

  
*Colorado Legislative Council Staff Fiscal Note*  
**STATE**  
**REVISED FISCAL IMPACT**  
 (replaces fiscal note dated April 29, 2011)

<b>Drafting Number:</b> LLS 11-0621	<b>Date:</b> May 4, 2011
<b>Prime Sponsor(s):</b> Rep. Looper	<b>Bill Status:</b> Senate Finance
Sen. Grantham; Nicholson	<b>Fiscal Analyst:</b> Harry Zeid (303-866-4753)

**TITLE:** CONCERNING THE RESOLUTION OF A DISPUTED CLAIM FOR A STATE INCOME TAX CREDIT FOR A DONATION OF A PERPETUAL CONSERVATION EASEMENT THAT INCLUDES A PROCESS THAT ALLOWS A TAXPAYER TO WAIVE AN EXPEDITED ADMINISTRATIVE HEARING FOR THE PURPOSE OF APPEALING DIRECTLY TO A DISTRICT COURT, AND MAKING AN APPROPRIATION THEREFOR.

Fiscal Impact Summary	FY 2010-11	FY 2011-12	FY 2012-13	FY 2013-14
<b>State Revenue</b>				
General Fund (cap reduction)*	\$2,000,000	\$4,000,000	(\$2,000,000)	(\$4,000,000)
General Fund (interest/penalty waiver)**	(67,900,000)			
Cash Funds				
Con. Easement Holder Cert. Fund		12,112		
<b>State Transfers or Diversions</b>				
Reduced Transfer from the General Fund to the State Education Fund	\$65,900,000			
<b>State Expenditures</b>				
General Fund	\$1,974	\$3,406,072	\$3,304,892	\$3,304,892
Cash Funds				
Con. Easement Holder Cert. Fund		12,112		
<b>FTE Position Change</b>		18.7 FTE	18.9 FTE	18.9 FTE

**Effective Date:** Upon signature of the Governor, or upon becoming law without his signature.

**Appropriation Summary for FY 2011-2012:** See the State Appropriations section.

**Local Government Impact:** None.

\* These impacts do not account for any General Fund revenue impact that may result from court determinations on disputed claims for state income tax credits on donated conservation easements. See the State Revenue section for further details.

\*\* The combined impact of the immediate waiver of all accrued penalties and interest, and the 2011 income tax year cap reduction for the conservation easement tax credit will reduce the required General Fund transfer to the State Education Fund by \$65.9 million in FY 2010-11. See the State Revenue section for further details.

## **Summary of Legislation**

The reengrossed bill authorizes a new expedited method for resolving disputed claims over conservation easement state income tax credits. As amended, the bill allows taxpayers to waive the hearing process before the Executive Director of the Department of Revenue and instead appeal directly to a district court. The bill further:

- immediately waives all accrued and future penalties and interest assessed by the Department of Revenue on tax matters representatives (TMRs) and transferees of a tax credit until such time as a final determination has been issued by the department, or if appealed, until such time as the district court enters a final judgement;
- establishes venue for the appeals in a manner that allows cases to be consolidated regionally;
- eliminates surety bond requirements for taxpayers who appeal directly to a district court;
- suspends the imposition of additional interest and penalties during the appeal for taxpayers who appeal directly to a district court;
- provides procedures for the administrative process;
- establishes a process for courts to publish notices to taxpayers who cannot be located;
- allows claims to be consolidated and settled, and allows additional parties to intervene at the discretion of the court; and
- specifies procedures related to discovery, case management conferences, the disclosure of information by the parties, trial management orders, and the phasing of issues to be resolved by the court.

The bill allows a taxpayer for a currently backlogged case who does not waive the hearing process before the executive director to request a hearing and final determination by July 1, 2014, unless a further extension is mutually agreed upon. In the case of a person who elects to remain in the hearing process, the executive director is given the authority to consolidate related cases. The executive director is required to issue a final determination on any remaining disputes by July 1, 2016. If a final determination has not been made by the dates specified, the authority of the executive director to dispute the allowance of the credits shall be waived and the credit claimed by the taxpayer is allowed. If a taxpayer fails to appear at a hearing with the executive director or fails to participate in the hearing process, the executive director may issue a final determination without further proceedings. Interest and penalties are waived for taxpayers who continue with the hearing process and pay an amount agreed upon for taxes owed.

The bill modifies the current law cap on the aggregate amount of conservation easements that can be claimed for income tax purposes as follows:

- for income tax years 2011 and 2012, the aggregate cap is lowered from \$26 million per year to \$22 million per year; and
- for income tax year 2013, the aggregate cap is increased from \$26 million to \$34 million.

The bill requires the executive director of the Department of Revenue, the State Court Administrator, and the Conservation Easement Oversight Commission to report certain findings and actions to committees of the General Assembly. Finally, the bill specifies that members of the Conservation Easement Oversight Commission are immune from liability in accordance with the Colorado Governmental Immunity Act.

## **Background**

**Conservation Easement Income Tax Credits.** The conservation easement income tax credit was originally enacted in 1999, and has been amended several times since. A credit is allowed for individuals and corporations who donate land for a perpetual conservation easement to a government entity or a charitable organization. The owner of an easement continues to maintain the right to prohibit certain acts with respect to the property in order to preserve its value for recreation, education, habitat, open space, or historical importance. If the taxpayer's state income tax liability is less than the amount of the tax credit, the unused portion of the credit may be carried forward for up to 20 years. Alternatively, the tax credit may be transferred to another taxpayer. Currently, a conservation easement tax credit can be claimed for an amount equal to 50 percent of the appraised value of the donation, up to a maximum of \$375,000 per easement. The cap on the tax credit is reached for a donation valued at a fair market value of \$750,000. For income tax years 2011, 2012, and 2013, current law caps the aggregate amount of conservation easement income tax credits that may be claimed at \$26 million per year.

**Current Dispute Resolution Status.** If the Executive Director of the Department of Revenue disputes the claim of the credit, a method is currently in place to allow for a hearing on the matter. Under current law, the case may not be appealed to a district court until the hearing has been held and a final determination has been made by the executive director. Additionally, it is difficult to consolidate related claims in the administrative process. There are currently a large number of disputes regarding conservation easement credit claims awaiting hearing and final determination by the executive director.

**Number and Value of Conservation Easements Tax Credits in Question.** Department of Revenue records indicate that approximately 600 conservation easements claimed during income tax years 2000 through 2007 have either been denied or may be denied for issues regarding the validity of the claim or for questionable appraisal values used to support the tax credit claimed. The total amount of income tax liability for these credits is \$222.8 million, including \$154.9 million from conservation easement credit claims; \$18.6 million in penalties assessed to date on denied credit claims; and \$49.3 million in interest on those denied credit claims. This includes both assessments for refunds paid to individuals and subsequently denied, and refunds denied at the time of filing.

## **State Revenue**

**Impact on General Fund Revenue.** The bill changes existing law that caps the aggregate amount of conservation easements that can be claimed in tax years 2011, 2012, and 2013. The bill lowers the cap by \$4 million per year to \$22 million per year in 2011 and 2012, but raises the cap

by \$8 million from \$26 million to \$34 million in 2013. Since the state fiscal year bridges two income tax years, the bill will affect state General Fund revenue as follows:

- \$2 million General Fund revenue increase for FY 2010-11;
- \$4 million General Fund revenue increase for FY 2011-12;
- \$2 million General Fund revenue decrease for FY 2012-13; and
- \$4 million General Fund revenue decrease for FY 2013-14.

The bill states that penalties and interest shall not be imposed or commence to accrue on any amount owed by a TMR or a transferee of a credit until such time as the department issues a final determination or, if the final determination is appealed, until such time as the district court enters a final judgement. To date, \$18.6 million in penalties and \$49.3 million in interest has accrued on disputed conservation easement credit claims. Therefore, General Fund revenue will be reduced in the current fiscal year, FY 2010-11, by \$67.9 million to account for the waiver of all interest and penalties accrued to date on these claims. The State Transfers or Diversions section describes the impact of this General Fund accrued revenue reduction on state transfer obligations to the State Education Fund.

**Impact on Conservation Easement Case Outcomes.** The impact of the bill on final case determinations by the court or by the Department of Revenue administrative hearings is indeterminate. Disputed cases involve \$222.8 million in tax credits, interest, and penalties. Final court judgements from these cases will likely be lower than the total amount being contested.

It is the position of the Department of Revenue that all of the conservation easement tax credits in question either do not meet the criteria to be eligible for the tax credit or are based on inaccurate or overvalued appraisals. The bill allows for an expedited settlement of the disputed claims through the option of either an administrative hearing before the Executive Director of the Department of Revenue or cases will be adjudicated through a hearing directly in a district court. The imposition of additional interest and penalties will be suspended for taxpayers who appeal directly to a district court.

**Department of Regulatory Agencies.** The department requires additional cash funds fee revenue of \$12,112 in FY 2011-12. In order to accomplish this, the 41 certified conservation easement holders registered with the Division of Real Estate will experience a one-time fee increase of \$296 from \$3,010 to \$3,306 in FY 2011-12 to cover the additional costs of reviewing previous conservation easement claims.

### **State Transfers or Diversions**

In total, the bill will reduce the General Fund transfer to the State Education Fund by \$65.9 million in FY 2010-11. SB11-156, signed by the Governor on March 9, 2011, specified that any moneys in excess of the required 2.3 percent General Fund reserve in FY 2010-11 be transferred to the State Education Fund. Based on the March 2011 Legislative Council Staff revenue forecast, an estimated \$447 million will be transferred to the State Education Fund. Including the impact of reducing the conservation easement income tax credit cap from \$26 million to \$22 million for

income tax year 2011, and the immediate waiver of all accrued interest and penalties on disputed claims, reengrossed HB 11-1300 will reduce General Fund revenue by an combined estimate of \$65.9 million in FY 2010-11. This will reduce General Fund moneys available for transfer to the State Education Fund by a corresponding amount.

**State Expenditures**

Preliminary estimates of state expenditures required to implement the bill are summarized in Table 1 below. These estimates will be updated as additional information becomes available.

<b>Cost Components</b>	<b>FY 2010-11</b>	<b>FY 2011-12</b>	<b>FY 2012-13</b>
Personal Services		\$1,987,111	\$1,968,190
FTE		18.7	18.9
Operating and Travel	\$1,974	321,432	301,702
Appraisal - Contract Services		1,035,000	1,035,000
Capital Outlay		62,529	
<b>TOTAL</b>	<b>\$1,974</b>	<b>\$3,406,072</b>	<b>\$3,304,892</b>

**Department of Revenue.** In addition to funds currently appropriated to the Department of Revenue and the Department of Law to resolve disputes concerning conservation easement tax credits, direct General Fund expenditures for the Department of Revenue are \$1,974 for postage in FY 2010-11, \$1,403,491 and 3.6 FTE in FY 2011-12, and \$1,332,664 and 3.6 FTE in FY 2012-13.

The expenditures identified below for the Department of Law will come from reappropriated funds from the Department of Revenue. Table 2 shows a breakdown of direct General Fund expenditures for the Department of Revenue.

<b>Cost Components</b>	<b>FY 2010-11</b>	<b>FY 2011-12</b>	<b>FY 2012-13</b>
Personal Services		\$305,923	\$258,044
FTE		3.6	3.6
Operating Expenses	\$1,974	62,568	39,620
Appraisals - Contracted Services		1,035,000	1,035,000
<b>TOTAL</b>	<b>\$1,974</b>	<b>\$1,403,491</b>	<b>1,332,664</b>

**Department of Law.** As shown in Table 3, the Department of Law will require \$1,349,581 and 9.1 FTE in FY 2011-12, and \$1,381,757 and 9.3 FTE in FY 2012-13. These moneys will be reappropriated from the Department of Revenue.

<b>Table 3. Expenditures For the Department of Law (Reappropriated Funds from the Department of Revenue)</b>		
<b>Cost Components</b>	<b>FY 2011-12</b>	<b>FY 2012-13</b>
Personal Services	\$1,110,667	\$1,139,625
FTE	9.1	9.3
Operating and Travel Expenses	131,714	134,932
Court Reporter Expenses	107,200	107,200
<b>TOTAL</b>	<b>\$1,349,581</b>	<b>\$1,381,757</b>

**Judicial Branch.** As shown in Table 4, the Judicial Branch will incur costs totaling \$653,000 and 6.0 FTE in FY 2011-12, and \$590,471 and 6.0 FTE in FY 2012-13. These costs will be paid from the General Fund.

<b>Table 4. Expenditures For the Judicial Branch</b>		
<b>Cost Components</b>	<b>FY 2011-12</b>	<b>FY 2012-13</b>
Personal Services	\$570,521	\$570,521
FTE	6.0	6.0
Operating	19,950	19,950
Capital Outlay	62,529	
<b>TOTAL</b>	<b>\$653,000</b>	<b>\$590,471</b>

Costs identified for the Judicial Branch are based on new case filings related to a notice of deficiency, disallowance, or rejection from the Department of Revenue regarding a claimed tax credit on conservation easements. Due to the ability to consolidate cases of common easements, it is projected that an additional 72 district civil cases will result from the bill. Since these cases will involve multiple parties in an effort to resolve complex legal issues, resource requirements will be greater than the normal civil case. Given the caseload and the complexity, the bill will require 3 additional judges. The Judicial branch expects to use retired judges to hear the cases. Each retired judge will require 1 support staff to handle the electronic processing of case documents along with other general support staff duties.

**Department of Regulatory Agencies.** The Division of Real Estate in the Department of Regulatory Agencies will experience a one-time cash funds expenditure requirement in FY 2011-12 of \$12,112. On or before August 1, 2011, the Conservation Easement Oversight Commission in the Division of Real Estate must review certain conservation easements that have not previously been reviewed by the commission. These include each conservation easements for which a tax credit has been claimed and for which a notice of deficiency, notice of rejection of claim, or notice of disallowance was issued on or before May 1, 2011, but for which a final determination has not been issued. The commission will issue an initial recommendation on whether each credit should be denied or accepted. Additionally, on or before July 1, 2011, and on a quarterly basis thereafter, the

commission must provide a report to the Joint Budget Committee and the Finance Committees of the General Assembly describing the conservation easement tax credits for which the commission provided advice to the Executive Director of the Department of Revenue.

Of the \$12,112 requested, \$8,000 is for contract personal services, \$1,760 is for board meeting expenses, and \$2,352 is for additional legal services. Currently, 41 certified conservation easement holders pay an annual fee of \$3,010 to the conservation Easement Holder Certification Fund. The fee will need to be increased by \$296 to \$3,306 for FY 2011-12 to cover the additional costs of reviewing previous claims for conservation easements.

### **State Appropriations**

For FY 2010-11, the Department of Revenue requires \$1,974 General Fund.

For FY 2011-12, the following appropriations are required:

- \$2,753,072 General Fund and 12.7 FTE to the Department of Revenue, of which \$1,349,581 and 9.1 FTE should be reappropriated to the Department of Law for the provision of legal services;
- \$653,000 General Fund and 6.0 FTE to the Judicial Branch, of which \$62,529 is for courthouse capital/infrastructure maintenance, and \$590,471 is for personal services and operating expenditures; and
- \$12,112 from the Conservation Easement Holder Certification Fund to the Department of Regulatory Agencies for the Conservation Easement Oversight Commission in the Division of Real Estate, of which \$2,352 should be reappropriated to the Department of Law for the provision of legal services.

### **Departments Contacted**

Revenue      Judicial      Law      Regulatory Agencies