

Commentary

Tax Benefits for Charitable Contributions of Land

by Dana P. Newman

Charitable donations have long had beneficial federal and state income tax treatment. Special rules for certain categories of appreciated property have made donations of such appreciated property particularly beneficial. Recently, California has added significant additional California state tax benefits for donations of land to eligible nonprofits for conservation purposes. Taken together, landowners may realize significant economic benefits from the contribution of land for conservation purposes. *In some instances, in fact, a landowner may realize greater economic benefits from making a charitable contribution of land for conservation purposes than from selling the land.*

General Contribution Rules.

As most people are aware, general federal and state income tax rules provide that a taxpayer making a donation of money or property to a qualified charity is entitled to claim a federal and state income tax deduction for the amount of the charitable contribution. Special rules apply in determining the tax deduction amount available for the charitable donation of property such as land. If the landowner has held the land as a capital asset for more than a year, the landowner will be entitled to a charitable contribution deduction equal to the current appraised fair market value of the land. This can be particularly beneficial to a landowner if the land has appreciated in value over its purchase price. *It allows the landowner to take a charitable tax deduction for the full fair market value of the land without ever recognizing the appreciation in value as taxable income.*

The federal and state income tax rule is not as beneficial, however, for property that is not a capital asset, such as inventory, or for property that has not been held by the landowner for at least a year. In such cases, the landowner is entitled to a charitable contribution deduction for the fair market value of the land *reduced by the amount of the appreciation.* This rule would generally apply to a real estate developer who holds land as inventory.

Natural Heritage Preservation Tax Credit Act.

If a landowner makes a donation of certain qualified land, then under a relatively new California law known as the Natural Heritage Preservation Tax Credit Act of 2000 (the "Act"), *a landowner may be entitled to a California state tax credit equal to 55% of the appraised fair market value of the contributed land in lieu of the state charitable contribution deduction.* Generally, a tax credit provides a greater financial advantage compared to a tax deduction, since a credit will reduce the landowner's tax liability dollar-for-dollar.

The Act was adopted by the California legislature to protect and conserve open space, agricultural land, rangelands, wildlife habitat, state and local parks and archaeological resources. To accomplish these goals, the program allows private landowners to donate land or water rights to state and local agencies or designated nonprofit organizations for conservation purposes. In return, the Act provides \$100 million in California tax credits for qualified

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donations. The Act identifies the Wildlife Conservation Board as the responsible party to implement this program.

To qualify for the tax credit, the donated land must help preserve wildlife and wildlife habitat, open space, agricultural land, fish, plants, water, or endangered species of plants and animals. Eligible land also includes land that will be used as a park or open space or will augment public access to or enjoyment of existing regional or local archaeological resources. However, the credit may not be claimed for land donated as a condition for obtaining use of the land from a public agency through a lease, permit, license, certificate, or other form of entitlement to property use.

Eligible donees include any state department or conservancy within the California Resources Agency as well as local agencies such as park and open space districts, cities, counties, and other land preservation agencies. In addition, a nonprofit organization is considered an eligible donee if (1) the nonprofit has been designated by a local government, state department or conservancy to accept property in lieu of the local government, state department or conservancy, and (2) qualifies as a nonprofit charitable organization under Section 501(c)(3) of the Internal Revenue Code and has as one of its primary purposes the conservation of land and water resources.

In exchange for a qualified donation, donors will receive a California State tax credit in an amount equal to 55 percent of the appraised fair market value ("FMV") of the contribution. This credit is in lieu of any other California credit or deduction which the taxpayer may otherwise claim with respect to the property or any interest that is donated. In the case of a partnership, limited liability company, Subchapter S corporation, or other pass through entity, the tax credit will be distributed to the partners or shareholders. If the donor cannot use the entire tax credit in one year, the excess may be carried forward to reduce the donor's net tax for the following eight years, or until all of the credit is exhausted.

Partial donations, such as a bargain sale, are eligible for the tax credit if the landowner and qualifying agency or organization agree to a sale of property for less than its appraised FMV. The donation value is the difference between the appraised FMV and the sales price. The donor's tax credit is 55% of that donation value.

California's state tax credit program will remain in effect until December 30, 2005, or until the entire \$100,000,000 in tax credits have been awarded, whichever comes first. (As of March 2002, approximately \$70 million in tax credits were still available.) Landowners interested in donating qualified lands must coordinate the preparation of an application package with an eligible donee. Before any application can be submitted to the Wildlife Conservation Board, a public hearing is held in the county from which the donation is made.

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