may not be carried back to a prior tax year.

### **Surplus Rule**

The general rule is expanded to allow taxpayers, but **not** transferees of such credits, to claim a partial refund of the credit if State revenues are in excess of certain thresholds. Taxpayers are limited in the amount of the credit they can claim in any given tax year if they claim an income tax refund created by this credit. For tax years beginning on or after January 1, 2000, but before January 1, 2003, this limit is \$20,000 per donation per tax year. This limit increases to \$50,000 for donations made in tax years beginning on or after January 1, 2003.

Because the tax attributes of a credit are generally determined by the laws as they exist in the year the credit is created, the increase in the limitation to \$50,000 does not apply to donations made prior to January 1, 2003, even if the credit from such donation is carried forward to tax years beginning on or after January 1, 2003.

*Status of Surplus.* The gross conservation easement credit is not refundable and is limited to the net tax liability for tax years 2002 through 2004 and 2006 through 2010. The State of Colorado did not have a budget surplus for the years ending June 30, 2002 through June 30, 2004, and as a result of Referendum C that passed at the November 2005 state-wide election, there will not be a budget surplus refund for the years ending June 30, 2006 through June 30, 2010.

The credit was refundable for tax years 2000, 2001, and 2005.

*Multiple Taxpayers.* If the credit generated by a donation is claimed by more than one taxpayer and any of those taxpayers claim a refundable credit, then the aggregate credit claimed by all the taxpayers claiming such credit is limited to \$50,000 (\$20,000 for pre-2003 credits.)

This includes:

- A married couple, regardless of whether they file jointly or separately,
- All members of a pass-through entity, which makes a donation,
- All tenants in common, joint tenants, or other similar ownership groups that donate a gross conservation easement on jointly owned land,
- A taxpayer who donates an easement and one or more transferees of that credit.

For taxpayers in such a group to be able to claim a refundable credit, it will be necessary for someone to coordinate the manner in which the credit is claimed by all taxpayers involved or to restrict the credit claimed by the taxpayers to each individual's net tax liability. Failure to do this may result in the credit being overclaimed by the taxpayers/shareholders/members, which would result in an assessment against those taxpayers.

**Example:** *Husband and wife donate a conservation easement in 2001 valued at \$50,000 on land they own as joint tenants. Husband and wife file separate income tax returns. Wife's Colorado income tax liability is \$10,000 and she claims \$20,000 of the credit (including a \$10,000 refund). Husband cannot claim a conservation easement tax credit for 2001.*

**Example:** *A limited liability company makes a donation in 2001 of \$60,000 and allocates the credit equally among each of the three members. One member's Colorado income tax liability is \$10,000 and claims another \$10,000 of the credit as a refund. The two other members have Colorado income tax liability of \$8,000 and \$9,000, respectively. The other two members cannot claim a credit for 2001 because the aggregate amount of credit utilized by all taxpayers who hold a credit generated by the donation is limited to \$20,000 if a refund is claimed by any taxpayer in the group. The other two members can carry forward their credit.*

**Example:** *Taxpayer A donates a conservation easement in 2005 valued at \$500,000. Taxpayer A sells \$210,000 of credit to Taxpayer B. Taxpayer A claims a \$50,000 credit with a 2005 tax liability of \$6,000. Taxpayer B can not claim any of the \$210,000 credit in 2005 because*

*Taxpayer A claimed a refundable credit of \$50,000, the limit for 2005.*

**Surplus Determination.** The state determines in October or November of each year whether there are sufficient excess revenues to permit this refund. During the fiscal year the Governor's Office of State Planning and Budgeting periodically prepares revenue projections. These projections are available at [www.state.co.us/gov\\_dir/govnr\\_dir/ospb/index.html](http://www.state.co.us/gov_dir/govnr_dir/ospb/index.html)

### **CHARITABLE DEDUCTION REQUIREMENT**

If a charitable contribution is not allowed because the donation does not meet the requirements of a qualified conservation contribution under the federal laws and regulations of section 170(h) of the Internal Revenue Code, then the Colorado gross conservation easement credit is not allowed for the donation of the easement. [§39-22-522(2), C.R.S.]. Examples of when a gross conservation easement credit is not allowed include:

- The contribution is not made exclusively for conservation purposes,
- The property is already protected by its ownership by a 501(c)(3) organization,
- The donation is made to an unqualified organization.

If a charitable contribution qualifies as a charitable contribution under federal laws and regulations but the deduction is not utilized on the federal return (e.g. the taxpayer's income and/or other deductions limit the charitable deductions claimed, a trust's governing instrument does not provide for the charitable deduction, etc.) the Colorado gross conservation easement credit is still allowed for the donation of the easement.

### **FEDERAL DEDUCTION ADBACK**

If a charitable deduction is claimed on the federal income tax return for any donation upon which this credit is also claimed, the amount deducted from federal taxable income must be added back to taxable income to determine the taxpayer's Colorado taxable income. [§§39-22-104(3)(g) and 39-22-304(2)(f), C.R.S.] This prevents a taxpayer from receiving a benefit of more than 100% for

any contribution. Please note that, if your federal deduction for this donation exceeds the amount of the credit created by the donation, you "addback" only an amount equal to the credit including any credit transferred to another taxpayer or carried forward to future tax years.

**Example:** A taxpayer donates a conservation easement in 2002 valued at \$440,000. A credit of \$100,000 is claimed in 2002, \$15,000 of which is used on the 2002 tax return with \$85,000 carried forward to 2003. Assuming the 2002 federal charitable contribution deduction claimed is greater than \$100,000, the amount added to taxable income in 2002 will be \$100,000.

### **High Income Taxpayers**

Taxpayers whose 2006 federal adjusted gross income is more than \$150,500 (\$75,250 if married filing separately) and who itemize deductions generally are not allowed to claim all of their itemized deductions for federal income tax purposes.

**NOTE:** Use this worksheet to determine the amount of conservation easement contribution deduction to addback to taxable income on Form 104.

1. Enter the amount from line 11 of your federal itemized deduction worksheet\* \$ \_\_\_\_\_
2. Enter the amount from line 3 of your federal itemized deduction worksheet \$ \_\_\_\_\_
3. Amount on line 1 (above) divided by amount on line 2 (above) \_\_\_\_\_%
4. Amount of charitable deduction for the easement donation from federal Schedule A \$ \_\_\_\_\_
5. Amount on line 4 multiplied by percentage on line 3 \$ \_\_\_\_\_
6. Amount on line 4 minus amount on line 5 \$ \_\_\_\_\_
7. Smaller of Line 6 or the credit generated by the donation.

The amount on line 7 above is the amount to enter as an addition to taxable income on Form 104.

\* The federal "Itemized Deductions Worksheet" can be found in the Schedule A instructions of the Federal 1040 instruction booklet.

**Example:** John Smith Jr. has \$167,238 in total federal itemized deductions. Of that, \$18,916 is not to be included in the computation (not subject to phase-out). After subtracting the amount not subject to phase-out from his total federal itemized deductions, \$148,322 is subject to phase-out. John's conservation easement deduction on federal Schedule A is \$105,000 and he claimed a gross conservation easement credit of \$52,500.

John's Federal Adjusted

Gross Income: \$430,508  
 Threshold Amount \$150,500  
 Excess \$280,008

Amount of Itemized Deductions NOT Allowed  $\$280,008 \times 3\% \times 2/3 = \$5,600$

Amount of Itemized Deductions Allowed  $\$167,238 - \$5,600 = \$161,638$

John's federal "Itemized Deduction Worksheet" would look like this:

Line 1: \$167,238 (total itemized deductions)  
 Line 2: \$18,916 (deductions not subject to phase-out)  
 Line 3: \$148,322 (deductions subject to phase-out)  
 Line 4: \$118,658 (80 percent of line 3)  
 Line 5: \$430,508 (federal adjusted gross income)  
 Line 6: \$150,500 (federal threshold)  
 Line 7: \$280,008 (excess income over threshold)  
 Line 8: \$8,400 (3 percent of amount on line 7)  
 Line 9: \$8,400 (smaller of line 4 or line 8)  
 Line 10: \$2,800 (Line 9 divided by 3)  
 Line 11: \$5,600 (Line 9 minus line 10)  
 Line 12: \$161,638 (allowable itemized deductions for federal income tax purposes)

John's conservation easement deduction addback to taxable income would be computed as follows:

- 1) \$5,600 - Federal itemized deductions phased out (the amount from line 11 of your federal itemized deduction worksheet)
- 2) \$148,322 - Federal deductions subject to phase-out (the amount from line 3 of your federal itemized deduction worksheet)
- 3) 3.776%: \$5,600 divided by \$148,322 [Amount on line 1 (above) divided by amount on line 2 (above)].
- 4) \$102,000 - John's charitable deduction associated with the conservation easement credit claimed

5) \$3,852 - Amount of conservation easement deduction disallowed for federal income tax purposes (amount on line 4 multiplied by percentage on line 3)

6) \$98,148 - Amount of charitable deduction allowed for federal purposes (amount on line 4 minus amount on line 5)

7) \$52,500 - Amount of charitable deduction to be added back on Colorado return (smaller of line 6 or the credit claimed).

### **Charitable deduction ceilings**

There is a federal ceiling on the amount an individual may deduct each year as a charitable contribution. If the deduction of the conservation easement contribution is limited by this federal ceiling, then the Colorado addback will also be limited to the amount of the contribution actually deducted after any 50% or 30% limitation. However, any contribution carried forward and claimed in a future year would still be subject to the Colorado addback in the year the contribution is actually deducted.

### **TRANSFERRING THE CREDIT**

**Taxpayer.** A taxpayer can transfer all or part of a credit to a "transferee" who meets the definition of a taxpayer who can claim the credit. [§39-22-522(7), C.R.S.]. The taxpayer cannot transfer a credit which has been used by the taxpayer to offset tax or to claim a refund.

**Pass-through entity.** A partnership, S Corporation or other similar pass-through entity may not purchase a credit. A pass-through entity is a qualified taxpayer eligible to pass a credit to its members only when it "donates a conservation easement as an entity." [§39-22-522(1), C.R.S.]

A pass-through entity can directly transfer a credit if:

- I) Each partner, shareholder or member consents to the transfer, and
- II) Each partner, shareholder or member could, under the restrictions of the law, have claimed and transferred their pro rata share of the credit directly. [§39-22-522(4)(b), C.R.S.] and
- III) The partners, shareholders or members have not yet filed Colorado tax returns and utilized a portion of the credit, sold a portion of the credit, or carried the credit forward to a future year. Once these actions have occurred,

any remaining credit must be sold by each individual taxpayer rather than at the entity level.

A pass-through entity must transfer the credit or distribute the credit to its members for the year the donation is made. The entity cannot carry forward a credit to future tax years.

*Multiple transfers.* A credit can be transferred only once. A transferee, to whom a credit is transferred, cannot thereafter transfer the credit to another. For donations made during tax years prior to January 1, 2003, the minimum amount of credit that can be transferred to any one taxpayer is \$20,000. For donations made beginning on or after January 1, 2003, the donor can transfer all or any portion of the credit. Credits transferred after January 1, 2003 for donations made prior to that date are subject to the \$20,000 limit.

*Non-refundable.* A transferred credit claimed by a transferee can never exceed the net tax liability reported on the tax return.

*Written statement.* Both the donor and transferee must file with their return Form DR 1305 setting forth detailed information for EACH credit.

*Federal Deduction Addback.* The transferor of the credit is required to addback the full amount of the gross conservation easement credit even though part or all of the credit is transferred to another taxpayer.

*Disallowed credit.* If a taxpayer sells a conservation easement credit to another taxpayer and that credit is later disallowed in an audit, the transferee will be held liable for the disallowed credit that was claimed plus penalty and interest. [§39-22-522(9), C.R.S.]. All protest rights regarding an adjusted or disallowed credit reside with the donor of the easement or the transferor of the credit who is considered the tax matters representative in all matters with respect to the credit. For additional information regarding the Tax Matters Representative, see regulation 39-22-522, paragraph 3(j). [§39-22-522(7)(i), C.R.S.]

*Timing.* On or after June 7, 2005, a transferee of a conservation easement credit must purchase the credit by the due date of the income tax return, not including extensions, on which the credit will be claimed. Prior to June 7, 2005, a transferee of a conservation easement credit must have purchased the credit prior to the end of the tax year to be able to claim the credit during that tax year. A purchased credit cannot be claimed or carried back to an earlier tax year than allowed by these rules. [§39-22-522(7)(g), C.R.S.]

*Deceased Taxpayer.* Upon the death of a taxpayer the gross conservation easement credit passes to the decedent's estate. If the decedent is the donor of the easement, the estate may use the credit to offset income tax owed by the estate or may transfer some or all of the credit according to the transfer rules. If the decedent is a transferee of the credit, the estate may use the credit to offset income tax owed by the estate but may not transfer the credit. [§39-22-522(7)(h), C.R.S.]

*Income from the sale.* The gain from the sale of the credit is generally recognized as ordinary income and included in federal taxable income. This income is subject to Colorado tax and must be included in Colorado taxable income.

*Nonresidents of Colorado.* A nonresident of Colorado may sell a credit received from a pass-through entity. The gain from the sale of the credit is generally recognized as ordinary income. The income is from intangible personal property related to a pass-through entity doing business in Colorado. Therefore, this income is sourced to Colorado and is included in Colorado income on the nonresident's Colorado income tax return. [§39-22-109(2)(a)(V), C.R.S.]

### **State Income Tax Deduction**

The Internal Revenue Service National Office has issued a Technical Assistance Memorandum For Area Counsel, Small Business/Self-employed, Area 5 (No. 200126005, release date 6/29/01) stating that individual taxpayers who purchase for value a conservation easement credit as transferees will not lose their federal

deduction for state income taxes when they apply the credit to their Colorado income tax liability.

### **LIMITS IN MULTIPLE CREDITS**

#### **Donors.**

A credit is earned from the qualifying donation of a conservation easement. Only one credit may be earned and claimed each year by the donor of an easement. If the entire credit is not applied against tax in the year the credit is claimed, any unused portion of the credit may be carried forward for up to 20 years.

- Multiple credits may not be earned in one year from multiple donations, even if the donations are made by different pass-through entities.
- Additional credits may not be earned by a taxpayer during any year to which a prior gross conservation easement credit is being carried forward. This is true whether the credit is being carried forward by the taxpayer, or by the transferee who purchased the credit from that taxpayer.

**Example:** ABC Company claims a \$75,000 gross conservation easement credit during 2000. The credit is claimed as follows:

2000 - \$30,000  
2001 - \$20,000  
2002 - \$24,500  
2003 - \$500

*In 2003, the company donates another easement that would qualify for the credit. However, since the \$75,000 credit is not fully claimed until the year 2003, no additional gross conservation easement credit may be claimed for the 2003 donation. If another donation were made in 2004, that donation would qualify for the credit.*

**Multiple year agreements.** A taxpayer can agree to make a series of annual donations in order to maximize the amount of gross conservation easement credit claimed. Each donation must qualify within the limitations of the law in effect at the time donation is made. There are several issues that must be considered to maximize the tax credit available within the constraints of the annual credit limitation.

1. The portion of the property on which the conservation easement is donated must be clearly identified each year.
2. The donation of the conservation easement must qualify as a federal charitable deduction in the year the credit is claimed.
3. The land must be re-appraised for each donation since future appraisals of the remaining property may be affected by prior conservation easements on adjoining land.
4. The entire credit created in a prior year must be completely utilized against Colorado tax, either by the donor or the taxpayer(s) who purchases a credit from the donor, before the donor can make another easement donation that will qualify for a gross conservation easement tax credit.
5. If the IRS determines that one or more of the donations made pursuant to the agreement constitutes a single donation, then the Department, will also treat the donations as one donation.
6. Each donation must stand on its own merits and can not rely on future donations to meet the requirements of a qualified donation.

**Transferees.** For tax years beginning on or after January 1, 2003, there is no limit to the number of transferred conservation easement credits a transferee can claim for any tax year.

For tax years beginning prior to January 1, 2003, a transferee of a credit can claim only one credit per year. A transferee cannot claim a new credit until the tax year after which a previously purchased or claimed credit was claimed in full.

### **PART-YEAR RESIDENTS AND NONRESIDENTS OF COLORADO**

Part-year residents may claim the credit only if the donation is made while they were a Colorado resident.

Nonresident individuals of Colorado cannot claim the gross conservation easement credit for a donation they have made or for a credit they have purchased.

The portion of the credit apportioned to nonresident members of a pass-through entity however, can be used to offset the

tax liability of the nonresidents. This is because there is no residency requirement for members of a pass-through entity. The credit must be allocated to the entity's partners or shareholders in proportion to the partners' or shareholders' distributive shares of income from such entity.

If a credit is claimed by a Colorado resident who later moves to another state, any carryover credit can still be utilized by that taxpayer if they continue to have a Colorado tax liability despite being a nonresident of Colorado.

### **DOCUMENTATION**

Form DR 1305 "Colorado Gross Conservation Easement Credit Schedule," must be attached to any Colorado income tax return that claims a gross conservation easement tax credit. If a credit is transferred, both the taxpayer who donated the conservation easement and the transferee of the credit must include the DR 1305 with their return. The DR 1305 may be obtained online at [www.taxcolorado.com](http://www.taxcolorado.com)

Both the taxpayer who donates the conservation easement and the transferee, if any, of such a credit must also file a summary of a qualified appraisal and federal form 8283 with their Colorado income tax return, but only for the first tax year in which they claim the credit. The appraisal and summary must be in compliance with 26 C.F.R. 1.170A-13 (1998). Among other requirements, the appraisal will not qualify if it is prepared more than 60 days prior to the date of the donation.

### **WATER RIGHTS**

A gross conservation easement that encumbers water rights will qualify for the credit only if it is a perpetual donation. If a conservation easement donation includes revocable water rights that do not qualify for a federal charitable contribution, then the donation would not qualify for the Colorado tax credit. [§38-30.5-103, C.R.S.]

### **FURTHER INFORMATION**

FYIs, commonly used forms and additional tax information are available on the Web at [www.taxcolorado.com](http://www.taxcolorado.com)

For additional Colorado tax information visit the "Tax Information Index" which covers a variety of topics including links to forms, publications, regulations, statutes and general questions and answers. The "Tax Information Index" is located at [www.taxcolorado.com](http://www.taxcolorado.com)

FYIs provide general information concerning a variety of Colorado tax topics in simple and straightforward language. Although the FYIs represent a good faith effort to provide accurate and complete tax information, the information is not binding on the Colorado Department of Revenue, nor does it replace, alter or supersede Colorado law and regulations. The Executive Director, who by statute is the only person having authority to bind the Department, has not formally reviewed and/or approved these FYIs.