



RANCH CONNECTIONS

SUMMER 2007

The New Federal Range War: IRS Attack on Conservation Easements

A new range war has erupted in Colorado. However, unlike our historic disputes over grazing rights and fencing, today's range war is a battle over tax deductions and "conservation easements."

Last year, the Internal Revenue Service (IRS) opened an extensive audit program challenging income tax deductions earned from granting conservation easements. Although the program's scope has not been formally disclosed, the IRS is challenging at least 250 Colorado conservation easements.

The IRS focus on Colorado is not accidental. With pressure and support from Washington, D.C., the IRS is specifically targeting Colorado taxpayers and Colorado conservation easements.

What is a conservation easement?

A conservation easement is a written instrument typically in the form of a deed that limits land use. When recorded in the land records and accepted, the deed conveys valuable property rights to a charitable organization—most often a land trust.

One type of a conservation easement is an agricultural conservation easement. This easement limits the landowner's use of the property to farming and ranching uses and limits construction except for buildings used for agricultural purposes or homes

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for the rancher and his family and employees.

The easement also prohibits removal of minerals and other natural resources if that removal adversely affects the land's conservation use.

Even after granting the easement, the rancher remains the "fee owner" reserving the right to operate and manage the property consistent with sound management practices. The rancher also can leave the ranchland to his heirs.

By granting a qualifying conservation easement, the rancher secures an immediate federal and state income tax benefit. The amount of this benefit is supported by a written appraisal report. The value described in the appraisal is the difference between the land's value before the restriction and the land's value after the restriction. This difference is the value given away to charity.

What is the IRS asserting?

The IRS is asserting a twofold challenge to Colorado easements. First, the IRS attempts to deny or disallow the entire federal income tax deduction. Second, and alternatively, the IRS claims that the deduction amount is far too large and the amount deducted was "overvalued."

Based upon our review and involvement in these audits, the IRS's position is not based on a solid understanding of conservation easements. Nor does the IRS approach respect established conservation practice. The IRS is pushing a narrow definition of a "qualified conservation contribution." The intent is to reduce the number of qualifying Colorado conservation easements.

By pushing a narrow definition, the IRS challenge runs counter to 26 years of accepted best practices (many of such practices were established to meet long-standing IRS regulations). And

importantly, this IRS attempt to narrow the qualifying definition was just rejected by the federal courts.

Why target Colorado?

The IRS focus on Colorado is not an accident. The focus stems from Colorado's tax credit program since Colorado is among only a handful of states that offer state tax credits. In other words, a Colorado landowner granting a conservation easement secures both a federal income tax deduction (in the form of a charitable contribution deduction) and a state income tax credit.

With these dual tax benefits, Colorado landowners have special financial incentives for granting qualifying conservation easements. Both the federal and state treasuries subsidize Colorado's conservation protection efforts.

Colorado credit program is unique

Since its inception in 2000, the Colorado conservation easement tax credit program has helped preserve thousands of acres of Colorado's most cherished private landscapes. Colorado has benefited from the protection and preservation of these valuable ranch- and farmlands, wildlife habitats, water resources, and scenic vistas. This achievement was secured by a Colorado income tax credit for Colorado landowners who donate a conservation easement to a qualified organization such as a land trust.

Colorado's "credit" is generous. The landowner may take up to a \$375,000 income tax credit (i.e., a dollar-for-dollar

reduction) for 50 percent of the fair market value of a conservation easement. By using this credit, landowners may offset their own state income tax obligation and apply an excess amount forward for up to 20 years. As an alternative to using the credit, the landowner can transfer (sell) the credit to a third party (who in turn can use the credit to satisfy his Colorado income tax obligations). Generally, sellers of credits receive approximately 80 to 85 percent of the face value of the credit. This credit sale feature is also a unique attribute of Colorado's state tax credit program.

What should Colorado landowners do?

When faced with a showdown with the IRS, Colorado land trusts and landowners are fighting back. Asserting your rights means employing experienced attorneys and accountants to defend income tax deductions and credits. Landowners should not be shy in asserting their rights and standing up for their tax deductions. When the IRS takes an extreme position, landowners can even ask that their attorney's fees be paid by the IRS.

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Colorado's legislators also may help. Colorado Senators Allard and Salazar have drafted strong letters to the IRS Commissioner expressing their concern over the Colorado audits. They reiterated the important value of Colorado conservation easements to protect open space and agricultural lands.

At this juncture, the outcome of the Colorado IRS audits is unknown. Tax audits can take months to conclude and defending tax deduction can require several types of protests. Rothgerber Johnson & Lyons LLP is well experienced in handling IRS tax audits and defending conservation easement transactions. When necessary, we also defend tax positions through the federal courts.