NEWS

IRS Delivers Major Blow to Virginia's Land Preservation Program

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On June 11, 2019, the IRS and U.S. Department of Treasury issued final regulations requiring taxpayers to reduce their charitable contribution deduction by the amount of any state or local tax credits received (or expected to be received) in return for the contribution. This hurts a variety of taxpayers who are expecting to receive a Federal income tax deduction in exchange for an otherwise qualified charitable contribution. Specifically, this affects those who plan to grant (or who have granted since August 27, 2018) a qualified conservation easement in the Commonwealth of Virginia in exchange for Land Preservation Credits under the Virginia Land Conservation Incentives Act (the "Act") and may put a "chill" on the conservation easement program in Virginia (as well as other state and local tax credit programs).

Pursuant to the Act, a taxpayer who subjects its land to a qualified conservation easement is eligible for Virginia income tax credits equal to forty percent (40%) of the value of the easement (the "Credits"). The Credits are valuable to a taxpayer because they reduce, on a "dollar for dollar" basis, the amount of Virginia income tax owed. The Credits are transferrable and may be carried forward for up to thirteen (13) years.

Under the Internal Revenue Code, a taxpayer who subjects its property to a qualified conservation easement is entitled to a Federal income tax deduction (the "Deduction"), which reduces the amount of the taxpayer's taxable income. Deductions for qualified conservation easement donations can be carried forward for up to fifteen (15) years. *Before* the proposed regulation (which is now final) came into effect, the amount of the Deduction was *equal to* the value of the easement. *Now*, the amount of the Deduction is *reduced*, on a dollar-for-dollar basis, by the amount of Credits the taxpayer receives (or expects to receive).

For example, a taxpayer who subjected its property to a qualified easement having a value of $1,000,000 *before* August 27, 2018 was entitled to a Deduction equal to the value of the easement (i.e., $1,000,000) and was eligible for Credits equal to forty percent (40%) of the value of the easement (i.e., $400,000). By contrast, a taxpayer who subjects its property to a qualified easement having a value of $1,000,000 *after* August 27, 2018 is eligible for the same amount of Credits (i.e., $400,000), but is entitled to a Deduction equal to the value of the easement *minus* the amount of the Credits (i.e., $1,000,000 - $400,000 = $600,000). As a result of this regulation, this taxpayer's total Deduction is reduced by $400,000.

This regulation, which blindsided many taxpayers when it was proposed on August 27, 2018, is now final, and, even though the official "effective date" is not until August 12, 2019, it applies to all contributions made after August 27, 2018. Taxpayers who donated a qualified easement after August

27, 2018, applied for Credits and claimed a Deduction for the full amount of the easement with the hope that the IRS would amend the proposed regulation to eliminate this outcome for donors of conservation easements, may face some significant and unexpected negative tax consequences due to the reduction in the amount of the allowable Deduction as a result of the final regulation.

So, why did the IRS do this? The answer has nothing to do with conservation easements. Unfortunately, conservation easements (and the taxpayers who donate them) are innocent bystanders caught in the crossfire between Congress and a few States.

Here's the story: In 2017, Congress passed the Tax Cuts and Jobs Act ("TCJA"), which imposed a $10,000 cap on the Federal income tax deduction available to taxpayers for state and local taxes ("SALT"), including property tax, income tax and sales tax. *Before* the TCJA, taxpayers were permitted to deduct 100% of the amount they paid for SALT. For taxpayers in states with high state and local taxes (namely, New York, Connecticut, New Jersey, California, Massachusetts, Illinois, Maryland, Rhode Island and Vermont), this deduction was particularly important and valuable.

In response to the TCJA, a number of the high-SALT states implemented state tax credit programs whereby taxpayers could make charitable contributions to certain state funds (such as schools) in exchange for state tax credits. In effect, taxpayers were allowed to "convert" their tax payments into charitable gifts. Since deductions for charitable gifts were not subject to the SALT cap under the TCJA, taxpayers were able to deduct these gifts and effectively circumvent the intent of the SALT cap.

Not to be outdone, the IRS proposed this regulation (which is now final) in an effort to stop taxpayers in high-SALT states from circumventing the cap by using tax credit programs to "convert" their SALT payments into charitable gifts. Unfortunately, in its haste to address this issue, the IRS made the rule applicable to all state and local tax credits, including land preservation credits, in direct contravention and derogation of the public benefit derived from land preservation programs.

While many observers expected that the IRS would amend the proposed rule to specifically exclude land preservation tax credit and other programs that serve a significant public benefit, that did not occur. It remains to be seen how this rule will affect Virginia's land preservation program (and others around the Country) in the long term. For now, taxpayers who have donated since August 27, 2018, or are planning to donate, a qualified conservation easement and who receive (or expect to receive) state or local tax credits in exchange, are stuck with a substantially reduced Federal income tax deduction for their donation.

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