



Virginia Tax Department Changes Conservation Easement Tax Credit Procedures

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The Virginia Department of Taxation ("Tax") is modifying its procedures for issuing land preservation tax credits and is trying to improve its customer service. At a meeting hosted by Molly Ward, Virginia Secretary of Natural Resources, on August 28, 2014, Tax representatives explained how they have amended and will continue to amend their procedures.

Background. Landowners can qualify for Virginia land preservation tax credits by making an irrevocable donation of a qualifying interest in land for conservation purposes. The tax credit is equal to 40% of the fair market value of the donation. The landowner receives the credit by applying for the credit on a form LPC-1. Once received, the tax credit is transferable to another Virginia taxpayer.

When the LPC-1 is filed with Tax, Tax reviews the donation for overall compliance with the statutory requirements. Tax issues the credits to the landowner if the application passes the preliminary review. Tax's issuance of the tax credit does not preclude Tax from auditing the donation. In fact, Tax audits about 10% of the donations made. According to Tax, half of the donations subject to this additional review are accepted as filed. Of the remaining half, Tax and the landowner usually resolve any disagreement without having to resort to litigation. According to Tax representatives, less than 3 percent of the donations since 2000 have been challenged by Tax.

The Virginia land preservation tax credit has incentivized many conservation donations. According to Tax, 3,221 qualifying donations have been made since the land preservation tax credit was allowed by Virginia law. The number of donations reached its peak in 2006 when 460 donations were made. In 2007, Virginia capped the number of tax credits it would issue. Currently the cap is one hundred million dollars per year. From 2007 through 2012, the cap was reached and some donors were required to wait for the following year's credits. In 2012 and 2013, the cap was not reached. In 2012, less than 60 million dollars of credits were issued. In 2013, less than 76 million dollars of credits were issued. In 2012 and 2013, the number of donations (222 donations in 2012 and 213 donations in 2013) was slightly less than in previous years. In 2014, as of August 28, 2014, there have been only six donations utilizing about 9.3 million dollars of credits. According to Tax representatives, there are no LPC-1 tax credit applications currently pending before Tax. The Virginia Outdoors Foundation reports that it has about 40 donations pending approval at its next board meeting.

The Virginia conservation community has expressed some concern about the reduced demand for

credits. There are several theories on why there is a drop. Those who work closely with conservation donors have continued to convey to Virginia government officials their belief that landowners are holding off on making donations because of Tax policies and government-favored statutes. Some landowners fear an audit from Tax that will reduce their expected benefits. Landowners fear having to give up a valuable interest in land value without knowing for sure whether the government will disagree with their good-faith attempt to value their donation. They fear the irrevocable nature of the gift coupled with the uncertainty of being audited any time over the next three or more years.

Other landowners make the donation with the expectation of receiving tax credits in the year of the donation. Until 2011, most believed that Tax had to issue the tax credits that a landowner claimed on his or her LPC-1. In 2011, the Virginia General Assembly gave Tax the authority not to issue the tax credits to a donor if Tax questioned the landowner's claimed value for the donation. The tax credits would not be issued until Tax and the landowner reached an agreement or a court resolved the disagreement. Some have speculated that the uncertainty over whether Tax will issue credits upon application also deters donations.

Tax representatives have said they believe that the cap is not being reached because (i) there is uncertainty as to how charitable conservation gifts will be treated at the federal level, and (ii) landowners are still waiting for land values to return to their pre-recession levels.

It appears that Virginia Governor Terry McAuliffe's administration is listening to the landowners' concerns and that Tax is getting pressure from the McAuliffe administration to administer the tax credit program in a way that gives landowners more confidence in making donations for conservation purposes. According to Secretary Molly Ward, Governor McAuliffe wants landowners to make more donations of land for conservation purposes so that all one hundred million land preservation tax credits available are used. At the meeting on August 28, 2014, Tax described how it intends to provide better customer service and how it is changing its procedures to provide landowners with more certainty. Tax's new procedures may not be sufficient to provide that confidence because several of those attending the meeting continued to request more certainty by having a pre-donation approval process. Tax representatives appeared unwilling to do more than what they were proposing in the meeting.

Tax's Proposals. The highlights of Tax's proposed changes follow:

1) Tax wants to expedite the processing and review of LPC applications. Tax intends to establish goals to process and review LPC applications in a timely manner. For applications seeking less than one million dollars of credits, the average review and processing times would be fifteen days, unless the application was filed in October, November or December, in which event the average goal would be thirty days. For applications seeking one million dollars of credits or more, the average review and processing times would be thirty days, unless the application was filed in October, November or December, in which event the average goal would be forty-five days.

2) Tax wants to enhance customer service.

a) Tax procedure has been to provide a preliminary review before issuing the credits and then, after the credits are issued, to look more closely at about ten percent of the donations.

Tax will now try to do a more thorough review before issuing the credits. Tax representatives could not promise that a donation would not be audited after the credits were issued, but their intention and hope were generally not to do so.

b) Land preservation tax credits cannot be transferred to third parties before Tax issues the credits to the landowner. In years past, Tax promised to issue the credits before the end of the year if a complete LPC-1 was filed before December 1. **Now the complete application needs to be filed before the close of business on November 1.** Even if the complete application is not filed by

November 1, Tax representatives expressed a willingness to work with landowners to try to issue credits before the end of the year when possible.

c) Tax intends to hire additional appraisers to review appraisals during periods of high volume.

d) In cases where Tax intends to seek a second appraisal, Tax intends to hire appraisers that are not employed by Tax. Tax representatives said that it is their hope that an outside appraiser will provide a more objective determination of value.

3) Tax intends to do more outreach to work with conservation agencies and others interested in conservation to identify and resolve issues.

4) Tax wants to increase visibility and access to LPC information and to add transparency to the LPC application process. Tax intends to improve the LPC-1 website, provide answers to frequently asked questions, and provide an instructional video that reviews the LPC application and review process at Tax. Tax hopes to have an online submission process by June 30, 2015.

Conclusion. It is unclear whether these changes will incentivize landowners to make more donations. Tax representatives appear to be sincere in their desire to work with landowners, but they also seem equally concerned with protecting the treasury and enforcing the law. The good news for the conservation community is that Tax is opening up a dialogue that, if continued, will only help to improve the process for all.

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