



NOVA SCOTIA NATURE TRUST

Cross-Border Conservation Gifts by U.S. Residents: Fact Sheet for Donor Advisors

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Purpose

Canadian land trusts are increasingly working in partnership with U.S. residents to protect important natural areas in Canada. Such cross-border gifts of land, conservation easements and remainder interests by U.S. residents are complex, involving Canadian, U.S. and international tax law and procedures. The purpose of this fact sheet is to provide an overview of key issues for professional advisors of U.S. cross-border conservation donors. The intent is to highlight key issues and to point to potentially useful resource and reference materials (see *Additional Resources* at the end of the document). This document is not intended to provide legal, financial or other advice, or to provide a comprehensive documentation of all issues relevant to cross-border giving.

Unique Aspects of Cross-Border Conservation Gifts

Advising U.S. donors on cross-border conservation gifts requires a solid understanding of both Canadian and U.S. tax law and conservation procedures, and the income tax treaty between Canada and the U.S. Cross-border gifts present a number of unique circumstances that may be unfamiliar to donors and their advisors:

Tax Implications

- ✓ U.S. donors might expect a U.S. tax benefit for their gift (as they would receive for a conservation gift within the U.S.). This simply may not be possible with a cross-border gift. They may in fact face tax obstacles.
- ✓ Depending on how the cross-border conservation gifting is pursued, there may be two Canadian and one U.S. agency involved in administering and reviewing cross-border conservation gifts: the Canada Revenue Agency (CRA), the Ecological Gifts Program of Environment Canada, and the Internal Revenue Service of the U.S. Department of Treasury (IRS).
- ✓ Income, estate and gift tax consequences of a gift of land, remainder interest or conservation easement (used in this document to refer also to servitudes and conservation covenants) vary depending on the status of the organization receiving the gift (i.e. the donee), and on the nature and type of gift, because of combined U.S. and Canadian tax laws.
- ✓ There is a deemed capital gain on gifts of land and interests in land (remainder interests or conservation easement) in Canada (with potential capital gains tax liability), just as if the land or interest in land had been sold.
 - In certain circumstances (where the donee is a Canadian charity or government agency), the donor may be able to reduce or eliminate the tax on capital gains through a Canadian income tax incentive program for Ecological Gifts¹).
 - Where the donee is a Canadian charity, government agency, or a U.S. organization with special *prescribed donee*² status in Canada, the donor may be able to reduce or eliminate the tax on capital gains through a special election under the Canadian Income Tax Act³.

- Gifts to other U.S. charities (i.e. who are not *prescribed donees*) result in full capital gains, and usually tax, which the donor may not be able to reduce or avoid.
- ✓ If the donor has Canadian-source income, gifts to Canadian charities may provide income tax deductions against Canadian-source income on the donor's U.S. tax return, as permitted under the income tax treaty between Canada and the U.S.⁴. Alternatively, conservation gifts to a U.S.-based charity can provide a tax benefit against U.S.-source income.
 - Under U.S. tax law, the fair market value of conservation gifts may be deductible⁵ up to a portion of the donor's adjusted gross income and any portion of the donation that remains unused in the year of the gift may be carried forward and used over the a set number of years, depending on the type of donation. The after-tax value of the gift (net tax savings) is a function many factors including but not limited to the value of the gift component as established through a qualified appraisal, the tax bracket of the donor, whether the gift triggers the alternative minimum tax and other financial circumstances.
 - A charitable tax deduction claim is made through the donor's income tax filings which must include a copy of an appraisal completed to specific IRS standards (see below) and through the filing of an IRS Internal Revenue Code Form 8283B "Non-cash Charitable Contribution," which must be signed by the donor, donee and appraiser.
- ✓ Whether given to a U.S. or Canadian charity, conservation easements and gifts of remainder interest (lifetime or testamentary gifts) must meet specific U.S. tax law requirements for "qualified conservation contributions"⁶ (see discussion below) to avoid gift taxes and significant estate tax problems and to ensure eligibility for certain income tax benefits⁷. Conservation easements must also meet the requirements of the respective jurisdiction in which the easement is held.
 - For conservation easements and remainder interests, Canadian land trusts need to take steps to qualify with the IRS as a *publicly-supported charity*⁸ (i.e. not a private foundation), before accepting such gifts (even if the gift is first made to a U.S. organization then transferred to the Canadian land trust), or the donor could face gift taxes, and estate tax problems. Because the donee does not meet U.S. tax law criteria for *qualified conservation contributions*, the estate may be taxed as if there are no restrictions in place on the land, creating a huge estate tax burden for the heirs⁹.
 - IRS recognition as a *publicly-supported charity* also increases the deduction limits⁵ applicable for the donor's Canadian-source income for any gifts of land, remainder interest, conservation easement, cash and appreciated securities to the Canadian charity.
- ✓ Testamentary gifts (i.e. through a will) of cash, land and conservation easements to Canadian charities may provide a U.S. estate tax deduction similar to a testamentary gift to a U.S. charity¹⁰.
- ✓ The tax rules for "bargain sales" (split-receipt donations¹¹) are different in the U.S. and Canada.

Steps and Procedures

- ✓ U.S. donors must obtain special clearance from the Canada Revenue Agency prior to making a donation of land, remainder interest, or conservation easement¹². Otherwise the *donee* may be liable to pay potentially significant withholding taxes from capital gains.
- ✓ It would be prudent to ensure that appraisals meet both U.S. and Canadian requirements (outlined by the Ecological Gifts Program) including timing requirements. U.S. tax law contains specific appraisal requirements for all conservation gifts¹³. Recent amendments to U.S. tax law have increased the penalties for overstated appraisals and tightened requirements for appraisals.
- ✓ A donor is required to file income tax returns and forms (including form 8283 for Noncash contributions) in both Canada and the U.S.
- ✓ Property tax consequences for donating conservation easements vary significantly across the country, from tax deductions or rebates, to potential tax penalties and increased property taxes.
- ✓ Canadian land trusts may be able to involve U.S. conservation partners in important conservation gifts from U.S. landowners to reduce certain tax impediments (especially to provide an income tax deduction against U.S. income).
 - The organization must seek professional advice and ensure it is not acting merely as an “agent” or “flow-through” for the Canadian land trust.
 - Steps may need to be taken to enable a U.S. organization to hold land or conservation easements in the specific province or territory where the property is located.
 - There is a new U.S. organization and program being set up specifically to help Canadian land trusts and U.S. donors with cross-border conservation gifts (the American Friends of Canadian Land Trusts¹⁴). It is hoped that by working through this organization’s cross-border conservation program, donors could benefit both from U.S. income tax benefits and avoidance of Canadian capital gains tax.
- ✓ Consequences for not completing transactions properly could range from forfeiting significant tax savings, or a hefty Canadian capital gains tax on the gift for the donee, to unanticipated gift and/or estate tax problems for the donor.

Impact of Donee on Taxation Outcomes

The income, gift and estate tax implications of cross-border conservation gifts of land, conservation easements and remainder interests depend on the donee and the nature of the gift. The following simplified scenarios summarize some of the key potential tax outcomes for cross-border gifts with each of four types of donees.

Scenario 1: Donee is a Canadian charitable organization, and recognized by the IRS as a *publicly-supported charity* (i.e. not a private foundation). There is no U.S. federal or state income tax deduction/benefit against U.S. income, however, there is a potential tax deduction against Canadian-source income. The deduction limits are 30% of adjusted gross income for gifts of land, 50% for gifts of cash, and 50% for conservation easements. There is a deemed capital gain and potential tax liability, even if this real property interest is donated. However, the donor has two potential options to reduce or eliminate this tax:

- a) Under Section 118 of the Canadian Income Tax Act, a donor may reduce the deemed disposition value to anywhere between the adjusted cost base and the fair market value, thereby reducing or eliminating the capital gain and subsequent tax. The donee must be a Canadian charity, government or *prescribed donee*.
- b) Capital gains tax may be eliminated by making the gift through the Canadian Ecological Gift Program. The gift must be accepted by the federal Ecological Gifts Program, and must be donated to a recognized Canadian charitable organization or government agency.

Status as a *publicly-supported charity* provides higher deduction limits for the U.S. resident against their Canadian-source income (i.e. 50% of adjusted gross income for cash gifts and conservation easements rather than 30%, and 30% rather than 20% for gifts of land). Such status is also necessary to accept a cross-border conservation easement without risking gift and estate tax problems for the donor (otherwise the gift does not meet the requirements of a *qualified conservation contribution* to be donated to a “qualified donee”).

Scenario 1 may be the only option if other conservation partners are not available. It may be preferable where payment of Canadian capital gain taxes outweighs the after-tax benefit of a U.S. income tax deduction/benefit (i.e. compared with granting to a U.S. charity).

Scenario 2: Donee is a Canadian charity that is not recognized as a *publicly-supported charity* by the IRS (and therefore automatically deemed a private foundation). The donor can eliminate the capital gains tax using the options listed above. There is no U.S. federal or state income tax deduction/benefit against U.S. income, however, there is a potential tax deduction against Canadian-source income. The donor’s deductions against Canadian-source income are reduced as compared to Scenario 1 (i.e. 20% for gifts of land, 30% for gifts of cash). There is no income tax deduction available for conservation easements to such a donee, and there is potential gift tax on such gifts, and a risk of estate tax problems. The value of a conservation easement may be completely ignored when valuing the estate.

Scenario 2 may be appropriate in situations where payment of Canadian capital gain tax outweighs the after-tax benefit of a U.S. income tax deduction and where a Canadian charity with recognition by the IRS as a publicly-supported charity is not available. It may not be appropriate for conservation easements.

Scenario 3: Donee is a U.S. charity, which is also recognized as a *prescribed donee* under the Canadian Income Tax Act. The donor would receive an income tax deduction against their U.S. income, and the deduction limits would be increased (50% for conservation easements or cash, and 30% for land or appreciated securities). Capital gains could be reduced through the Canadian Income Tax Act Section 118 election.

Scenario 3 provides the ideal scenario in most circumstances. It eliminates Canadian capital gain taxes and offers the full compliment of U.S. income and estate tax deductions.

Scenario 4: Donee is a U.S. charity, but not recognized as a *prescribed donee*. There is a deemed capital gain and potential Canadian tax liability— even if this real property interest is donated. There is no option to reduce or eliminate the capital gains tax.

The donor would receive an income tax deduction against their U.S. income, and the deduction limits would be increased (50% for conservation easements or cash, and 30% for land or appreciated securities).

Scenario 4 may make sense if payment of the Canadian capital gain tax liability is relatively minor in comparison to the U.S. income tax and estate benefits of making the gift to a qualified U.S. conservation organization.

Key Steps for Cross-Border Conservation Gifts

In addition to standard procedures for typical conservation gifts in Canada by Canadian donors, some of the following steps may be required for cross-border conservation gifts:

1. Canadian donee seeks recognition as a *qualified donee* by the IRS (i.e. recognition as a *publicly-supported charity*, not the default status of being considered a private foundation).

For gifts of partial interest in land (such as conservation easements or remainder interests), to be eligible for U.S. income, gift and estate tax deduction, such gifts must meet certain requirements for *qualified conservation contributions*. They must be: comprised of a qualified real property interest; made to a qualified organization; and made exclusively for qualified conservation purposes.

A qualified organization may be a public agency, 501(c)3 or 509(a)(2) non-profit organization. The donee of a gift of partial interest in land must be a “qualified organization”, whether a Canadian or U.S. charity. A first step in completing cross-border giving for a Canadian land trust accepting a gift (or intending to accept a gift transferred first to a U.S. land trust) is to apply for status as a “publicly-supported charity” in the U.S. Such status is essential to ensure the donor avoids gift tax, and to ensure that the easement is recognized for estate tax purposes upon the donor’s death. Such recognition also increases the deductibility of the gift (against either the donor’s U.S. or Canadian income).

- a. Application for an employer identification number with the IRS.
- b. Application for recognition as a publicly-funded charity (*Form 8734- Support Schedule for the Advance Ruling Period*). The income tax treaty between Canada and the U.S. recognizes Canadian charities as equivalent to a 501(c)(3) organization, but by default assumes it is a private foundation, rather than a publicly-supported charity. Recognition as a publicly-supported charity means that the charity is a “qualified organization” under Section 170(h) of the Internal Revenue Code. It can then receive gifts of conservation easements and remainder interests as “qualified conservation contributions.” Such status avoids potential estate tax problems for the donor. It can also provide donors with enhanced deductibility against their Canadian-source income. Such recognition does not mean the charity is actually a U.S. charity that can provide income tax deductions against U.S.-source income—this is only possible for U.S.-based charities.

(Note: this recognition is required to receive a cross-border conservation easement, even if it is first being donated to a U.S. partner organization with potential transfer to the Canadian land trust in future. The easement must be transferred to a “qualified donee” or the donor’s income tax deduction is disallowed, and the easement may be ignored in assessing estate tax, creating a potential devastating estate tax problem for the donor’s heirs).

2. U.S. donee completes steps necessary to hold land or conservation easement in the province/territory of the gift. This may involve such steps as getting listed with the local registry of joint stock companies, applying for recognition under provincial legislation, or amending provincial conservation easement legislation to allow a U.S. organization hold a conservation easement in that jurisdiction.

3. Conservation easement drafted meeting both local easement and/or tax legislation requirements, and requirements of Internal Revenue Code Section 170(h) for qualified conservation contributions.
 - a. Land trusts should be familiar with the requirements for *qualified conservation contributions* under Section 170(h) of the Internal Revenue Code and Treasury Regulations 170A(14). It would be prudent for all cross-border conservation easements, whether donated to a Canadian land trust or U.S. conservation partner, to meet these requirements (for the reasons discussed above), which includes both specific wording in the easement and additional steps not required for typical easements within Canada. See sample cross-border conservation easement template listed in *Additional Resources*.

A qualified conservation contribution must be for one or more of the following purposes: the preservation of land for outdoor recreation by, or the education of, the general public; the protection of relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; the preservation of open space (including farmland and forest land) where such preservation is for the scenic enjoyment of the general public. To further support the foregoing, the conservation purposes should be pursuant to a clearly delineated Federal, State or local government conservation policy with significant public benefit (this requirement may not be necessary where the purpose is the protection of habitat of fish, wildlife or plants). Last, the conservation purpose must be protected in perpetuity. Limited term easements (e.g. 10 year, 20 year easements, are not acceptable).

Specific requirements for the conservation easement itself relate to the following: inconsistent uses, transferability of the easement to other donees, donor notice regarding exercise of reserved rights, enforceability, the right to enter the property for compliance monitoring, requirements for restoration, extinguishment of the easement, and proceeds of disposition in case of extinguishment.

There are also specific requirements related to mineral interests. A letter from a geologist or other expert may be required indicating that surface mining is prohibited or the likelihood so remote as to be negligible.

4. Baseline study meeting Internal Revenue Code Section 170(h) requirements for *qualified conservation contributions*.
5. Title work including mortgage subordination as required by Internal Revenue Code Section 170(h).
 - a. For conservation easements, all mortgages must be removed or subordinated to the easement's terms (i.e. if the bank forecloses on the mortgage, the easement will remain intact) as required by Internal Revenue Code Section 170(h).

6. Appraisal acquired, meeting both U.S. (including Section 170(h) requirements for “qualified conservation contributions”) and Canadian appraisal requirements. *For further information on requirements, see Appraiser Fact Sheet in resources section below.*
 - a. Because of the complexity and potential scrutiny by both the U.S. and Canadian governments of cross-border gifts, it is recommended that all appraisals meet the key appraisal requirements of the Ecological Gifts Program.
 - b. U.S. tax law provides specific guidance and requirements for appraisals (for further information, see *resources* below).
 - c. To meet U.S. tax law requirements, the appraisal must be completed between 60 days preceding the donation date and the date of the donor’s next U.S. income tax filing.
 - d. U.S. tax law requires the appraisal to be commissioned by the donor, not the donee (to ensure deductibility of the gift for the donor).
 - e. U.S. tax law prohibits certain fee arrangements including fees based on the value of the donor’s tax deduction or a percentage of the appraised value.
 - f. Recent amendments to U.S. tax law in 2006 have increased the penalties (for appraisers, donees and donors) for overstated appraisals, and have tightened requirements for appraisals.
 - g. Because of the additional time required to complete all the steps for cross-border gifts, the appraisal may need to be updated or a letter provided by the appraiser verifying the currency of the valuation, to meet both Canadian and U.S. appraisal timing requirements.
7. Ecological Gift approval and appraisal review (if donee is a Canadian charity or government qualified as an EcoGift recipient and gift meets program requirements)
 - a. *Certificate for Donation of Ecologically Sensitive Land* (submission and approval). The Minister of the Environment (or designate) must certify that the land is ecologically sensitive, by completing this certificate.
 - b. *Application for Appraisal Review and Determination*. The donee also submits an appraisal and an application form which the Minister verifies after review by Environment Canada’s Appraisal Review Panel. Once reviewed, the Minister will issue a *Notice of Determination of Fair Market Value* that indicates the value for which the Minister intends to issue a certificate, usually within 90 days and equal to the appraised value. The donor then has 90 days to finalize the donation or request an appeal of the determination. If accepted, the Minister issues a *Certificate of Fair Market Value*. Note: the appraisal review process may take time, and the delay may result in the need for an appraisal update or new appraisal.
 - c. Tax Return Filing. The donor submits the Certificate for Donation of Ecologically Sensitive Land, the Certificate of Fair Market Value, and the charitable donation receipt issued by the Canadian donee with the Canadian tax return for the year in which the gift is made.

Note: An appraisal update may be required depending on timing of approval process

8. Application for Certificate of Compliance for Non-Resident Disposition of Real Estate:
 - a. Application (Form T2062) (*see CRA Document 72-17R4 for guidance*).
 - i. Declaration of Proceeds of Disposition. If the donee is a Canadian charity, government agency or a “prescribed donee” under Canadian Income Tax Act Regulations 3504, the prospective donor may make an election to avoid (or reduce) capital gains tax owing on the gift under Section 118(1) of the Canadian Income Tax Act. The donor must decide what value to claim as the “disposition value” for the gift based on his/her particular tax circumstances. The disposition value can be any value between the adjusted cost base and fair market value, thereby reducing or eliminating the capital gains tax.
 - ii. Substantiation of value (an appraisal or other documentation satisfactory to the Minister).
 - iii. Letter from the donee indicating that they are a registered charity, that they intend to accept the gift of conservation real estate, and that they will issue a charitable tax receipt for the gift.
 - iv. Undertaking provided (for prescribed donees only) stating that the property will be used for conservation purposes and will be held for use in the public interest.
 - b. Payment of a portion of capital gains tax or provision of security satisfactory to the Minister (i.e. evidence that there is no tax owing).
 - c. Certificate of Compliance provided by the Minister (T2068).
 - i. Without the Certificate, the donee, by accepting real property from a non-resident, may be liable for payment of a portion of the Canadian capital gains taxes arising from the disposition.
9. Canadian Charitable Gift Receipt stating the disposition value (for Canadian donees).
 - a. For a U.S. donee, a letter should be drafted including key information required for a Canadian tax receipt under Section 3501 of the Income Tax Act including: name and address of the charity, date of donation, date receipt issued, name and address of donor including first name and initial, amount of cash donation, authorized signature. For noncash gifts, also include a description of the property, fair market value of the property, name and address of the appraiser. For split-receipt donations (“bargain sales”), the letter should include the full value of the property, the “advantage,” (i.e. any money paid for the property) and the gift portion (i.e. the difference between fair market value and what was paid for the property). *See CRA website for sample tax receipts and required contents www.cra-arc.gc.ca*
10. Letter Acknowledging the Gift (for U.S. charities, such a letter is used in place of a tax receipt). For cross-border conservation gifts, it would be prudent even for a Canadian donee to provide such a letter to satisfy IRS requirements.

- a. Contents of the letter should include verification that the donee is a charity, that it is recognized as a “publicly-supported charity” by the IRS, its U.S. tax identification number, a description of the gift, and an indication of whether the donee provided goods or services in consideration for the gift (and the value of any consideration).

11. Canadian Tax Return Filed.

- a. Canadian Tax Receipt attached (or letter from U.S. donee from step 10 above). *See CRA website for sample Canadian tax receipts with required contents (www.cra-arc.gc.ca).*
- b. Final payment of capital gains tax (if taxes owing) or declaration claiming an exemption or reduction in capital gains tax through the Income Tax Act election under Section 118(1), or through the Ecological Gifts Program attached.
- c. If the gift is an Ecological Gift, the donor also includes the Certificate for Donation of Ecologically Sensitive Land, the Certificate of Fair Market Value by Environment Canada and the appraisal.

12. U.S. Income Tax Return Filed.

- a. *Internal Revenue Service Form 8283--Noncash Charitable Contributions* included with the return, signed by the appraiser and the donee. The purpose of the Form 8283 is to document the fact that a noncash charitable contribution has been made, the details of which are included in a full narrative appraisal. See sample IRS Form 8283 listed under *Additional resources* below. Components of the Form 8283 include the following:
 - i. Name and taxpayer identification number of the donor (social security number if donor is an individual or employee identification number if donor is a partnership or corporation);
 - ii. Description of the property;
 - iii. Brief summary of the physical condition of the property;
 - iv. Manner of donor's acquisition of the property (purchase, gift, etc.) and the date of donor's acquisition;
 - v. Donor's cost or adjusted basis (adjusted cost base) in the property;
 - vi. Name, address and tax identification number of the donee;
 - vii. Date the donee received the property or interest in property;
 - viii. Name, address and tax identification number of the appraiser;
 - ix. Appraised fair market value of the property interest on the date of contribution;
 - x. A appraisal summary defining the gift, the fair market value (“before and after” the gift for conservation easements), and certain declarations by the appraiser pertaining to interests in the transaction, and the fee arrangement and stating that the appraisals prepared by the appraiser are not being

disregarded by the IRS, that the appraisal was prepared for income tax purposes, and that the appraiser understands he/she may be subject to penalties for significant misstatement must also be included (*significant penalties exist for appraisers, donors and charities involved in misstatements of appraised value*).

- xi. Statements by the donor including verification that the donation meets Section 170(h) requirements for “qualified conservation contributions”, and the conservation purpose; statements concerning baseline documentation, ownership of nearby land, regulatory approval or contractual obligations related to the donation, when and how the donor acquired the property;
 - xii. Signature of donee, acknowledging receipt of the gifted property.
- b. The full appraisal must be attached for gifts over \$500,000 in value.
 - c. Donee gift acknowledgement letter, as discussed.

Summary

Cross-border conservation gifts are complex, involving the unique circumstances of each parcel of land, donor financial circumstances, donee status and capacity and the overlapping yet distinct requirements of multiple federal agencies. Fortunately, there is a growing body of resources, support mechanisms, experience and expertise to assist land trusts in Canada with cross-border conservation gifts. The Nova Scotia Nature Trust’s Cross-Border Conservation Kit, including a more in-depth technical guide to cross-border conservation gifts, fact sheets for land trusts, donors and appraisers, and a sample cross-border conservation easement template, may provide helpful background information to ensure a smooth process for cross-border conservation gifts. The *American Friends of Canadian Land Trusts* is creating a program to assist and support Canadian land trusts with cross-border conservation gifts. See www.nsnt.ca for updates on the tool kit and on the *American Friends of Canadian Land Trusts*.

Additional Resources

Individuals interested in obtaining more information on cross-border conservation gifts are directed to the resources listed below:

Resources

Cross-Border Conservation Tool Kit, Bonnie Sutherland. Nova Scotia Nature Trust, 2006.
Available at www.nsnt.ca or (902) 425-5263.

A Guide to Cross-Border Conservation Gifts by U.S. Residents.

Cross-Border Conservation Gifts by U.S. Residents: Fact Sheet for Donors.

Cross-Border Conservation Gifts by U.S. Residents. Fact Sheet for Appraisers.

Cross-Border Conservation Gifts by U.S. Residents: Fact Sheet for Land Trusts.

Cross Border Conservation Easement Template.

Other Canadian Publications

Ecological Gifts Program Guidelines for Appraisals, Environment Canada. Ecological Gifts Program

Ecological Gifts Program website: www.cws-scf.ec.gc.ca/egp-pde/

The Canadian Ecological Gifts Program Handbook. Environment Canada Ecological Gifts Program

Gifts of Capital Properties to a Charity and Others. Bulletin IT-288R2. Canadian Revenue Agency.

Information Circular, IC-72-17R5 *Procedures Concerning the Disposition of Taxable Canadian Property by Non-Residents of Canada - Section 116.* Canada Revenue Agency.

U.S. Publications

Charitable Contributions, Publication 526, U.S. Treasury Department

Federal Tax Law of Conservation Easements. Stephen J. Small, 1997.

Federal Tax Law of Conservation Easements, Second Supplement. Stephen J. Small, 1996.

Federal Tax Law of Conservation Easements, Third Supplement. Stephen J. Small, 2000.

Information on the United States-Canada Income Tax Treaty. Publication 597. U.S. Department of the Treasury

The Conservation Easement Handbook, Second Addition. L. Byers, et. al., Land Trust Alliance, 2005.

Stephen J. Small *Preserving Family Lands: Book I (Essential Tax Strategies for the Landowner)*, 3d ed. (Boston, M.A.: Landowner Planning Centre, 1998).

Stephen J. Small *Preserving Family Lands: Book II (More Planning Strategies for the Future)*, (Boston, M.A.: Landowner Planning Centre, 1997).

Stephen J. Small *Preserving Family Lands: Book III (New Tax Rules and Strategies and a Checklist)*, (Boston, M.A. Landowner Planning Centre, 2002).

Other

Guidance Relating to Article XXI of the United States-Canada Income Tax Convention, Notice 99-47. U.S. Department of the Treasury.

Key Statues

Canadian

Section 115 (*Taxable Gain on Disposition of Real Property and Election to Reduce Capital Gains Taxes*)

Section 116 (*Capital Gains Tax and Non-resident Dispositions of Real Estate*)

Section 118 (*Taxable Gain on Disposition of Real Property and Election to Reduce Capital Gains Taxes*)

Regulation 3504 (*Prescribed Donees*)

U.S. Internal Revenue Code

Section 170(h) (*Qualified Conservation Contributions/ Conservation Easement Requirements*)

Treasury regulations 1.170A14 (*Qualified Conservation Contributions/ Conservation Easement Requirements*)

Sections 2055, 2703, 2036, Treasury Regulations 20.2055 and 25.2703-1 (*Estate Taxes*)

Section 2522, Treasury Regulation. § 25.2522-1 (2003) (*Gift Taxes*)

I.R.C. § 170(f)(3)(B) (2004). (*Donations of partial interest in land*)

I.R.C. § 170(f)(4) (2004). (*Appraisal Requirements*)

I.R.C. § 501 (2004). (*Publicly-supported charity*)

I.R.C. § 509 (2004). (*Public support test*)

I.R.C. § 2031 (2004). (*Gross Estate-Special Estate Tax Deductions for Conservation Easements within U.S.*)

I.R.C. § 6114 (2004). (*Treaty-based return positions*)

Treasury Regulation § 1.170A-12 (*remainder interests and conservation valuation*)

Treasury Regulation § 1.170A-13 (2003). (*Appraisal Requirements*)

Pension Protection Act. 2006. (*Section 1219 Appraisal Penalties*) (*Section 1206 Enhanced Deductions for Conservation Easements*)

Convention between the United States of America and Canada with respect to Taxes on Income and on Capital (*Canada-U.S. Tax Treaty and Deductions Against Canadian-Source Income*)

Footnotes

¹ **Ecological Gifts Program** – An Ecological Gift is a donation of land or an interest in land that has been certified as “ecologically sensitive” by the federal Minister of the Environment or the Minister’s designate, in accordance with the provisions of the Canadian Income Tax Act, that is donated to a Canadian charity or government agency eligible to accept Ecological Gifts, and that otherwise meets the requirements of the Act that give rise to special tax benefits. Favourable tax treatment for Ecological Gifts includes the provision of a tax credit and a reduction in the taxable capital gain realized on the disposition of the property. Unlike in the case of other charitable gifts, there is no limit to the amount of charitable donations eligible for the credit. Any unused portion of the gift may be carried forward for up to five years. Section 38(a.2)(i) of the Income Tax Act indicates the inclusion rate for capital gains is 25%. The federal 2006 budget reduced the capital gains inclusion rate on Ecological Gifts from 25% to zero. This eliminates capital gains tax on Ecological Gifts retroactive to May 2, 2006 (this change announced in the budget has not yet been changed in law). Donors can also reduce their capital gain by designating the amount of the gift to be a lower amount, between its fair market value and its adjusted cost base (i.e. the original purchase price). This designated amount is also used to calculate the tax benefit. While this is great news for Canadian donors, unfortunately this measure will not benefit U.S. donors seeking a U.S. tax deduction (against U.S. income), as the donee must be a Canadian charity to be eligible under the Ecological Gifts Program. Further information on the Ecological Gifts Program can be obtained from Habitat Conservation Division, Canadian Wildlife Service Environment Canada Ottawa ON K1A 0H3, or from the Canadian Ecological Gifts website.

² **Prescribed Donee (Canada)** – A prescribed donee is an organization, as listed under section 3504 of the Canadian Income Tax Act Regulations, to which individuals who are non-residents of Canada may make a gift of capital property and receive the tax benefit of electing to reduce capital gains on their gift under section 118 of the Income Tax Act. Currently the only prescribed donee is The Nature Conservancy (U.S.). No prescribed donees are active in cross-border conservation with Canadian land trusts. A new organization, the American Friends of Canadian Land Trusts hopes to secure such status, and to be able to provide cross-border conservation gift donors with the ideal tax scenario: a tax deduction against U.S. income, and avoidance of Canadian capital gains tax.

³ **Section 118 Election (Canada)** – Under Section 118.1(6) of the Canadian Income Tax Act, a donor, whether Canadian or non-resident, may elect to choose a disposition value anywhere between the fair market value of the gift of land or conservation easement, and the adjusted cost base, in order to eliminate or reduce any capital gains tax owing on a gift. The donee must be a Canadian charity, government or a *prescribed donee*.

⁴ **Canada-U.S. Income Tax Convention** – Article XXI(5) of the tax treaty allows U.S. donors to claim a charitable donation deduction for U.S. tax purposes for donations to Canadian registered charities, against their Canadian-source income up to the amount that would be allowed under the percentage limitations of U.S. laws. Under the tax treaty, bequests to Canadian charities provide the same estate tax deductions as bequests to U.S. charities. Claiming such treaty benefits may be subject to the taxpayer to reporting requirements on Form 8833, pursuant to Internal Revenue Code 6114. See more about *Deduction Limits* below.

⁵ **Deduction Limits (US)**—Gifts to private foundations (including Canadian charities that have not been recognized by the I.R.S. as *qualified donees*) have a deduction limit of certain percentage of the donor’s adjusted gross income (20% for most gifts of capital property including fee simple donations of land, and 30% for gifts of cash). By applying for designation as a qualified donee, the Canadian charity can accept conservation easements by U.S. residents and still meet the necessary income and estate tax requirements under U.S. tax law. The deduction limit increases to 30% for gifts of capital property and 50% for gifts of cash.

Under new legislation passed in August 2006 (*Under the Pension Protection Act of 2006 Section 1206*), special tax deduction rules apply for certain “qualified conservation easements that meet IRS requirements under Section 170(h) of the Internal Revenue Code.” Under the previous tax rules, such donations were restricted to a deduction of 30% of adjusted gross income with a carry-forward of five years. Under amended legislation, this deduction is raised to 50% of adjusted gross income, and the carry-forward is fifteen years. This new legislation is currently only effective for the 2006 and 2007 tax years. See ww.lta.org for current information on this new tax benefit.

⁶ **Qualified Conservation Contribution (US)**—These are contributions of a qualified real property interest to a qualified organization, exclusively for conservation purposes under the Internal Revenue Code Section 170(h) and 1.170A (a) of the Treasury Regulations. To qualify for U.S. income, estate and gift tax benefits, gifts of partial interest in land (i.e. easements and remainder interests for conservation purposes) must meet these requirements, which range from meeting specific conservation purposes, to restrictions on donees, transferability and exercise of reserved rights, to requirements for baseline documentation.

⁷ **Tax Benefits for Gifts of Partial Interest in Land** – To be eligible for U.S. income tax benefits (Internal Revenue Code Section 170 (h) and Regulations 1.170A-14), to avoid U.S. gift tax (Internal Revenue Code Section 2522 and Regulations 25.2522) and to ensure that the gift provides estate tax benefits (Internal Revenue Code Section 2055 and Regulations 20.2055), gifts of partial interest in land must be given to a *qualified donee*, and must be a *qualified conservation contribution* within the meaning assigned by section 170 (h) (1) of the Internal Revenue Code and by § 1.170A-14 (a) of the Treasury Regulations to Internal Revenue Code section 170 (h). This means that Canadian charities accepting conservation easements by U.S. residents

must first be recognized by the IRS as a *qualified donee* which in turn requires the donee to be recognized as a *publicly-supported charity*. See more below under *Deduction Limits*.

⁸ **Application for Recognition as a Publicly-Funded Charity (U.S.)** – Under U.S. tax law, gifts to private foundations (including Canadian charities that have not been recognized by the I.R.S. as *qualified donees*) have a deduction limit of certain percentage of the donor’s adjusted gross income. By applying for designation as a qualified donee, the Canadian charity can increase the deduction limit (see more on *Deduction Limits* below). Such status is also needed to accept conservation easements, to ensure the donor does not face gift taxes and estate tax problems as a result of the gift.

To receive a determination that a charity is not a private foundation, the charity must complete Internal Revenue Service *Form 8734, Support Schedule For Advance Ruling Period*, for the last five years or the years the charity has been in existence if less than five years. The charity should first apply for an Employer Identification Number using *Form SS-4: Application for Employer Identification Number*.

⁹ **Estate Tax on Qualified Conservation Contributions (US)**—Internal Revenue Code section 2703 provides that the value of property for U.S. estate tax purposes shall be determined without regard to restrictions on the right to sell or use the property. However, Regulation 25.2703-1(a)(4) provides that such a restriction does not include a perpetual restriction on the use of real property that qualified for a charitable deduction for U.S. gift tax or estate tax purposes.

¹⁰ **Estate Tax Deductions for Gifts to Canadian Charities (US)**—Under Internal Revenue Code Section 2055, a charitable deduction would generally be allowed for testamentary gifts to Canadian charities that would, if they were U.S. organizations, meet the requirements for a charitable organization for U.S. tax purposes.

¹¹ **Split Receipt Donation (Canada)**—The Income Tax Act allows for a donation receipt in circumstances where an intention to make a gift is present, but the donor also receives some benefit (or “advantage”). The donor’s tax credit is based on the eligible amount of the gift. Such a conservation gift is often called a *bargain sale* in the U.S. Further resources on split receipting include Environment Canada’s *Ecological Gifts Program Handbook*, and environment Canada’s fact sheet, *Confirmation that Ecological Gifts are Eligible for Split-Receipting* and “Proposed Guidelines on Split Receipting.” *Income Tax Technical News*, No. 26, December 24, 2002.

¹² **Clearance Certificate for Non-Resident Disposition of Land (Canada)** – Where the donor is a U.S. resident disposing of Canadian real estate (whether through sale or gift), the Canadian Income Tax Act Section 116 (1), includes provisions for the CRA to secure payment of tax on capital gains. The donor must notify the CRA of a planned or completed property disposition (before they dispose of the property or within ten days after the disposition). The donor must pay a portion of the capital gains tax (or provide security satisfactory to the Minister), prior to receiving a Certificate authorizing the disposition. The process entails completing a “Request by non-resident for a Certificate of Compliance related to the disposition of Taxable Canadian Property” (Canada Revenue Agency Form 2062E). A useful reference is the Canada Revenue Agency document 72-17R4 Procedures Concerning the Disposition of Taxable Canadian Property by Non-Residents of Canada-Section 116.

¹³ **Qualified Appraisal/Appraiser Requirements (U.S.)** – Appraisal requirements are outlined in Internal Revenue Code Sections Section 170(f)(4), Section 170(f)(11), and Section 170(h) and U.S. Treasury Regulations 1.170A-12, 1.170A-13, and 1.170A-14. Revisions made to the Internal Revenue Code in August 2006 (under the Pension Protection Act of 2006 (H.R. 4) Section 1219 and Section 170(f)(11), and new Section 6695A) redefine who is a “qualified appraiser” and gives the Internal Revenue Service the power to issue new regulations on appraiser qualifications. See Notice 2006-96 for guidance regarding appraisal requirements until final changes are made to the Internal Revenue Code Section 170(f)11, Section 6695 of the Internal Revenue Code, and Section 1219 of the Pension Protect Act of 2006 and amended regulations under Section 170(f)11 and 1.170A – 13(c)(3) and (5).

¹⁴ **American Friends of Canadian Land Trusts (U.S.)** – The American Friends of Canadian Land Trusts (AFoCLT) is a United States based organization whose mission is to facilitate cross-border conservation gifts. AFoCLT is in the process of applying for status as a U.S. charity, and as a *prescribed donee* in Canada. If approved, a U.S. resident should be able to donate real property or interest in real property to AFoCLT, eliminate capital gain tax liability on the gift, and be eligible for a U.S. income tax deduction against U.S.-source income.

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