

Rulings of the Tax Commissioner

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Tax Type: Individual Income Tax
Brief Description: Land Preservation Tax Credit
Topics: Credits
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Supersedes P.D 05-76

July 22, 2005

Re: Ruling Request: Individual Income Tax

Dear *****:

You requested a ruling on the eligibility of a conservation easement for Land Preservation Tax Credits (the "Virginia credit") authorized under the Virginia Land Conservation Incentives Act of 1999 (the "Act"). You wish to know whether a determination by the Internal Revenue Service ("IRS") that, for federal income tax purposes, a donation of a particular land conservation easement does not qualify as a deductible charitable donation under Internal Revenue Code ("IRC") § 170(h), would necessarily render that donation ineligible for tax credits under the Act. The Department of Taxation (the "Department") initially responded to this inquiry on May 19, 2005, which was published as Public Document ("P.D.") P.D. 05-76 (May 19, 2005).

Following publication of P.D. 05-76, the Department received additional information concerning widespread variations in certain clauses and language that may, or in some cases should, be included in the documents conveying conservation easements to various donees. After reviewing this information, the ruling published as P.D. 05-76 is hereby withdrawn and revoked, and this ruling is issued in its place.

FACTS

The Department has recently been informed that Land Preservation Tax Credits have been claimed on Virginia tax returns based upon several land conservation easements that may possibly be defective as to the form of the instrument. While these easement instruments may convey enforceable preservation rights to eligible conservation entities, they lack certain language that is arguably required to qualify for the federal charitable deduction under IRC § 170(h) and, thus, for the Virginia credit. At this time, the Department is unaware that the IRS has ruled that any Virginia conservation easements are defective for tax purposes because of the absence of certain language.

You are writing to request that the Department institute a policy that will allow the Virginia credit to be claimed and maintained in spite of the fact that the credits are based on easement instruments that are found to be defective under IRC § 170(h). You ask that this policy remain in place even if the IRS disqualifies those easements under IRC § 170(h).

RULING

The Act, codified at *Va. Code* § 58.1-510, *et esq.*, provides a credit equal to fifty percent of the value of real property, or an interest in real property, donated to an eligible charitable organization or instrumentality of the Commonwealth for qualifying land conservation purposes. In order to qualify for the Virginia credit, a donation of a less than fee simple interest in real property must qualify as a charitable deduction under IRC § 170(h). See *Va. Code* §§ 58.1-511 and 58.1-512 B 2. This section of the IRC and the regulations issued pursuant to it contain several requirements that must be met in order for an easement to be eligible for a charitable deduction.

You have requested that the Department disregard any findings made by the IRS pertaining to whether the easements qualify as charitable deductions under IRC § 170(h). In other words, you are urging the Department to allow Virginia taxpayers to claim conservation easement tax credits, notwithstanding the fact that the instruments by which the easements were conveyed, failed to meet the requirements of IRC § 170(h) and its regulations.

Because the Act grants a credit or abatement of tax, it must be strictly construed. *Forst v. Rockingham Poultry Mktg. Coop.*, 222 Va. 270, 279 S.E.2d 400 (1981)¹. This means that an easement must qualify as a charitable deduction under IRC §

170(h). If the easement does not meet any of those requirements, it also does not meet the conditions established under the Act, and, therefore, the easement cannot qualify for the Virginia credit. The statute provides no authority for the Department to allow an exception.

Furthermore, the Department cannot ignore noncompliance. Thus, should the IRS review a land conservation easement and disallow the associated charitable deduction for failure to qualify under IRC § 170(h), the Department is required by *Va. Code* § 58.1-512 B 2 to make corresponding adjustments to Virginia taxable income and also disallow the Virginia Credit. If, upon such a review, the IRS determined to allow the charitable deduction, however, the Department will accept that decision and allow the Virginia credit if it otherwise qualifies under the Act. In any event, the Department is not required to wait for a decision from the IRS. Instead, the Department may act and, in its own right, disallow the Virginia Credit.

Regardless of whether shortcomings existed in any land trust organizations' template instruments suggested for use by a taxpayer contemplating a donation of an interest in land for a conservation purpose, that does not mean that any donations of conservation easements held by such organizations are necessarily ineligible for the Virginia Credit. Frequently, donors' legal advisers draft original instruments or modify templates to conform to the donors' wishes and other requirements of the law. I am certain that many practitioners pay particular attention to the requirements of IRC § 170(h) to ensure the donor is eligible for all tax benefits that may accrue. Thus, as noted above, each donation must be examined on a case-by-case basis to determine eligibility for the Virginia Credit. Moreover, I note that some of the requirements of IRC § 170(h) addressed indirectly in this letter do not apply in the circumstances where the donation of the conservation interest in land is in fee simple.

In the unusual circumstance that a recorded instrument does not qualify for the Virginia Credit because of missing or defective language, but still conveys an enforceable easement¹ and the parties intended for the document to comply with the IRS requirements, existing law may allow the document to be reformed, and the conveyance would then qualify for the credit from the date of reformation. The value of the easement, however, would be governed by the value on the date that the enforceable easement was originally conveyed, not the date that the documents were reformed to qualify for tax benefits. A different conclusion would be reached, of course, if the IRS acted to deny the charitable deduction regardless

of the reformation, or issued a ruling that accepts the reformation yet establishes a different value. Nothing in this letter is intended to rule ultimately on either the real property or federal tax law issues discussed in this paragraph. Again, each donation would have to be examined on a case-by-case basis.

In conclusion, should a taxpayer have a Land Preservation Tax Credit that is based on an easement that lacks language that is arguably required under IRC § 170(h), he or she should consult with his or her tax advisor to determine eligibility for any intended tax benefits and to choose an appropriate course of action.

I trust that this reply answers your ruling request. The *Code of Virginia* sections cited and other reference documents are available on-line in the Tax Policy Library section of the Department's web site located at www.tax.virginia.gov. If you should have any questions regarding this ruling, you may contact ***** in the Office of Policy and Administration, Policy Development, at *****.

Sincerely,

Kenneth W. Thorson

Tax Commissioner

¹ "The rule of strict construction stems from the announced policy of this Commonwealth to distribute the tax burden uniformly and upon all property. Va.Const. art. X, § 1. Thus, any provision granting an immunity from taxes, whether called an exclusion, limitation or exemption is narrowly construed." Forst v. Rockingham Poultry Coop., 222 Va. 270, 276, 279 S.E.2d 400, 403 (1981).

² See, e.g., United States of America v. Peter F. Blackman, Supreme Court of Virginia, Record No. 042404, June 9, 2005, at pp. 12, 14-15 [A valid conservation easement may be conveyed irrespective of whether the easement meets the tests of common law (or, impliedly, other statutes for different, though closely related purposes, or later-enacted statutes).]