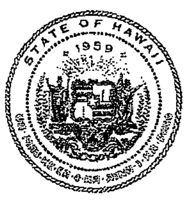
LINDA LINGLE
GOVERNOR

JAMES R. AIONA, JR.
LT. GOVERNOR



KURT KAWAFUCHI
DIRECTOR OF TAXATION

SANDRA L. YAHIRO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809

PHONE NO: (808) 587-1510
FAX NO: (808) 587-1560

SENATE COMMITTEE ON ECONOMIC DEVELOPMENT & TAXATION

TESTIMONY REGARDING HB 2518 HD 1 SD 1
RELATING TO LAND CONSERVATION

TESTIFIER: KURT KAWAFUCHI, DIRECTOR OF TAXATION (OR DESIGNEE)
DATE: MARCH 18, 2008
TIME: 1:15PM
ROOM: 224

This legislation provides a nonrefundable income tax credit for bargain sales or contributions of land for purposes of preservation.

The Senate Committee on Water & Land amended the measure by inserting the text of SB 2198. The Department's comments are made accordingly.

The Department of Taxation defers to the Department of Land & Natural Resources on the policy merits of this legislation; however the Department also has **strong concerns** with this measure and **requests amendments.** Though the Department has strong concerns with this measure, it has been and will continue to work with other interested parties to resolve these issues.

The Department initially points out that this measure has not been factored into the Executive Budget and is not one of its tax relief priorities this session.

The Department very much recognizes the importance of preserving conservation and culturally relevant lands in order to maintain Hawaii's priceless lands. However, the Department has issues with administering this tax credit.

I. TECHNICAL COMMENTS

The following technical issues are apparent:

USE OF FAIR MARKET VALUE—The Department is always apprehensive when "fair market value" is used as the standard by which a tax credit or other tax incentive is calculated. Fair market value can mean something different to anyone, especially when a tax benefit is involved. The concern for the Department relates more to perceived frauds and abuses of land prices used to

calculate the amount of the credit.

This bill was amended to clarify that fair market value for purposes of the credit is to be determined pursuant to federal law regulating appraisals for charitable purposes. Assuming fair market value is the only measure that can be used for this credit and use of an appraisal is the preferred method, the Department strongly suggests that the bill be amended to incorporate a penalty similar to Internal Revenue Code § 6695A that will penalize an appraiser who is complicit in a fraudulent land deal for purposes of this credit. An additional penalty similar to that provided under § 6662 of the Internal Revenue Code would prohibit taxpayers from similarly misusing any appraisals.

"**§231-A Accuracy-related penalty on underpayments due to substantial valuation misstatements.** (a) There shall be added to tax an amount of twenty per cent of the portion of an underpayment of tax required to be shown on a return if the portion of underpayment is due to a substantial valuation misstatement.

(b) There is a substantial valuation misstatement if the value of any property (or the adjusted basis of any property) claimed on any return of tax is one hundred and fifty per cent or more of the amount determined to be the correct amount of such valuation or adjusted basis, as the case may be.

(c) No penalty shall be imposed by a person under this section unless that portion of the underpayment for the taxable year attributable to the substantial valuation misstatement exceeds $1,000.

§231-B Substantial valuation misstatements attributable to incorrect appraisals. (a) There shall be assessed a penalty upon any person:

(1) Who prepares an appraisal of the value of property and such person knows, or reasonably should have known, that the appraisal would be used in connection with a return or a claim for refund; and

(2) The claimed value on a return or claim for refund which is based on such appraisal results in a substantial valuation misstatement under section 231-A.

(b) The penalty assessable under subsection (a) shall be equal to the lesser of:

(1) The greater of:

(i) Ten per cent of the amount of the underpayment attributable to the misstatement under subsection (a); or

(ii) $1,000; or

(2) One hundred and twenty-five per cent of the gross

income received by the person described in subsection (a) from the preparation of the appraisal.

(c) No penalty shall be imposed under this section if the person establishes that the value established in the appraisal was more likely than not the proper value."

PROPERTY CLASS STANDARDS—The Department is concerned about certain of the definitions used with the credit. For example, "conservation and preservation purpose" and "cultural property" are both very broad terms and the express definitions only increase the expanse of these definitions. The Department recognizes the rulemaking authority; however settling the issue in statute is the preferred method.

PUBLIC OR PRIVATE CONSERVATION AGENCY—There is concern over who will be running any conservation program. In order to ensure continuity and consistency, the Department suggests amending the bill to ensure some specific government agency be charged with implementing the conservation program before any tax credit is available.

PASS-THROUGH ENTITY PROVISION—Subsection (g) is unnecessary and confusing. Well-settled principles of partnership (pass-through) entity law typically do not allow any tax consequences for the "entity." All tax attributes of a partnership flow through to the partners that realize the tax consequences on individual tax returns. When an election is made by a partnership or limited liability company to be taxed at the entity level as a corporation, the entity is then considered a corporation for tax purposes and no longer a pass-through. The Department strongly suggests that subsection (g) be eliminated entirely. The Department submits that existing conformity to partnership and corporate tax principles is sufficient.

All that is needed is the following language:

"(g) In the case of a partnership, S corporation, estate, or trust, the tax credit allowable shall be determined at the entity level. Distribution and share of credit shall be determined in accordance with section 235-2.45(d)."

POSSIBLE LOSS OF FEDERAL AND STATE CHARITABLE CONTRIBUTION DEDUCTION—In its prior testimony, the Department had concerns with a potential double benefit by receiving the credit under this bill and a state charitable deduction. After further analysis, the loss of a generous federal benefit as a result of this credit is of greater concern. Generally, the taxpayer would receive a charitable contribution deduction for the donation of the property to a government entity or a nonprofit entity. The Internal Revenue Service has indicated that an issue exists as to whether providing a state tax credit in exchange for a donation of a conservation easement qualifies as a deductible charitable contribution and recommended public guidance be published on this issue. *See CCA 200238041, attached.* The IRS has yet to publish any guidance on this issue. Therefore, it is unclear whether donors would lose their federal and state charitable contribution deduction if the donor utilizes the credit. In addition, any requirement that conditions the credit on qualifying for the

Section 170 charitable contribution deduction may be unworkable.

RULEMAKING—The Department already has broad rulemaking authority. Subsection (i) is unnecessary. There is also a conflict between subsection (i) and (j). Do both agencies get to make concurrent rules? Will one agency's rules trump the other?

CERTIFICATION PROCESS—In light of the Department's concerns, the Department also suggests a certification process whereby, rather than the Board of Land & Natural Resources being authorized to make rules for this credit, the DLNR could be authorized to certify credits, maintain information, and simply send a certificate to the Department to process the credit. Other similar certification processes are currently administered with the Department of Business, Economic Development & Tourism and the Hawaii Film Office. *See e.g.*, HRS § 235-17.

TRANSACTIONS SUBJECT TO POTENTIAL ABUSE—The Department mentions that the IRS has highlighted possible abusive transactions relating to donations of conservation easements. In certain cases, the IRS has disallowed deductions and assessed penalties on transactions it has found to be shams. The Committee should be aware that conservation easements have been used in the past in allegedly abusive tax transactions.

II. REVENUE IMPACT

This legislation will result in a revenue loss of approximately $3.2 million for FY 2009.

The Legacy Land Conservation program under DLNR provides matching funds for non-profits to engage in land purchases for conservation. In many of these cases, a part of the land interest is gifted to the non-profit. It is assumed that most conservation land donation transactions goes through this mechanism.

Gifts through the Legacy Lands project for 2008 are projected to be $3,238,500. The Department assumed that this covers half of all eligible transactions under the credit (including investments covered in section (c) paragraph (2)). Thus the Department projects the value of eligible transactions to be $6.5 million, of which a 50% tax credit would cause of revenue loss of $3.2 million.

Impact for future years is indeterminate, due to the large volatility in gift amounts from year-to-year.

CCA 200238041

UIL No. 170.14-00; 170.12-07; 164.03-00; 162.05-15; 1001.00-00

Headnote:

IRS has supplemented its earlier chief counsel advice concerning transferee of Colorado conservation easement credit being entitled to federal tax deduction when using credit to reduce state taxes.

Reference(s): IRC Sec(s). 170 ; IRC Sec(s). 164 ; IRC Sec(s). 162 ; IRC Sec(s). 1001

FULL TEXT:

Release Date: 9/20/2002

Reply to: CC:ITA:B1

INTERNAL REVENUE SERVICE NATIONAL OFFICE LEGAL ADVICE

MEMORANDUM FOR AREA COUNSEL,

SMALL BUSINESS/SELF-EMPLOYED, AREA 5

FROM: Associate Chief Counsel

(Income Tax and Accounting)

SUBJECT: Colorado Conservation Easement Credit

PRESP-152782-01

This memorandum responds to your request for advice. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

Previously, by a memorandum dated May 31, 2001, we provided Chief Counsel Advice to your office on a related matter. At that time, we concluded that the transferee of a Colorado conservation easement credit is entitled to a federal tax deduction when using the credit to reduce state taxes. We also stated that we would provide a supplemental response on issues affecting the original recipient of the credit.

After consideration, we have determined that these issues, along with certain other issues raised in

connection with the federal tax treatment of state tax credits, would be best addressed in official published guidance. This will allow full consideration of concerns we have identified with respect to the tax treatment of these and other refundable and transferable state tax credits, and help ensure uniform treatment of taxpayers. In addition, we will be able to take into account the interplay of the issues you raised with certain legislation concerning the tax treatment of conservation easements now pending in Congress. Accordingly, our office will recommend that the treatment of state tax credits, including credits such as the Colorado conservation easement credit, be addressed in published guidance. Please be aware that the decision to issue published guidance must be approved at higher levels.

Pending resolution of these issues, we cannot furnish definitive advice on the questions you raised. However, we are providing an updated summary of the facts and a brief discussion of the two key questions concerning the tax treatment of the original recipient of the conservation easement credit, and some of the concerns and considerations that will need to be taken into account in answering those questions.

FACTS

For tax years beginning on or after January 1, 2000, a Colorado state income tax credit is available for the donation of all or part of the value of a perpetual conservation easement in gross by resident individuals, C corporations, partnerships, S corporations, other similar pass-through entities, estates, and trusts. Colo. Rev. Stat. § 39-22-522 (2001); see generally Colorado Department of Revenue, FYI — Income 39 - Gross Conservation Easement Credit (December 2001) ("State Explanation"). If a charitable deduction is claimed on the federal income tax return for any donation subject to the credit, the amount deducted from federal taxable income must be added back to determine the taxpayer's Colorado taxable income. Colo. Rev. Stat. §§ 39-22-104(3)(g) and 39-22-304(2)(f) (2001). However, if the federal deduction exceeds the amount of the credit created by the donation, then the "addback" is only the amount equal to the credit, including any credit carried forward to future tax years. See State Explanation p. 2.

Amount: For tax years beginning on or after January 1, 2000, but before January 1, 2003, the credit is equal to the fair market value of the donated portion of a perpetual conservation easement in gross created upon real property located in Colorado, but the credit cannot exceed $100,000 for any donation. For tax years beginning on or after January 1, 2003, the credit is equal to 100% of the first $100,000 of the fair market value of the donated portion of such conservation easement when created, and 40% of all amounts of the donation in excess of $100,000, except that the credit cannot exceed $260,000 per donation. Colo. Rev. Stat. § 39-22-522(4)(a). To the extent of a taxpayer's net income tax liability, a taxpayer can always use the credit in full. If the credit exceeds the tax liability, there are three possibilities: carryover, refund, or transfer.

Carryover: Any unused portion of the credit may be carried forward by the taxpayer for up to 20 years. Colo. Rev. Stat. § 39-22-522(5)(a). Only one credit may be claimed each year. Section 39-22-522(6). Additional credits may not be earned by the taxpayer during any year to which a prior conservation easement credit is being carried forward, either by the taxpayer or by another taxpayer who has received a transferred credit from that taxpayer. Id. (A taxpayer is not permitted to carry back the credit to years prior to the donation of the easement.)

Refund: Refundability of the credit will depend on whether there are excess state revenues in the prior year that must be refunded to Colorado taxpayers under the state constitution. [1] If there is no surplus, the credit is not refundable. If there is a surplus, at the election of the taxpayer the credit can exceed the amount of the net tax liability, with the balance being refunded to the taxpayer. However, in such a case for donations made during tax years beginning on or after January 1, 2000, but before January 1, 2003, the total credit for the year, including the nonrefundable and refundable portions, cannot exceed $20,000. For donations made during tax years beginning on or after January 1, 2003, the amount is $50,000. Colo. Rev. Stat. § 39-22-522(5)(b)(III).

Transfer: A taxpayer may transfer all or a part of the unused portion of the credit to a transferee who

meets the definition of a taxpayer who can claim the credit. [2] Colo. Rev. Stat. § 39-22-522(7). The credit may be transferred to more than one transferee. For donations made during tax years beginning on or after January 1, 2000, but before January 1, 2003, the minimum amount of unclaimed credit that can be transferred to any one transferee is $20,000. For donations made during tax years beginning on or after January 1, 2003, there is no minimum amount. Transferred credits are always nonrefundable for the transferee, although they may be carried over. A transferee may not transfer the credit to another.

DISCUSSION

I. Major issues

The key feature that raises the two primary issues in this fact pattern is the fact that the transfer of the conservation easement-which is generally appreciated property-entitles the taxpayer to a substantial financial benefit for up to the full fair market value of the easement.

The first major issue this raises is whether, to the extent a taxpayer is effectively reimbursed for the transfer of the easement through the use, refund, or transfer of the credit, that benefit is a quid pro quo that reduces or eliminates a charitable contribution deduction under § 170. (A subsidiary issue is whether, when the benefit takes the form of a reduction in state tax liability, disallowing a deduction under § 170 entitles the taxpayer to an equivalent deduction for a deemed payment of state tax under § 164 or § 162.)

The other major question is whether the benefit of the state conservation easement credit is, in substance, an amount realized from the transfer of the easement under § 1001, generally resulting in taxable capital gain. Although there may be authority to defer recognition of that gain until the benefit is actually realized through use, refund, or transfer of the credit, failure to tax that gain altogether is arguably unfair to taxpayers who sell conservation easements or other appreciated property and receive cash.

To take a simplified example, assume a taxpayer in State A and a taxpayer in State B each transfer a conservation easement with a tax basis of $4,000 and a fair market value of $10,000 to a state agency. The taxpayer in State A sells the easement to a state agency for a cash payment of $10,000. The taxpayer in State B donates the easement to a state agency and receives a cash payment of $10,000 as a refundable tax credit. For federal income tax purposes, the taxpayer in State A would not have a § 170 deduction and would pay tax on the $6,000 of capital gain. If the taxpayer in State B is able to deduct $10,000 as a charitable contribution and avoid paying tax on the capital gain-a "double benefit" that is generally allowed under § 170 when taxpayers donate appreciated property-it is difficult to explain why the two taxpayers should be treated differently, since both received $10,000 in cash. Even if the $10,000 § 170 deduction for the taxpayer in State B is offset by treating the $10,000 refundable credit payment as ordinary income, the resulting offset cancels out the benefit of the charitable deduction but still allows the taxpayer in State B to exclude 100% of the $6,000 capital gain -a benefit not available to the similarly-situated taxpayer in State A, even under the proposed legislation discussed below. Similar concerns are raised when the benefit of the state conservation easement credit is realized in the form of a reduction in state tax, or through sale of an excess credit to a third party. Finally, there is the question of whether taxpayers should be treated differently because they donated an easement to a charitable organization rather than a state agency.

II. Charitable deduction under § 170

The first issue that will need to be considered under the §170 analysis is whether the receipt of a state tax credit is a substantial return benefit. The external features of a transaction should be examined to determine whether a taxpayer transferred money or property to a charity with the expectation of a quid pro quo. Hernandez v. Commissioner, 490 U.S. 680, 690-691 (1989). Here, a taxpayer receives the state credit for transferring an easement to a governmental entity or § 501(c)(3) organization. As demonstrated by Singer Co. v. United States, 449 F.2d 413 (Ct. Cl. 1971), the benefit does not need to

come from the donee and the benefit does not need to be specifically quantifiable at the time of the transfer. See also § 1.170A-14(h)(3)(i).

Under the return benefit analysis, we will need to consider the fact that the tax benefit of a federal or state charitable contribution deduction is not viewed as a return benefit that reduces or eliminates a deduction under § 170, or vitiates charitable intent. [3] The question is whether a program such as Colorado's is distinguishable.

If there is a return benefit, we need to determine whether a taxpayer, at least in some circumstances, can satisfy the requirements under United States v. American Bar Endowment, 477 U.S. 105 (1986), to show that the taxpayer knowingly contributed an easement in excess of the value of the state credit received in return. See § 1.170A-14(h)(3)(i). For example, do the external features of a transaction demonstrate donative intent to the extent a taxpayer arranges to sell the credit to a third party for a discounted amount before transferring the easement to a charity? See generally § 1.170A-1(h)(1); Rev. Rul. 67-246, 1967-2 C.B. 104.

III. Disposition under § 1001

The second primary issue to consider is whether, because the original recipient of the conservation easement credit has essentially transferred property, usually appreciated property, in return for a payment or other financial benefit measured by the value of the transferred property, the transaction should be treated as a disposition of property generally resulting in capital gain.

A. Refunds

This issue is most clearly presented in the case of a refundable credit that is paid to a taxpayer in return for an easement transferred to the state. As discussed in the example above, it is difficult to distinguish this situation from other situations in which state agencies purchase conservation easements for cash.

B. Credits

If the benefit received by a particular taxpayer is a reduction in state tax liability resulting from the application of the credit, we need to consider whether the general treatment of a "nonrefundable" state tax credit as a reduction in tax liability should apply. A reduction in liability generally confers a benefit in the same manner as an outright payment, and is often taxed as such. But when the liability that is reduced is one that, like the liability for state tax, would be deductible if paid, it is often unnecessary and overly complex to recharacterize the transaction as a deemed payment to the taxpayer, followed by a deemed payment by the taxpayer, since the resulting income and deduction would simply offset each other. See, e.g., § 108(e)(2) ("Income not realized to extent of lost deductions"); Rev. Rul. 79-315, 1979-2 C.B. 27, Holding (3) (Iowa income tax rebate used to reduce state tax liability is neither gross income nor deductible under § 164 as state income tax paid).

However, one situation in which a transaction is generally recharacterized is one in which a liability is reduced or satisfied by the transfer of property. In order to reflect accurately the substance of the transaction, such a transaction is generally treated as a deemed disposition of the property, resulting in the realization of gain or loss, followed by a deemed payment of the sales proceeds in satisfaction of the liability. For example, in our previous Chief Counsel Advice on the tax treatment of a purchaser of a Colorado conservation easement credit, we advised that rather than treating the purchaser's use of the credit as a reduction in state tax liability, which would deprive the purchaser of a deduction for the payment of state tax, we viewed the situation as analogous to one in which the state permitted the taxpayer to pay the state tax liability with property. In such a case, the taxpayer would be treated as having first disposed of the credit, with the "face amount" of the credit as an amount realized, and then paid the proceeds to the state, resulting in a deduction for the full face amount under § 164. We need to consider whether a similar approach is appropriate for the original recipient of the conservation credit as well, who would be treated as having disposed of the easement and then made a deemed

payment of state tax with the proceeds. [4]

C. Transfers

If the benefit received by the transferor of a conservation easement takes the form of cash received on the sale of the credit to another taxpayer, the question is whether that benefit should be treated as an amount realized from the disposition of the easement, from the disposition of the credit itself, or in some other manner. This would affect the character of any gain as well as the basis to be used in the calculation.

D. Bargain sale

Another question is whether a taxpayer could be treated as making a bargain sale of an easement in certain circumstances-for example, as discussed above, to the extent that the amount received on the transfer of a credit is less than the value of the easement, and the requirements of American Bar Endowment are satisfied.

E. Timing

If or to the extent that it is determined that the benefit of the credit is an amount realized from the transfer of the easement, an additional issue to consider is whether the transaction should be considered as "closed," resulting in an amount realized in the year the easement is transferred. Alternatively, since the credit can be carried forward, can the taxation of gain be deferred until the benefit of the credit is "realized" through sale, refund, or use, in a manner similar to an installment sale, perhaps under the principles of Arrowsmith v. Commissioner, 344 U.S. 6 (1952)? Such treatment would also raise the issue of how the basis of the easement should be handled.

F. Transfers to charity

Another question is whether, for § 1001 purposes, the benefit of the tax credit should be viewed as an amount realized from the transfer of an easement even though the easement is transferred to a charitable organization rather than the state. [5]

IV. Effect of pending legislation

Finally, we note that a bill pending in the Senate contains a provision that, if enacted, would affect the analysis of the state conservation easement credit for easements transferred after December 31, 2003. Specifically, section 107 of H.R. 7 would add a new Code section 121A to provide for the exclusion of 25% of the long-term capital gain for certain sales of land interests to eligible entities for conservation purposes. In the case of a bargain sale, a taxpayer will not fail to qualify for a charitable contribution deduction solely because the taxpayer derives a tax benefit from the partial exclusion of long-term capital gain from the sale. The version of H.R. 7 passed by the House does not contain a provision similar to section 107.

Associate Chief Counsel

(Income Tax and Accounting)

By

PAUL M. RITENOUR

Chief, Branch 1

1

Under section 20(7) of Article X of the Colorado constitution, this surplus is based on spending limits determined by factors such as inflation, population growth, voter authorization, etc. The determination of whether there is a surplus is announced in October or November of the following year. It is our understanding that the State of Colorado had surpluses for the past few years and does not expect to have surpluses for the next several years.

2

A state non-profit organization will act as a clearinghouse for the transfer of these credits. Donors will register with this organization to sell their credits for a specified percentage of "face value" (e.g., 80%), buyers will sign a letter of intent to pay a specified percentage of face value (e.g., 90%), and the difference will go to the organization to cover its costs.

3

See McLennan v. United States, 23 Cl. Ct. 99 (1991), subsequent proceedings, 24 Cl. Ct. 102, 106 n.8 (1991), aff 'd, 994 F.2d 839 (Fed. Cir. 1993); Skripak v. Commissioner, 84 T.C. 285, 319 (1985); Allen v. Commissioner, 92 T.C. 1, 7 (1989), aff'd, 925 F.2d 348 (9th Cir. 1991); see also Browning v. Commissioner, 109 T.C. 303 (1997) (addressing the question of tax benefits as an amount realized in a charitable bargain sale, rather than as a quid pro quo issue).

4

Note that recharacterizing the transaction in this way has the advantage of providing a rationale for allowing a deduction under § 162 or § 164 that would compensate for the denial of a § 170 deduction. This is appropriate, since, unlike the refund or transfer scenarios, the taxpayer does not end up with cash when the state tax credit is used to reduce state tax liability.

5

Cf. Rev. Rul. 88-95, 1988-2 C.B. 28; Notice 87-26, 1987-1 C.B. 470; Standley v. Commissioner, 99 T.C. 259 (1992), aff'd without published opinion, 24 F.3d 249 (9th Cir. 1994).

END OF DOCUMENT -

© 2008 Thomson/RIA. All rights reserved.

Notice 2004-41, 2004-28 IRB 31, 06/30/2004, IRC Sec (s). 170

Charitable contributions—conservation easements—disallowed deductions.

Headnote:

In light of possible improper charitable deductions, IRS is advising those who participate in transferring real property easement to charitable org or making payments to such org. in connection with real estate purchase from org. or who promote these type of transactions that it will disallow deductions as necessary and may impose penalties and excise taxes. IRS also reviewed requirements for donation of conservation easement under Code Sec. 170(h); , and noted that in situations involving purchase of real property from charitable org, it would apply substance-over-form doctrine to find that payment to charity for property and "donation" is in reality purchase price for property. IRS might also challenge exempt status of org., based on operation for substantial nonexempt purpose or impermissible private benefit.

Reference(s): ¶ 1704.45; Code Sec. 170;

Full Text:

The Internal Revenue Service is aware that taxpayers who (1) transfer an easement on real property to a charitable organization, or (2) make payments to a charitable organization in connection with a purchase of real property from the charitable organization, may be improperly claiming charitable contribution deductions under § 170 of the Internal Revenue Code. The purpose of this notice is to advise participants in these transactions that, in appropriate cases, the Service intends to disallow such deductions and may impose penalties and excise taxes. Furthermore, the Service may, in appropriate cases, challenge the tax-exempt status of a charitable organization that participates in these transactions. In addition, this notice advises promoters and appraisers that the Service intends to review promotions of transactions involving these improper deductions, and that the promoters and appraisers may be subject to penalties.

Contributions of Conservation Easements

Section 170(a)(1) allows as a deduction, subject to certain limitations and restrictions, any charitable contribution (as defined in § 170(c)) that is made within the taxable year. Generally, to be deductible as a charitable contribution under § 170, a transfer to a charitable organization must be a gift of money or property without receipt or expectation of receipt of adequate consideration, made with charitable intent. *See U.S. v. American Bar Endowment* , 477 U.S. 105, 117-18 [58 AFTR 2d 86-5190](1986); *Hernandez v. Commissioner* , 490 U.S. 680, 690 [63 AFTR 2d 89-1395](1989); *see also* § 1.170A-1(h)(1) and (2) of the Income Tax Regulations.

Section 170(f)(3) provides generally that no charitable contribution deduction is allowed for a transfer to a charitable organization of less than the taxpayer's entire interest in property. Section 170(f)(3)(B)(iii) provides an exception to this rule in the case of a qualified conservation contribution.

A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for certain conservation purposes. Section 170(h)(1), (2), (3), and (4); § 1.170A-14(a). A qualified real property interest includes a restriction (granted in perpetuity) on the use that may be made of the real property. Section 170(h)(2)(C); *see also* § 1.170A-14(b)(2). For purposes of this notice, qualified real property interests described in § 170(h)(2)(C) are referred to as conservation easements.

One of the permitted conservation purposes listed in § 170(h)(4) is the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem. Section 170(h)(4)(A)(ii); *see also* § 1.170A-14(d)(1)(ii) and (3). Another of the permitted conservation purposes is the preservation of open space ("open space easement"), including farmland and forest land, for the scenic enjoyment of the general public or pursuant to a clearly delineated governmental conservation policy. However, if the public benefit of an open space easement is not significant, the charitable contribution deduction will be disallowed. *See* § 170(h)(4)(A)(iii); *see also* § 1.170A-14(d)(1)(iii) and (4)(iv), (v), and (vi). Section 170(h) and § 1.170A-14 contain many other requirements that must be satisfied for a contribution of a conservation easement to be allowed as a deduction.

A charitable contribution is allowed as a deduction only if substantiated in accordance with regulations prescribed by the Secretary. Section 170(a)(1) and (f)(8). Under § 170(f)(8), a taxpayer must substantiate its contributions of $250 or more by obtaining from the charitable organization a statement that includes (1) a description of any return benefit provided by the charitable organization, and (2) a good faith estimate of the benefit's fair market value. *See* § 1.170A-13 for additional substantiation requirements. In appropriate cases, the Service will disallow deductions for conservation easement transfers if the taxpayer fails to comply with the substantiation requirements. The Service is considering changes to forms to facilitate compliance with and enforcement of the substantiation requirements.

If all requirements of § 170 are satisfied and a deduction is allowed, the amount of the deduction may not exceed the fair market value of the contributed property (in this case, the contributed easement) on the date of the contribution (reduced by the fair market value of any consideration received by the taxpayer). *See* § 1.170A-1(c)(1), (h)(1) and (2). Fair market value is the price at which the contributed property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and each having reasonable knowledge of relevant facts. Section 1.170A-1(c)(2). *See* § 1.170A-14(h)(3) and (4) for a discussion of valuation.

If the donor (or a related person) reasonably can expect to receive financial or economic benefits greater than those that will inure to the general public as a result of the donation of a conservation easement, no deduction is allowable. Section 1.170A-14(h)(3)(i). If

the donation of a conservation easement has no material effect on the value of real property, or enhances rather than reduces the value of real property, no deduction is allowable. Section 1.170A-14(h)(3)(ii).

Purchases of Real Property from Charitable Organizations

Some taxpayers are claiming inappropriate charitable contribution deductions under § 170 for cash payments or easement transfers to charitable organizations in connection with the taxpayers' purchases of real property.

In some of these questionable cases, the charitable organization purchases the property and places a conservation easement on the property. Then, the charitable organization sells the property subject to the easement to a buyer for a price that is substantially less than the price paid by the charitable organization for the property. As part of the sale, the buyer makes a second payment, designated as a "charitable contribution," to the charitable organization. The total of the payments from the buyer to the charitable organization fully reimburses the charitable organization for the cost of the property.

In appropriate cases, the Service will treat these transactions in accordance with their substance, rather than their form. Thus, the Service may treat the total of the buyer's payments to the charitable organization as the purchase price paid by the buyer for the property.

Penalties, Excise Taxes, and Tax-Exempt Status

Taxpayers are advised that the Service intends to disallow all or part of any improper deductions and may impose penalties under § 6662.

The Service intends to assess excise taxes under § 4958 against any disqualified person who receives an excess benefit from a conservation easement transaction, and against any organization manager who knowingly participates in the transaction. In appropriate cases, the Service may challenge the tax-exempt status of the organization, based on the organization's operation for a substantial nonexempt purpose or impermissible private benefit.

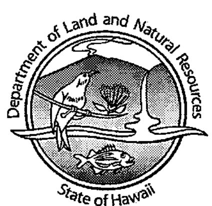
In addition, the Service intends to review promotions of transactions involving improper deductions for conservation easements. Promoters, appraisers, and other persons involved in these transactions may be subject to penalties under §§ 6700, 6701, and 6694.

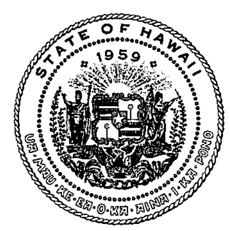
Drafting Information

The principal author of this notice is Patricia M. Zweibel of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Ms. Zweibel at (202) 622-5020 (not a toll-free call).

© 2008 Thomson/RIA. All rights reserved.

LINDA LINGLE
GOVERNOR OF HAWAII





LAURA H. THIELEN
CHAIRPERSON
BOARD OF LAND AND NATURAL RESOURCES
COMMISSION ON WATER RESOURCE MANAGEMENT

RUSSELL Y. TSUJI
FIRST DEPUTY

KEN C. KAWAHARA
DEPUTY DIRECTOR - WATER

AQUATIC RESOURCES
BOATING AND OCEAN RECREATION
BUREAU OF CONVEYANCES
COMMISSION ON WATER RESOURCE MANAGEMENT
CONSERVATION AND COASTAL LANDS
CONSERVATION AND RESOURCES ENFORCEMENT
ENGINEERING
FORESTRY AND WILDLIFE
HISTORIC PRESERVATION
KAHOOLAWE ISLAND RESERVE COMMISSION
LAND
STATE PARKS

STATE OF HAWAII
DEPARTMENT OF LAND AND NATURAL RESOURCES
POST OFFICE BOX 621
HONOLULU, HAWAII 96809

TESTIMONY OF THE CHAIRPERSON OF THE BOARD OF LAND AND NATURAL RESOURCES

on House Bill 2518, House Draft 1, Senate Draft 1 – RELATING TO LAND CONSERVATION

BEFORE THE SENATE COMMITTEE ON
ECONOMIC DEVELOPMENT AND TAXATION

March 18, 2008

House Bill 2518, House Draft 1, Senate Draft 1 provides a land conservation incentive tax credit to encourage the preservation and protection of land in the State. The Department of Land and Natural Resources (Department) supports the intent of this measure to provide incentives for landowners to preserve and protect their important mauka lands, but defers to the Department of Taxation on tax implications and effects the bill would have on their operations.

Over half of the lands in Hawai'i are privately owned and *mauka* lands, including intact forests, open woodlands, and pasture lands, and provide a significant amount of "ecosystem services," that support all of Hawaii's residents and visitors. These services include the delivery of clean drinking water, carbon sequestration that stabilizes the climate, cultural practices, opportunities for recreation, and many others. These lands also play a critical role in supporting Hawaii's unique native plants and animals. It is essential to provide solid stewardship incentives for private landowners to care for *mauka* lands that are critical in ecosystem service production.

The Department participated in a working group formed in response to House Concurrent Resolution 200, 2006 Legislative Session, to conduct an analysis of local, national, and international incentive programs that promote landowner protection of important *mauka* lands and recognize the public benefits of the ecosystem services provided by those lands. The establishment of state tax credits for donated conservation easements and landowner-funded activities that promote conservation on private lands was one of the key recommendations in the working group report (http://hawaii.gov/dlnr/reports/2008/division-of-forestry-wildlife/FW08-Important-Mauka-Lands-Report.pdf).

Promoting conservation easements is a valuable conservation tool. Conservation easements are restrictions placed on land to enhance conservation values. They are either voluntarily sold or donated by a landowner. The Legacy Land Conservation Program, Chapter 173A, Hawaii Revised Statutes, provides State funding for the acquisition of conservation easements on lands having value as a resource to the State. This measure would provide tax credits for landowners that donate or make a bargain sale of land or conservation easements or voluntarily invest in conservation management. These credits would be added to federal tax benefits for these

actions. The combination of existing federal tax benefits and proposed state tax credits will likely provide an immediate stimulation to expanded conservation actions and promote delivery of ecosystem services on *mauka* lands throughout the State with its public benefits.

The Department is aware of the Department of Taxation's concerns with certifying what donations of land or investments in management of land qualify for the tax credit. The Department is the appropriate agency to certify donations or management actions for natural and cultural resources and the Department of Agriculture (DOA) would be the appropriate agency for agricultural easements or management. The Department is willing to work with the Department of Taxation on how best to implement such a process and identify ways to streamline the process and book-keeping and reporting requirements. The Department was given the authority to adopt rules for this process. DOA should be given this authority as well.

The Department notes that the Senate Water and Land Committee amended the House version of this measure by replacing its content in its entirety with the content of Senate Bill 2198, Senate Draft 2, which requires that the appropriate state agency work with the taxpayer to identify opportunities for public access if appropriate and reasonable. The Department supports this approach because it allows flexibility in dealing with public access to the lands qualifying for the tax credit. Requiring public access to all potential lands will be a disincentive for some landowners to participate. While appropriate for some lands such as beach or recreational access, open public access may not be appropriate for other lands such as cultural and historic properties, and working farms or ranches that have legitimate concerns about vandalism, resource theft, and liability. The taxpayer should be required to provide access to the public or private conservation agency holding the conservation easement to monitoring the status of the conservation easement or to verify that conservation management actions have been implemented on the property. Public access should be encouraged and required where appropriate to fulfill the purpose of the easement, but not be required in cases where it would jeopardize or degrade resources intended for protection or create an undue hardship or liability for the landowner.

LINDA LINGLE
Governor

SANDRA LEE KUNIMOTO
Chairperson, Board of Agriculture

DUANE K. OKAMOTO
Deputy to the Chairperson

State of Hawaii
DEPARTMENT OF AGRICULTURE
1428 South King Street
Honolulu, Hawaii 96814-2512

MAR 17 2008

TESTIMONY OF SANDRA LEE KUNIMOTO
CHAIRPERSON, BOARD OF AGRICULTURE

BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION
TUESDAY, MARCH 18, 2008
1:15 p.m.
Room 224

HOUSE BILL 2518, HOUSE DRAFT 1, SENATE DRAFT 1
RELATING TO LAND CONSERVATION

Chair Fukunaga, Vice-Chair Espero and Members of the Committee:

Thank you for the opportunity to testify on House Bill No. 2518, House Draft 1, Senate Draft 1 that seeks to establish a tax credit to encourage the preservation and protection of certain donated or "bargain sale" lands in the State at less than fair market value, and in perpetuity. The Department of Agriculture supports the intent of this bill and offers an amendment. We defer to the Department of Taxation regarding the tax credit and its implications on the State budget.

The amendment is to Section 2 (page 1, lines 4-13) to clarify that only agricultural lands qualifying for the land conservation tax credit that are designated as IAL may access incentives for IAL that will be developed and enacted by the Legislature. The amendment is in bold and double-underlined.

SECTION 2. Section 205-45, Hawaii Revised Statutes, is amended by amending subsection (a) to read as follows:

"(a) A farmer or landowner with lands qualifying under section 205-44 may file a petition for declaratory ruling with the commission at any time in the designation process. The holder of an interest in agricultural lands that qualifies for the land conservation incentives tax credit under section 235-

may petition the commission for designation of the agricultural lands as important agricultural lands, and**, upon designation,** enjoy the incentives for important agricultural lands provided under section 205-46."

Emailed to: testimony@Capitol.hawaii.gov

Mar. 16, 2008

Denise Antolini 59-463 Alapi`o Road Pūpūkea, O`ahu 96712
(808) 638-5594

Senate Economic Development and Taxation Committee
Hearing March 18, 2008
1:15 p.m. Conf. Room 224

Dear Chair Fukunaga, Vice Chair Espero, and Members of the Committee:

I write in **strong support of HB2518 HD1 SD1**, providing tax credits for land conservation.

The State of Hawaii needs -- **NOW, this session** -- a broader range of land conservation tools to protect the "crown jewels" of our coastal, agricultural, and rural landscape.

For proposed public-private acquisitions, such as the **Galbraith** agricultural lands in Central O`ahu, the **Turtle Bay** property on the North Shore, and the **many other high priority needs around the state**, this new tool of tax credits for willing landowners is critical to add to the toolbox.

The cost to the state is "pennies on the dollar" compared to the benefits, particularly now when the real estate market has slowed down considerably. With appropriate safeguards to ensure proper valuation, this tool can result in considerable long-term savings to taxpayers through avoided costs of development.

Twelve other states in the country have this kind of tax credit for conservation program -- Hawaii should proudly become the 13th state to join this effort that brilliantly leverages state and private resources for permanent land conservation.

Mahalo for your support.

Sincerely,

Denise Antolini

Hawaii Agriculture Research Center
99-193 Aiea Heights Drive, Suite 300
Aiea, Hawaii 96701
Ph: 808-487-5561/Fax: 808-486-5020

TESTIMONY BEFORE THE SENATE COMMITTEE ON ECONOMIC DEVELOPMENT AND TAXATION

HB 2518 HD1 SD1

RELATING TO LAND CONSERVATION

March 18, 2008

Chair Fukunaga and Members of the Committee:

My name is Stephanie Whalen. I am President and Research Director of the Hawaii Agriculture Research Center (HARC). I am testifying today on behalf of the center, our research and support staff, and our members and clients.

HARC **strongly supports HB 2518 HD1 SD1 Relating to Land Conservation**.

In order to preserve some of the lands of Hawaii incentives are important. Because of the unique land holding situation in Hawaii many land owners do not qualify for the federal tax credits provided to those helping to preserve lands for the purposes proposed in this measure. Although there have been efforts to make an exception specifically for Hawaii to allow our land owners to receive these federal tax credits, those efforts have not been successful.

It is in the public interest of this state to provide those tax credits to ensure some lands for unique or special use are preserved in perpetuity.

Thank you for this opportunity to provide **SUPPORT** for **HB 2518 HD1 SD1**, preserving land in Hawaii for the public interest.

The Nature Conservancy of Hawai'i
923 Nu'uanu Avenue
Honolulu, Hawai'i 96817

Tel (808) 537-4508
Fax (808) 545-2019

nature.org/hawaii

Testimony of The Nature Conservancy of Hawai'i
Supporting H.B. 2518, SD1 Relating to Land Conservation
Senate Committee on Economic Development and Taxation
Tuesday, March 18, 2008, 1:15PM, Room 224

The Nature Conservancy of Hawai'i supports H.B. 2518, SD1 Relating to Land Conservation. **We also suggest a few amendments noted below and attached.**

Undeveloped private lands often provide significant benefits and services to the general public such as watersheds, erosion control, carbon sequestration, green space, recreational opportunities, and cultural preservation. However, landowners do not presently receive any remuneration for the ecosystem services their lands provide. While the public depends upon the provision of these services, society often treats them as essentially free.

For many private landowners, there is significant pressure to convert forests, ranch and agricultural lands, open spaces, and lands with historical or cultural features to uses that generate greater income to the landowner. A mix of existing government and private funding for conservation land purchases, as well tax incentives like those in this bill can enable landowners a variety of options to avoid conversion and help government achieve a public benefit. Indeed, tax incentives that allow landowners to retain ownership while committing to protection can help achieve public conservation priorities without requiring the government to expend many millions more to buy and manage the land itself.

We ask that you consider lengthening or, preferably, eliminating the 2012 sunset date in Section 5 in favor of a reporting requirement by the relevant state agencies.

In other states, it took at least three years before even a nominal number of land owners completed the land donation tax credit process. In many cases, landowners will want to test the water with a small donation and follow up a few years later with a more meaningful donation. California adopted a 10-year sunset, prior to which they could assess the effectiveness of their legislation. For many other states, rather than adopting a sunset provision, they implemented a reporting requirement to gather data about the use of the tax credits. States have found that the tax credits were useful money savers in their quest to protect scarce resources. The trend has actually been to amend statutes to provide more generous incentives to inspire more donations.

Finally, we suggest an amendment to give rule making authority to both DLNR and Deptartment of Agriculture to assist the Department of Taxation with certifying donations. And, we suggest an amendment to give penalty authority to the Department of Taxation to prevent appraisal misstatements.

Attachment

BOARD OF TRUSTEES
S. Haunani Apoliona Peter D. Baldwin Christopher J. Benjamin Zadoc W. Brown, Jr. Carl A. Carlson, Jr. David C. Cole Samuel A. Cooke
Peter H. Ehrman Kenton T. Eldridge Guy Fujimura J. Stephen Goodfellow Thomas Gottlieb James J.C. Haynes Ron Higgins Peter Ho
Stanley Hong J. Douglas Ing Mark L. Johnson Dr. Kenneth Kaneshiro Bert A. Kobayashi, Jr. Faye Watanabe Kurren Duncan MacNaughton
Bill D. Mills Wayne Minami Michael T. Pfeffer H. Monty Richards Jean E. Rolles Scott Rolles James Romig Eric Yeaman

Suggested amendments by The Nature Conservancy of Hawai'i to H.B. 2518 SD1 [addition to (j), new (k) and (l), delete sunset]

(j) The chairperson of the board of land and natural resources and the chairperson of the board of agriculture may adopt rules pursuant to chapter 91 to effectuate this section and to certify that donations or investments claimed for a tax credit under this section fulfill a conservation or preservation purpose pursuant to subsection (c).

(k) The director of taxation, the chairperson of the board of land and natural resources and the chairperson of the board of agriculture shall together prepare and submit an annual report to the Legislature not later than twenty days prior to the convening of the regular session of the use and effectiveness of the tax credit provided in this section, including the relevant details of the value of tax credits claimed and the types of donations made by taxpayers. The director of taxation my include this report in that department's annual report to the legislature."

(l) Any appraisal prepared pursuant to the requirements of subsection (e)(1) shall be subject to all requirements, including the same level of penalties for valuation misstatements, for appraisals and appraisers under applicable federal law and regulations governing charitable contributions."

SECTION 4. New statutory material is underscored.

SECTION 5. This Act shall take effect on July 1, 2050, and shall apply to taxable years beginning after December 31, 2007~~; provided that this Act shall be repealed on December 31, 2012~~.

Legislative Testimony

HB 2518, HD 1, SD 1, RELATING TO LAND CONSERVATION

Senate Committee on Economic Development and Taxation

March 18, 2008 1:15 p.m. Room: 224

The Office of Hawaiian Affairs supports the intent of H.B. 2518, H.D. 1, S.D. 1, which would provide an incentive tax credit for conservation and preservation lands.

OHA has substantive obligations to protect the cultural and natural resources of Hawaiʻi for its beneficiaries, the people of this land. The Hawaii Revised Statutes (HRS) mandate that OHA "[s]erve as the principal public agency in the State of Hawaii responsible for the performance, development, and coordination of programs and activities relating to native Hawaiians and Hawaiians; . . . and [t]o assess the policies and practices of other agencies impacting on native Hawaiians and Hawaiians, and conducting advocacy efforts for native Hawaiians and Hawaiians." (HRS § 10-3)

Because of these mandates, we must examine all proposals with a view toward the best possible preservation and perpetuation of constitutionally and judicially protected Native Hawaiian rights and practices. On its face, this bill appears to provide for such interests by promoting preservation and conservation through providing tax incentives for private land donations.

While OHA appreciates that language was added to this bill that attempts to address the issue of access, we do not believe that the new language goes far enough to protect Native Hawaiian access. OHA notes that Native Hawaiians are guaranteed a separate and additional layer of access from what is afforded to the public at large. Moreover, the state has a responsibility to preserve Native Hawaiian's constitutionally and statutorily protected right to access.

Therefore, we would prefer if the bill included specific language that assured preservation of Native Hawaiian access, gathering and religious rights and practices within the donated lands that would qualify for the proposed tax exemption. Arguably, these rights run with undeveloped land, but for clarity purposes OHA would prefer language included in the statutory amendment.

Furthermore, OHA requests that the language relating to public access that was added to the bill be clarified. In the statement, "[…] the state agency work with the taxpayer to identify opportunities for public access if appropriate and reasonable," the phrase "if appropriate and reasonable" maybe too vague and discretionary.

We also have questions about the proposed Section 235 - ___ (c)(2), which states that the tax credit would apply to an eligible State taxpayer who "voluntarily invests in the management of land to protect or enhance a conservation or preservation purpose under a land protection agreement, conservation management agreement, or other legal instrument that is consistent with a conservation or preservation purpose." This subsection needs to be clarified so that people do not profit or get subsidized for fulfilling management responsibilities that they already have and should be completing. What qualifies as investment and appropriate land management? Also, must this management investment be toward a conservation or preservation purpose that will run with the land in perpetuity, as in the case of a conservation easement, or could the management investment be a temporary one that may lead to development of the same parcel?

Thank you for the opportunity to testify and for considering our concerns.

Hawai'i Office
212 Merchant St.
Suite 320
Honolulu, HI
96813
T: 808-524-8560
F: 808-521-8565
www.tpl.org

THE TRUST FOR PUBLIC LAND'S TESTIMONY IN SUPPORT
HB 2518
Senate Committee on Economic Development and Taxation
Tuesday, March 18, 2008, 1:15 p.m., Room 224
testimony@capitol.hawaii.gov

Dear Chairperson Fukunaga and Vice Chair Espero:

The Trust for Public Land (TPL) supports HB 2518 Relating to Land Conservation.

As development and urban sprawl increase, concern about the future of land use and its relation to Hawai'i's natural resources, economy and heritage have come to the forefront of community concern. Some of these concerns are protected and embodied in recent laws providing funding for the acquisition of private lands for public conservation purposes. The recent State Legacy Lands Act is but one example.

Funding from programs such as the Legacy Lands Conservation Program yield great benefits to the people of Hawai'i, but further incentives are necessary to provide alternatives to the tremendous financial pressures to convert needed agricultural or conservation land to other uses that generate greater revenue. It is also impossible for the government to acquire and take care of all of these lands.

H.B. 2518 provides a voluntary incentive for private landowners to protect our precious lands and offers an alternative to acquisition and government management. It advances conservation by creating a competitive class of land use in an economy where conversion by private landowners to other uses are an attractive or economic necessity.

We urge you to support HB 2518.

Mahalo for this opportunity to testify,

Lea Hong

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: INCOME, Land conservation incentives tax credit

BILL NUMBER: HB 2518, SD-1

INTRODUCED BY: Senate Committee on Water and Land

BRIEF SUMMARY: Adds a new section to HRS chapter 235 to allow an eligible taxpayer who is the owner of land to claim a land conservation incentives tax credit if the taxpayer: (1) donates the land in perpetuity or completes a bargain sale in perpetuity to the state or public or private conservation agency that fulfills a conservation or preservation purpose provided that any donation or sale that represents a less-than-fee interest qualifies as a charitable contribution deduction under IRC section 170(h); or (2) voluntarily invests in the management of land to protect or enhance a conservation or preservation purpose under a land protection, conservation, or management agreement. Requires the taxpayer to provide reasonable public access to lands under this section. Donations of land for open space to fulfill density requirements to obtain subdivision or building permits do not qualify for the credit.

Permits a holder of an interest in agricultural lands to petition the land use commission for designation of the agricultural lands as important agricultural lands so as to be able to claim the credits proposed in this measure.

The amount of the tax credit shall be 50% of the fair market value of the land that the eligible taxpayer donates in perpetuity on or after January 1, 2008 for a conservation or preservation purpose to the state or public or private conservation agency; or 50% of the amount invested in the management of land. Limits the credit to $2.5 million per donation regardless of the value or interest in the land. The credit may be claimed only once per tax year. Delineates procedures for the claiming of the credit by a pass-through entity. This credit shall be repealed on December 31, 2012.

Credits in excess of a taxpayer's income tax liability may be applied to subsequent income tax liability. Claims for the credit, including any amended claims, must be filed on or before the end of the twelfth month following the close of the taxable year. The director of taxation may adopt rules pursuant to HRS chapter 91 and prepare the necessary forms to claim the credit and may require proof to claim the credit.

Defines "bargain sale," "conservation or preservation purpose," "cultural property," "eligible taxpayer," "interest in land or real property," "land" and "public or private conservation agency" for purposes of the measure.

Amends HRS section 205-45 to allow a holder of interest in agricultural land that qualifies for the land conservation initiative tax credit to petition the commission for the designation of agricultural lands as important agricultural lands.

EFFECTIVE DATE: July 1, 2050, applicable to tax years beginning after December 31, 2007

STAFF COMMENTS: This measure proposes an incentive in the form of an income tax credit to encourage a landowner to donate, complete a bargain sale to the state or a conservation agency, or voluntarily invest in the management of land to protect or enhance a conservation or preservation purpose.

While the credit may be intended as an incentive, it lacks accountability. In considering this measure, lawmakers should ask themselves just how much will this program cost the state treasury? If this program required an appropriation, how much would lawmakers be willing to appropriate for this program? The financial impact of the proposed credit is no different from the expenditure of public dollars albeit out the back door and hidden from public scrutiny.

Tax credits generally are designed to mitigate the tax burden of those individuals or businesses that do not have the ability to pay their share of the tax burden. These credits are justified on the basis that low-income taxpayers should be relieved of the burden imposed by taxes that are not based on the income of the taxpayer, such as the general excise tax. The proposed credit contained in this measure bears no relationship to the tax burden of the landowner. Thus, the credit amounts to nothing more than a subsidy by state government. Such subsidies are more accountable if funded with a direct appropriation of state funds.

It has been noted that the federal law has incentives for such donations, it should be noted that Hawaii already conforms to this provision of the federal law by allowing for the deduction of contributions made to government or nonprofit agencies. The federal government does not have a credit for such donation to government or charities as this measure proposes. While there may also be other states that have such credits, they are not as generous as the one proposed in this bill. States where such credits are available are those states which have relatively vast acreage of land which has very little value anyway. That is not the case in Hawaii. Thus, comparing Hawaii to those states is like comparing fruit with vegetables.

Given the economic outlook for the state and the financial picture for state government this is a credit that the state simply cannot afford, for though this is a tax credit, it is nothing more than an expenditure of tax dollars that would otherwise have paid for a general fund program or service.

Digested 3/17/08

THE UNIVERSITY OF HAWAII ENVIRONMENTAL CENTER IS PLEASED TO SUBMIT THIS TESTIMONY IN ACCORDANCE WITH ACT 132 OF 1970 WHICH CREATED THE CENTER. AUTHORS ARE MEMBERS OF THE UNIVERSITY COMMUNITY.

RL: 2198

HB 2518 HD1 SD1
RELATING TO LAND CONSERVATION

Senate Committee on Economic Development and Taxation
Public Hearing – March 18, 2008
1:15 p.m., State Capitol, Conference Room 224

By
David Duffy, Botany
Peter Rappa, Environmental Center

HB 2518 HD 1 provides a tax credit to encourage the preservation and protection of conservation land in the State. We emphasize that our testimony on this measure does not represent an official position of the University of Hawaii.

We agree with the intent of this bill. Tax credits have been used effectively in other states to encourage the preservation and protection of conservation lands. This practice can potentially save the state millions in conservation land purchases as it will allow the state some leeway of whether or not to purchase all the land it wishes to preserve. This can work to the state's benefit especially when leveraged with NGO or Legacy Land Conservation Commission funds to preserve contiguous tracts of land.

Thank you for the opportunity to comment on this bill.

2500 Dole Street, Krauss Annex 19, Honolulu, Hawai'i 96822-2313
Telephone: (808) 956-7361 • Facsimile: (808) 956-3980