



NOVA SCOTIA **NATURE** TRUST

**GUIDE TO
CROSS-BORDER CONSERVATION GIFTS
BY U.S. RESIDENTS**

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NOVA SCOTIA NATURE TRUST

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Section 1: Introduction

1.1 Background and Purpose of Guidebook

Many U.S. residents own land in Canada, often ecologically important natural areas, from coastal islands and lakeshores to vast tracts of older forests. As witnesses of rapid urban sprawl, industrialization, and landscape change in their home states, they appreciate the wild and undeveloped natural splendour of Canada. Their home states may have long and exciting histories of open space and nature preservation, which fosters an awareness of and support for the land trust movement. Many are interested in conserving their Canadian property.

But for a U.S. resident to protect land in Canada, a range of barriers and complex issues may arise – from capital gains tax on their gift, or estate tax problems, to special procedural and documentation requirements – on both sides of the border. The issues are unique both for Canadian land trust personnel familiar only with conservation gifts by Canadian donors, and for U.S. donors (and their professional advisors) familiar only with land conservation within the U.S. This guide will shed light on such issues and provide background information on the “how to” of such transactions.

Significant problems could arise if cross-border conservation gifts are not handled properly. A gift made without Canadian tax authority clearance, for example, could mean a significant and unanticipated tax burden for the recipient charity. A gift of a remainder interest that does not meet U.S. tax law requirements may not be tax deductible. Devastating estate tax problems could arise as a result of an easement to a Canadian land trust that has not been recognized as a “qualified donee” under U.S. tax law, or because easement wording does not meet the “conservation purposes” requirements of U.S. tax law. For these and other reasons – from donor confidence and satisfaction, to minimizing the recipient charity’s time and resources – it is vital that all parties understand the background issues, seek appropriate professional advice, and follow required procedures on both sides of the border.

This guide assumes that land trusts (and U.S. donors) will err on the side of caution with respect to international tax and legal issues of cross-border conservation gifts¹. The issues are complex and to some extent unresolved, as there are few guiding precedents or formal rulings. In practice, some of the issues discussed in this guide may arise only through a strict, literal reading of tax laws. It is our position however, that Canadian recipients or facilitators of cross-border gifts have certain responsibilities to our donors. We should be aware of and inform donors of potential problems, take reasonable steps to address the issues, help to identify possible methods for completing gifts, and encourage donors to seek appropriate professional guidance.

This guide is based on the applicable provisions and judicial and administrative interpretations of the U.S. Internal Revenue Code, the Canadian Income Tax Act and other relevant tax statutes and regulations, and the Canada-U.S. Income Tax Treaty as of August 31, 2006². It does not take into account or anticipate any changes in law or practice by way of judicial, governmental, or legislative action or interpretation.

1.2 Intended Audience

This guide is intended as a background guide for land protection personnel working on cross-border conservation gifts. It is intended to familiarize land trust personnel with key issues, tax and procedural matters, and options for cross-border gifts. It deals with gifts of interests in real property³ situated in Canada, by U.S. residents, to Canadian land trust organizations for conservation purposes.

Some sections of the guide may prove useful as reference and background for other readers, including professional advisors to U.S. donors, U.S. land trust personnel with members interested in protecting their Canadian properties, and U.S. donors contemplating cross-border gifts, although the more simplified and abbreviated sources listed below may be more appropriate. The guide may also prove useful for municipal, provincial/territorial or federal governments and other conservation organizations (i.e. that are not land trusts), although specific issues that may arise in cross-border giving relevant to these entities are not covered in the guide.

Cross-Border Conservation Toolkit

The following additional resources have been created by the Nova Scotia Nature Trust to assist Canadian land trusts and their U.S. donors with cross-border giving:

Cross-Border Conservation Gifts: Fact Sheet for Donors
Cross-Border Conservation Gifts: Fact Sheet for Donor Advisors
Cross-Border Conservation Gifts: Fact Sheet for Appraisers
Cross-Border Conservation Gifts: Fact Sheet for Land Trusts
Cross-Border Conservation Easement Template

Available at www.nsnt.ca or call (902) 425-5263 for information

For other resources and technical information for cross-border giving see *Appendix 2: Useful Resources*. Key words and phrases are explained in Appendix 1: Glossary of Terms and Acronyms.

1.3 Acknowledgements

The Nova Scotia Nature Trust began this project as a simple exercise in documenting our findings and recommendations as we completed our first cross-border conservation gifts. In doing so, we recognized that such transactions are sufficiently complex to warrant more extensive research. We learned that other land trusts across the country face similar questions, technical issues and barriers regarding cross-border giving, and precious conservation dollars were being spent on duplicate and unsystematic research efforts. We therefore led an initiative to create a “conservation tool kit” including this guidebook and associated fact sheets and a cross-border conservation easement template, to serve as informative background documents and technical guides on cross-border giving for all land trusts in Canada. The work continued to evolve as we recognized the need for infrastructure and a program to support cross-border gifts. The project ultimately resulted in the creation of a new U.S. organization (*American Friends of Canadian Land Trusts*) and a program to support Canadian land trusts in cross-border conservation.

The Nova Scotia Nature Trust received generous funding from a number of sources to undertake this work. We greatly appreciate their support:

DAVIS CONSERVATION FOUNDATION
DONNER CANADIAN FOUNDATION
EJLB FOUNDATION
ENVIRONMENT CANADA’S ECOACTION COMMUNITY FUNDING PROGRAM
ENVIRONMENT CANADA’S ECOLOGICAL GIFTS PROGRAM
GEORGE CEDRIC METCALF CHARITABLE FOUNDATION
NORCROSS WILDLIFE FOUNDATION
SALAMANDER FOUNDATION

We would like to express our sincere thanks to several individuals who provided the author, Bonnie Sutherland, with much appreciated technical assistance in preparing the guide. Stephen J. Small and Stefan Nagel, attorneys and conservation easement law experts located in Boston, were very generous in answering some of the more obscure and complex U.S. tax/easements law questions and in reviewing the guide. Karin Marchetti Ponte, of Land Conservation Legal Services and the Maine Coast Heritage Trust, provided technical review, and created a cross-border conservation easement template to accompany the guide. Ian Attridge, Counsel to several Ontario land trusts, reviewed the text from the perspective of a Canadian lawyer active in the area of land trusts. Susan Mehinagic, a noted Canadian lawyer and accountant in this field provided many useful comments and suggestions. Peter Mushkat, Lori Rogers and William Hayes provided drafting and editing assistance. Thank you for making this pioneering guidebook possible.

The guide includes information from Stephen J. Small’s publications, *The Federal Tax Law of Conservation Easements*, *Preserving Family Lands: Essential Tax Strategies for the Landowner*, *Preserving Family Lands: Book II: More Planning Strategies for the Future*, and *Preserving Family Lands: Book III*.

1.4 Disclaimers and Exclusions

This Guide is not intended as, and should not be relied upon as legal, tax, accounting, or other professional advice. Tax rules are complex and they change. Regional or local laws affecting cross-border gifts vary across and between both countries. This guide is not a comprehensive review of all relevant tax law, tax strategies, and estate planning issues. It merely provides an overview of key issues. It is a starting point.

It cannot be overemphasized that donors and conservation organizations must obtain independent advice from appropriate professionals to complete specific transactions. It is equally important that donors seek such advice early in the planning process, as financial considerations may influence choices regarding both timing and how a transaction is structured. Donors may need to involve specialist advisors, with professional experience in land conservation. It is also important for donors to “run the numbers” for various options. It is difficult to generalize complex tax scenarios, involving different types of tax issues, and from two different legal/tax systems.

This guide focuses on ecologically important gifts to non-governmental land trusts whose focus is conservation and who have charitable status. It does not cover specific issues related to: easements of primarily historic/heritage value, options for protecting land with government agencies or organizations that are not charities, gifts by U.S. corporations, gifts of inventory land, land transfer taxes, goods and services taxes, land title issues and procedures, or property tax implications of gifts.

1.5 Summary of Guide Sections

Section 1: An introduction to the guide

Section 2: A summary of the unique aspects of cross-border conservation gifts from both a U.S. landowner perspective, and from a Canadian land trust perspective; overview of conservation options for cross-border conservation gifts

Section 3: Background on the potential income tax, gift and estate tax issues of cross-border gifts

Section 4: The basic steps and documentation required for cross-border conservation gifts

Section 5: Recommended steps for Canadian land trusts to facilitate cross-border giving

Appendices: Glossary, list of resources, sample tax calculations and sample Internal Revenue Service form for noncash gifts

Endnotes

Section 2: Cross-Border Conservation Gifts Overview

Before delving into the complex income, estate and gift tax issues and procedural requirements involved in cross-border conservation gifts, we begin with an overview of the key differences between cross-border gifts and typical gifts of Canadian real estate by Canadian donors, or typical gifts of U.S. real estate by U.S. donors. The chapter also highlights the key conservation options for cross-border gifts.

2.1 Unique Aspects of Cross-Border Conservation Gifts

- ✓ U.S. donors might expect a U.S. tax benefit for their gift (as they would get for a conservation gift within the U.S.) which simply may not be possible with a cross-border gift. They may in fact face tax obstacles.
- ✓ Income, estate and gift tax consequences of a gift of land, conservation easement⁴, or remainder interest⁵ vary depending on the status of the organization receiving the gift (the *donee*⁶), because of combined U.S. and Canadian tax laws.
- ✓ There is a deemed capital gain on gifts of land and interests in land (i.e. conservation easements and remainder interests) in Canada. There is therefore potential capital gains tax⁷, just as if the property or easement had been sold. This concept may be new to U.S. donors and their advisors.
 - In certain circumstances the U.S. donor may be able to reduce or eliminate the tax on capital gains depending on the donee of the gift and the type of land involved.
 - Where the donee is a Canadian charity or government agency and the land or interest in land qualifies under the program, the donor may be able to reduce or eliminate capital gains tax by donating the gift through the Canadian Ecological Gifts Program.
 - If the donee is a Canadian charity, government agency or *prescribed donee*⁸, the donee may be able to reduce or eliminate capital gains tax through a special election under the Canadian Income Tax Act,
 - A *prescribed donee* is an organization recognized under the Canadian Income Tax Act regulations 3504. *Prescribed donees* can provide U.S. donors with the best income tax scenario: a tax deduction against their U.S. income, and avoidance of Canadian capital gains tax. Currently, there are no *prescribed donees* active in cross-border conservation. A new U.S. organization, the *American Friends of Canadian Land Trusts*⁹ is being set up to assist land trusts and U.S. donors in cross-border conservation gifts. It is seeking *prescribed donee* status.
 - Gifts to other U.S. charities (i.e. who are not *prescribed donees*) result in full capital gains (and usually capital gains tax), which the donor may not be able to reduce or avoid.

- ✓ U.S. donors must obtain special clearance from the Canada Revenue Agency prior to making a donation of land, remainder interest, or conservation easement. Otherwise the *donee* may be liable to pay potentially significant withholding taxes from capital gains.
- ✓ If the donor has Canadian-source income, gifts to Canadian charities may provide income tax deductions against such Canadian-source income on the donor's U.S. tax return, as permitted under the income tax treaty between Canada and the U.S. Alternatively, conservation gifts to certain U.S.-based charities can provide a tax benefit against U.S.-source income.
- ✓ Whether given to a U.S. or Canadian charity, U.S. donors of conservation easements and gifts of remainder interest (lifetime or testamentary gifts) must meet specific U.S. tax requirements for *qualified conservation contributions* (in terms of wording of the instrument of conveyance, documentation, structure of easement/remainder interest etc.) to avoid gift taxes and significant estate tax problems and to ensure eligibility for certain income tax benefits. Conservation easements must also meet the requirements of the respective jurisdiction in which the easement is held.
- ✓ For conservation easements, Canadian land trusts need to take steps to qualify with the Internal Revenue Service as a *publicly-supported charity* 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 and estate tax problems and their income tax benefits may be reduced.
- ✓ Internal Revenue Service recognition of the Canadian charity as a *publicly-supported charity* also increases the deduction limits applicable for the donor's Canadian-source income for any gifts of land, remainder interest, conservation easement (and also for cash and securities)
- ✓ 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.
 - The U.S. conservation partners must be qualified to hold land interests and/or conservation easements in the respective province or territory.
 - The organization must seek professional advice and ensure it is not acting merely as an "agent" or "flow-through" for the Canadian land trust.
 - There is a new U.S. charity 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 Trusts*).
- ✓ Testamentary gifts of cash, land and conservation easements to Canadian charities provide a U.S. basic estate tax deduction similar to a testamentary gift to a U.S. charity (*note: special additional deductions under Section 2031(c) of the Internal Revenue Service Code do not apply for lands outside 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.
- ✓ U.S.-based donees may need to take additional steps to be eligible to hold land or conservation easements in a specific Canadian province or territory.

- ✓ Special U.S. tax deductions apply for conservation easements donated in 2006 and 2007 (it is hoped that these benefits will be extended beyond this period). Because this special tax benefit (increasing the deduction limits and increasing the number of years unused deduction can be carried forward), it may be advantageous for a donor whose income is modest compared to the value of their conservation land to consider donating a conservation easement instead of an outright gift of land if the more favourable tax deduction is important.
- ✓ The tax rules for *bargain sales* or *split-receipt donations* are different in the U.S. and Canada.
- ✓ Appraisals should meet both U.S. and Canadian requirements (as outlined by the Ecological Gifts Program), including timing requirements, to ensure a gift is eligible for tax benefits. U.S. tax law contains specific appraisal requirements for all conservation gifts.
- ✓ A donor is required to file income tax returns and forms (including form 8283) in both Canada and the U.S.
- ✓ Consequences for not completing transactions properly could range from forfeiting significant tax savings, or a hefty Canadian capital gains tax on the gift, to unanticipated U.S. gift and/or estate tax problems for the donor.

2.2 Conservation Tools

There are several different “tools” that U.S. residents can use to protect conservation land in Canada. There are also different types of conservation organizations (“donees”) that may be able to assist in protecting such lands. Some of the options (tools and donees) available are the same as those available in the U.S. There are, however, some important differences. There is also a unique combination of tax laws affecting cross-border gifts which may impact decisions on the most appropriate tool and donee for any specific situation. An overview of options is provided below, with detailed discussion and technical references included in the following chapters.

2.3.1 Outright Gifts of Land

Donating land to a conservation charity is one of the finest legacies one can leave to future generations. Who would give away land?

- ✓ Landowners who acquired property for its natural values and who wish to keep the land as it is in perpetuity. Many U.S. residents acquire land in Canada specifically because of its natural values.
- ✓ Landowners who no longer want the responsibilities of land ownership and property taxes.
- ✓ Landowners who do not intend to pass land on to heirs.
- ✓ Landowners who are “land rich and cash poor” and face serious U.S. estate tax issues. Estate taxes can be a large concern for U.S. taxpayers and strong motivator for conservation gifts.

Many of these motivations are not tax-driven, and some donors are satisfied to structure their transactions to accomplish the non-tax goals, without achieving full tax benefits. While this guide focuses on tax implications, it is important to be aware of these other motives.

Procedures and tax considerations for outright gifts of land in Canada by U.S. residents are quite similar to those for gifts of land within the U.S., or within Canada by Canadians. Some key differences are that Canadian capital gains issues apply to such gifts and the donor may not be able to eliminate the tax, depending on the donee of the gift (and the donor’s personal tax situation). The Canada Revenue Agency requires special clearance of the disposition of real estate by a non-resident. The donee must be a qualified U.S. charity to provide certain income tax benefits for the donor against their U.S.-source income. The donee must be a registered Canadian charity or government to provide certain Canadian income tax benefits. To ensure deductibility of the gift, appraisals should meet U.S. tax law requirements, regardless of the donee.

For legal and tax reasons, if the donor wishes to place certain restrictions on a gift of land, it may be prudent to use a conservation easement in combination with the gift, rather than restrictions in a deed. It may also be advisable to do so to ensure that donor wishes are met in perpetuity.

2.3.2 Gifts of Conservation Easements

For property owners who wish to protect natural values of a property, while maintaining ownership, a conservation easement may be preferable. Conservation easement agreements are in some ways similar in nature in Canada and the U.S. A conservation easement (also called a servitude or conservation covenant) is a legal interest in real property established by a deed or indenture agreement that protects natural values of a property by restricting certain activities in relation to the land. The restriction may take the form of a “negative” (prohibiting certain activities) or “positive” (requiring certain actions) condition or a combination of the two. In either case, the conservation easement protects the natural values of the property. The conservation easement applies to the land and is recorded (or registered) in the public records just like the property deed. The restrictions will apply to whoever owns the land in the future. The right to enforce the conservation easement is given to a conservation agency or organization. The conservation easement holder (i.e. the conservation easement recipient, who enforces the conservation easement conditions) becomes the “steward” of the conservation easement and ensures that future owners look after the land as set out in the conservation easement agreement.

A conservation easement is a flexible conservation tool that can be made to fit the specific interests of the landowner, the conservation organization that will hold and enforce the conservation easement, and the conservation needs of the specific property. A conservation easement can apply to all or just part of a property. It enables landowners to continue to own and enjoy use of their property while ensuring its natural values are protected, even after the owner and the owner’s heirs no longer own it.

As with gifts of land, there are some unique aspects to cross-border gifts of conservation easements, from capital gains issues to clearance requirements of the Canada Revenue Agency. There is also a need for Canadian land trusts to obtain special status in the U.S. before accepting a cross-border conservation easement, and unique U.S. tax law requirements for appraisals and conservation easement wording and contents. Only conservation easements that meet these requirements, and that are “permanent” (without a time limit or “in perpetuity”) will be eligible to receive tax benefits (and to avoid gift and estate tax problems) under U.S. tax law.

Additionally, who may hold a conservation easement on Canadian land will depend on each province’s or territory’s conservation easement legislation. For example, in Nova Scotia, there are no U.S. charities currently listed as eligible conservation easement holders under the Conservation Easements Act, although the Act does allow for such charities to apply. In contrast, Ontario’s Conservation Land Act regulations specifically recognize U.S. conservation charities as eligible holders of easements. Steps may need to be taken before any conservation easements can be transferred to a U.S. charity.

2.3.3 Gifts of Remainder Interest Subject to a Reserved Life Estate

Landowners can also donate land to a conservation organization but retain the right to live on the land or use a cottage on the property for their own lifetime or the lifetimes of other family members. This gift technique is called a *donation of remainder interest with reserved life estate*.

Unique aspects of cross-border gifts of remainder interest with reserved life estate are similar to those for conservation easements since both are gifts of a “partial interest in land.”

2.3.4 Testamentary Conservation Gifts (by Will)

Conservation land and conservation easements can also be donated as cross-border gifts through a testamentary gift (i.e. a gift donated through a will)¹⁰. Testamentary gifts of land and conservation easements may make sense for donors who are unsure of their future financial situation and, consequently, they do not want to restrict use of the property now. They have the freedom to use the property as they need to during their lifetime, but they know it will be protected beyond their lifetime. Placing the gift in a will may also be preferable for a donor wanting freedom to change his or her mind about protecting the property down the road. For landowners who have a property that, despite the most creative estate tax and conservation easement planning, will trigger an enormous estate tax bill, making a testamentary gift of the land can help the family to meet an important conservation goal, provide significant estate tax relief, and “free up” other assets for the heirs. Such a gift also ensures property will be protected in the case of an elderly or ill donor who is concerned that they might not survive until their gift through a conservation easement or other tool is completed.

As with outright gifts of land, there are potential capital gains taxes on the gift, and special Canada Revenue Agency clearance requirements apply. The donee must be a registered charity to avoid U.S. gift taxes and to provide estate tax benefits for the donor. The appraisal must also meet U.S. tax law requirements.

Testamentary gifts of partial interest in land (i.e. conservation easements) must meet the same U.S. tax law criteria as lifetime gifts of partial interests in land.

2.3.5 Gifts of Land for Resale by Donee

In some cases, a landowner may wish to make a gift of valuable real estate (i.e. land with no conservation value) to a land trust to support its operations. The land trust may be willing to accept such a gift, if the donor’s intentions are clear that the trust can later sell the property and use the funds for other conservation efforts.

As with conservation gifts of land, Canada Revenue Agency clearance requirements apply and the donee must be a registered charity (either U.S. or Canadian) to avoid potential U.S. tax problems, and to provide potential tax benefits for the donor. The appraisal should meet both U.S. and Canadian tax law requirements to ensure eligibility for deduction.

2.3.6 Bargain Sales (Split-Receipt Donations) of Land and Conservation Easements

Land can also be protected through a “bargain sale” or what is called a *split-receipt donation* in Canada. This option involves a landowner selling land or a conservation easement¹¹ below its fair market value¹² and receiving a charitable tax receipt for the gift portion of the transaction. It

may be appropriate for donors who wish to protect their land for conservation purposes, but who are not in a position to donate the full value of the property.

If the land is transferred as a split-receipt donation to a Canadian charity, the donor receives a Canadian tax receipt for the gift portion of the transaction, which is the difference between the amount paid to secure the property (i.e. the “advantage”) and the appraised fair market value of the land. This receipt may be used to reduce or eliminate any Canadian capital gain realized by the transfer of the property, as well as to offset income tax owing. This procedure is also available under the Ecological Gifts Program and provides a greater opportunity to reduce capital gains taxes owing on the gift (if the donee is a Canadian charity or government agency).

For gifts to a Canadian charity or government agency (and subsequent tax benefits against Canadian-source income), split-receipting is permitted only if certain conditions are met:

- The transfer is voluntary
- The transfer is made to a qualified recipient
- There is clear intent by the donor to enrich the donee
- The value of the property and the value of any advantage obtained by the donor in making the gift have been clearly ascertained
- The value of the advantage does not exceed 80% of the property’s fair market value (in exceptional circumstances, the advantage may exceed 80%, if donative intent is clear and accepted by the Minister).

A U.S. resident could also do a split-receipt donation for Canadian land with a U.S. charity. In most cases, the donor would be liable for the full amount of their Canadian capital gains tax (i.e. tax on the difference between the adjusted cost base for the property and the disposition value of the property) but would have a U.S. income tax benefit to offset a portion of their U.S. income.¹³ If the U.S. charity is recognized as a *prescribed donee* in Canada, the donor could eliminate their capital gains tax on the donated portion of the transaction.

In either case, as with outright gifts of land, there are potential capital gains taxes on the transfer, and special Canada Revenue Agency clearance requirements apply. The donee must be either a U.S. or Canadian charity. The appraisal should meet both U.S. and Canadian tax law requirements to ensure eligibility for deduction.

2.4 Potential Donees

In addition to considering what conservation tool might best suit the landowners' interests, the property itself, and the conservation values to be protected, the donor will certainly want to consider who is best situated to protect and steward the land over time.

U.S. residents may be fortunate in having a number of conservation partners willing to help protect a specific property. There may be a local, regional, provincial or national Canadian land trust, land trust association, other conservation organization, government department, or a U.S.-based land trust or other charity, available and willing to assist. Each organization has its own particular mandate, mission, personality and resources, and it is important to find a good match for the property and the landowners' interests. A landowner's conservation goals or site stewardship needs and arrangements may fit most closely with those of a local land trust. In another case, the complex stewardship issues involved in a very large property may require the resources and expertise of a provincial or national agency.

If there is a choice of donees, the potential income, gift, and estate tax consequences of such a choice may be significant. Unfortunately, donating to a Canadian land trust means U.S. residents do not receive income tax benefits against their U.S.-source income. On the other hand, donating a cross-border gift to most U.S. charities means having to pay the full capital gains tax on the gift. Depending on the donor's tax situation, and the capital gains taxes created by the conservation gift, one of these options may offer a significant tax advantage over the other.

In some situations, a partnership with more than one conservation organization may be necessary to properly protect a property and to overcome tax barriers for the donor. The conservation gift may be given to a U.S. partner (so the donor has a tax benefit against their U.S. income), then ultimately transferred to a Canadian land trust for long-term stewardship. Such an arrangement is complex and subject to certain restrictions. There are important legal and procedural considerations in such a transfer, and in the case of conservation easements or gifts of remainder interest, both donees need to meet certain U.S. tax law requirements. The U.S. organization must also exercise a certain degree of control over the original gift of the land or conservation easement (i.e. the gift from the U.S. donor to the U.S. organization), and not be acting as a mere conduit or agent of the Canadian organization¹⁴. ***Independent legal advice is essential for such a transaction.***

Currently, only one donee provides the very best tax benefits for a cross-border gift by a U.S. donor—The Nature Conservancy (a U.S.-based charity, independent of the Nature Conservancy of Canada). Because it has unique tax status on both sides of the border, donors are able to take advantage of U.S. income tax benefits (against U.S.-source income), while at the same time avoiding Canadian capital gains taxes. While The Nature Conservancy may technically provide the best tax benefits, it is focused on properties in Canada considered “highest priority” based on its own criteria and priorities. Its mandate is not focused on specific regionally or locally significant natural features in Canada, nor on cross-border gifts, and it does not have the mandate or resources to facilitate every cross-border donation in Canada. Ultimately, The Nature Conservancy will not likely be an option for many cross-border conservation gifts across the country.

AMERICAN FRIENDS OF CANADIAN LAND TRUSTS

A new U.S. charity is being created specifically to assist Canadian land trusts with cross-border gifts. A national task force on cross-border conservation, with members representing Canadian land trust and other conservation organizations as well as conservation consultants, was set up by the Nova Scotia Nature Trust to undertake the creation of this new cross-border giving mechanism. The *American Friends of Canadian Land Trusts* is now an incorporated organization in the State of Washington, and has a combined U.S. and Canadian Board of Directors. It is hoped that this new charity will ultimately have the same unique tax status as The Nature Conservancy (i.e. a U.S.-based charity with *prescribed donee* status in Canada). Such a charity could provide the very best of both Canadian and U.S. tax benefits for U.S. donors of cross-border conservation gifts. This charity will have its mandate focused on protecting conservation lands in Canada, by supporting the cross-border conservation efforts of all Canadian land trust organizations. The organization will facilitate and stream-line cross-border conservation gifts through an *American Friends of Canadian Land Trusts* program. It is hoped that the program will be operational by 2007 or 2008.

In some cases, donee options may be limited by legal or technical considerations. In Nova Scotia, for example, no U.S. organizations are currently designated to hold conservation easements under the Conservation Easements Act, although the regulations do provide for a U.S. charity to apply to become eligible.

In other jurisdictions, there may be restrictions on who can own land or special procedures to be eligible to own land and, therefore, out-of-province organizations (including national/international charities) may not be able to accept gifts of land, or may be limited in some way by provincial law.

The important differences in the tax consequences (Canadian income tax, and the U.S. income, gift and estate tax implications), procedures, and documentation associated with these different options (tools and donees) for cross-border conservation gifts are discussed under *Section 3: International Tax Issues* and *Section 4: Process and Documents*. Additional sources of information are also included in the *Appendices*.

Section 3: International Tax Issues

3.1 Introduction

U.S. residents may be familiar with the tremendous success of U.S. land trusts in protecting conservation land with private landowners. They are likely aware of the generous income and estate tax benefits of making such gifts in the U.S. There are, however, important differences if a U.S. resident donor wishes to do the same with their Canadian land.

It is critical that all parties involved in a cross-border conservation gift, from the landowner and donee (i.e. the recipient charity), to the donor's professional advisors, understand key tax issues for such a gift. Without proper consideration of tax issues, significant negative tax consequences could result for the donor, the donor's heirs, and, possibly, for the donee.

From a tax planning perspective, there are certain principal objectives that most donors wish to achieve in making a conservation gift of Canadian land or interest in land:

- To avoid paying tax on Canadian *capital gains* (deemed on gifts of real estate);
- To reduce U.S. and/or Canadian income and possibly other taxes (certain taxes such as land, probate and GST taxes may be significant and should be factored into overall tax planning, although most are beyond the scope of this guide);
- To secure estate tax benefits (or to at least avoid estate tax problems); and/or
- To avoid gift tax.

This chapter addresses these objectives and outlines the relevant Canadian and U.S. tax issues:

- Table summarizing key income, gift and estate tax issues
- Income tax issues
- Estate tax issues
- Gift tax issues
- Implications of the donee and of the type of gift (conservation tool) on tax issues
- Special U.S. tax law requirements for *Qualified Conservation Contributions*
- U.S. and Canadian perspectives on appraisals and conservation easement valuation
- Cash gifts from U.S. donors

Reminder: This information is for educational purposes only and does not replace independent legal or tax advice. Donors should consult with appropriate professionals (ideally specialists with experience in land conservation and relevant tax law), and should do so early in the planning process. Legal and financial considerations may influence choices made, timing and how a transaction is structured. Donors need to consider various options before making any commitment. It is very difficult to generalize complex U.S. and Canadian tax scenarios to determine which options are “best”. Also, there may be additional taxes applicable at the federal, provincial, territorial or local level that will need to be considered in tax planning. However, these additional tax issues are beyond the scope of what is covered in this guide.

Table 1: Potential Tax Consequences of Conservation Gifts – A Summary

Landowner Action	U.S. Income Tax Deduction	Can. Income Tax Credit ^b	Option to reduce or eliminate Can. Capital Gain ^c	U.S. Gift Tax Exemption ^d	U.S. Estate Tax Savings ^e	What Happens to the Property
Sell now for cash at Fair Market Value	No	No	No	N/A	N/A	Land Sold Conservation values may be lost
Give land to children now	No	No	No	Yes/No ^j	Yes – value of estate reduced ⁱ	Land may or may not be protected by children May have to include land value in estate if donor retains any right to use land
Leave to children in will	No	No	No	N/A	No	Children may be forced to sell because of high estate taxes Conservation value may be lost
Donate land now to Canadian Charity	No ^a	Yes	Yes	Yes	Yes – value of estate reduced	Land can be protected by conservation charity
Donate land now to U.S. Charity	Yes	No	No/yes ^g	Yes	Yes – value of estate reduced	Land can be protected by conservation charity
Donate Easement ^f now to Canadian Charity	No ^a	Yes	Yes	Yes	Yes – value of estate reduced	Land can be protected in perpetuity by conservation charity Land can be passed on to heirs with reduced estate tax
Donate Easement ^f now to U.S. Charity	Yes	No	No/Yes ^g	Yes	Yes – value of estate reduced	Land can be protected in perpetuity by conservation charity Land can be passed on to heirs with reduced estate tax
Donate Remainder Interest ^f to Canadian Charity	No ^a	Yes	Yes	Yes	Yes – value of estate reduced	Land can be protected in perpetuity by conservation charity (with use during donor's/named beneficiaries' lifetime(s))
Donate Remainder Interest ^f to U.S. Charity	Yes	No	No/Yes ^g	Yes	Yes – value of estate reduced	Land can be protected in perpetuity by conservation charity (with use during donor's/named beneficiaries' lifetime(s))

Landowner Action	U.S. Income Tax Deduction	Can. Income Tax Credit ^b	Option to reduce or eliminate Can. Capital Gain ^c	U.S. Gift Tax Exemption ^d	U.S. Estate Tax Savings ^e	What Happens to the Property
Testamentary gift of land to Canadian Charity	No	Yes ⁱ	Yes	N/A	Yes – estate tax deduction	Land can be protected by conservation charity
Testamentary gift of land to U.S. Charity	No	No	No/yes ^g	N/A	Yes – estate tax deduction	Land can be protected by conservation charity
Testamentary gift of an Easement ^f to Canadian Charity	No	Yes ⁱ	Yes	N/A	Yes – estate tax deduction	Land can be protected in perpetuity by conservation charity Land can be passed on to heirs with reduced estate tax
Testamentary gift of an Easement ^f to U.S. Charity	No	No	No/yes ^g	N/A	Yes – estate tax deduction	Land can be protected in perpetuity by conservation charity Land can be passed on to heirs with reduced estate tax

^a In general, U.S. income tax benefits are only available for gifts to US-based charities. For gifts to Canadian charities, U.S. donors may claim a charitable deduction against their Canadian-source income on their U.S. tax return (50% for cash or 30% for capital gain property, with a 5-year carry-forward, if the Canadian organization is recognized as “qualified donee” by the Internal Revenue Service. If not, deduction limits are 30% for cash and 20% for capital property). Gifts of partial interests in land (i.e. conservation easements and remainder interests) must meet U.S. tax law requirements to be eligible for U.S. income tax benefits and the donee must be a “qualified donee¹⁵”. The deduction limit is 50% with a 15 year carry-forward, for gifts made in 2006 and 2007 (this law may be extended to future years).

^b For gifts to Canadian charities, donors receive a Canadian charitable receipt which can be used as a credit to offset Canadian-source income (including capital gains tax owed from gifts of property). The donor claims this tax benefit on either their U.S. or Canadian tax form, but not both.

^c All gifts of real estate interest have a deemed capital gain as if sold and are taxed accordingly. Donors may make election to reduce or avoid tax if gift is to a *prescribed donee* (has special tax status in Canada) or a Canadian charity or government. The donor may also reduce or eliminate capital gains tax if the gift is through the Ecological Gifts program, meets ecological sensitivity criteria, and is to a Canadian conservation charity eligible to receive Ecological Gifts.

^d There is no gift tax on land donated to a registered Canadian or U.S. charity. Gifts of partial interests in land must meet U.S. tax law requirements to avoid gift tax, and donee must meet requirements as a “qualified donee” in the U.S.

^e Donee must be a Canadian or U.S. charity to ensure estate tax deduction. Special deductions under Section 2031 do not apply to land outside the U.S.

^f Gifts of partial interests in land must meet U.S. tax law requirements to benefit from income and estate tax benefits and to avoid gift tax or estate tax problems, and the donee must be a “qualified donee” in the U.S. as defined in Section 170(h) of the Internal Revenue Code.

^g No, unless the donee is a *prescribed donee*. For gifts of remainder interest to other U.S. donees, capital gains tax is payable on the full value of the land, rather than just the remainder interest donated.

^h The estate tax will be less because the land will not be part of the estate. Because the transfer is subject to gift tax, and the gift and estate taxes are coordinated, it is unlikely to reduce gift and estate taxes in aggregate.

ⁱ The estate would benefit from the charitable donation for Canadian tax purposes

^j There is a limit on “lifetime” gifts to family members before gift tax applies.

Note: Assuming significant capital gains, the best overall tax benefits result if the donee is a U.S.-based charity recognized as a *prescribed donee* in Canada (avoids Canadian capital gains tax and provides US income, estate and gift tax benefits). A Canadian donee enables the donor to avoid capital gains taxes (advantageous where land increased in value significantly since acquired) but the donor does not receive a US tax deduction. A U.S. donee (which is not a *prescribed donee*) provides the donor with U.S. tax benefits but the donor pays full capital gains tax (advantageous where land has not increased in value significantly since acquired so there is little capital gain).

See discussion about U.S. tax law requirements for *qualified donees* in *Section 5: Canadian Land Trusts and U.S. Publicly-Supported Charity Status*¹⁵ and requirements for *qualified conservation contributions* under *Section 3.7 Qualified Conservation Contributions (U.S.)*¹⁶.

3.2 Income Tax Issues

Summary of Income Tax Issues

Donations of Canadian real estate (other than real estate inventory) are subject to *capital gains tax*.

Canadian capital gains tax can be eliminated or reduced for gifts made to a Canadian charity, or to foreign-based charity recognized as a *prescribed donee* in Canada.

Donors only receive U.S. income tax deductions against U.S. income for charitable gifts to U.S.-based charities.

Donors can offset tax on Canadian-source income (as a deduction on their U.S. return or a tax credit on their Canadian return) for qualifying gifts to qualifying Canadian charities.

Donating conservation gifts to a U.S. charity recognized as a *prescribed donee* in Canada provides the best income tax situation: U.S. income tax benefit against U.S. income, and relief from Canadian capital gains tax.

In light of current capital gains tax rules, where such an option is not available, and when the value of the land has not increased significantly since it was acquired, it may be best to donate to a U.S. charity, as a gift or as a bargain sale (split-receipt donation).

If there is large capital gain (“appreciation”), it may be more advantageous to donate to a Canadian charity to avoid capital gains tax on the gift, but the donor must “work the numbers” to ascertain the best tax scenario for any specific circumstance.

Note: It is hoped that the Canadian government will continue the move to reduce or eliminate capital gains on all donated conservation real estate.

3.2.1 Canadian Capital Gains Tax Issues

Although it may seem unbelievable to U.S. taxpayers, donors of a gift of real estate in Canada are deemed by law to receive capital gains on the gift, just as if the property was sold (except for donations of a principal residence or an Ecological or Cultural Gift). Most dispositions of personal real estate in Canada trigger capital gains and any consequent income tax on the taxable portion of those gains. In simple terms, a capital gain is the difference between the original cost of the property and its value when donated or sold (current fair market value). The donor would then be subject to tax based on this gain. As a general rule, fifty percent of capital gains are now taxable in Canada and the rate of tax is based on the donor’s personal income tax rate.

The Canada Income Tax Act has three primary provisions that allow a donor to reduce or avoid any Canadian capital gains tax liability:

Election to Reduce Capital Gain under Section 118

At the time the gift is made, a donor (U.S. or Canadian) can choose a “disposition value” for the land (or conservation easement or remainder interest) that provides the best tax advantage. This would be done through an election (i.e. a choice indicated in tax form documents), under Section 118 of the Canadian Income Tax Act, to deem the proceeds of disposition of the gift of land (or conservation easement or remainder interest) at the adjusted cost base (basically, the cost of acquiring the property¹⁷) or any value between the adjusted cost base and current fair market value¹⁸. In other words, the donor can choose to “dispose” of the land at the same value for which they acquired it. If they do, there is no capital gain and therefore no tax liability (see *Appendix 4: Sample Tax Calculations*). However, the elected reduced value will also be the value for determining a donation amount and the consequent Canadian credit applicable against tax owing. The best disposition value will vary depending on the donor’s overall tax circumstances in both the U.S. and Canada.

This election can only be made if the gift is made to a registered Canadian charity, a U.S. charity that is recognized under the Income Tax Act regulations as a *prescribed donee* (special status enabled by the federal government) or other qualified recipient such as a Canadian municipality or government. The election must be made on a Canadian income tax return (even if the U.S. donor has no other reason to file a Canadian return), and must be supported by a charitable tax receipt and an appraisal.

Canadian Tax Credit for Charitable Gift

If the gift is to a Canadian registered charity, the donor receives a “charitable gift receipt” from the charity¹⁹. This receipt would be for the property’s fair market value or such lower amount as the donor elects under Section 118.1(6) of the Income Tax Act, as discussed above. For individuals, the charitable donation then gives rise to a credit against Canadian income taxes owing, including tax on a capital gain arising from the deemed disposition on the donation. For corporations, the charitable receipt is applied as a deduction.

Ecological Gifts Program²⁰

Environment Canada’s Ecological Gifts Program is a Canadian federal program that provides favourable tax treatment of the donation of ecologically sensitive land or interests in land to eligible recipient organizations. The program was put in place to encourage greater conservation of the country’s natural heritage.

For cross-border gifts, the Ecological Gifts program may be useful in cases where a U.S. donor of an ecologically sensitive gift has significant Canadian-source income (including a large capital gain on the gift). The donor and donee should be aware that there are restrictions concerning the donee of Ecological Gifts, and requirements on use and disposition of land certified under this program, with significant tax penalty provisions for violations of these requirements.

Upon application, the Minister of the Environment (or designate) must certify that the land is ecologically sensitive under broad national or specific provincial criteria by completing a ***Certificate for Donation of Ecologically Sensitive Land***. The proposed fair market value of the property must be submitted to Environment Canada for approval. The donee submits an appraisal and an ***Application for Appraisal Review and Determination***, which the Minister verifies after review by Environment Canada's Appraisal Review Panel. Once reviewed and approved, the Minister will issue a ***Notice of Determination of Fair Market Value*** indicating the value for which the Minister intends to issue a certificate, usually within 90 days. 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***. The donor submits this with the ***Certificate for Donation of Ecologically Sensitive Land*** and the charitable gift receipt issued by the donee as part of that year's tax return.

Ecological gifts give rise to federal and provincial income tax credits for donors²¹. The federal tax credit is calculated by applying a rate of 16% to the first \$200 of the gift, and 29% to the balance. The donor can carry-forward the credit for up to five years. Provincial income tax credit calculations may vary. The program provides additional income tax benefits. The credit can offset up to 100% of the taxpayer's net income reported on the Canadian return (unlike other charitable gifts), and recognition as an Ecological Gift also reduces the taxable inclusion rate of capital gain (i.e. the percentage of the capital gain included into income and then subject to tax) from 50% (the tax rate on most other capital gains) to 0%²².

The Canadian Income Tax Act only allows Canadian charities and governments to be accepted as recipients of Ecological Gifts, not U.S. charities. U.S. donors can therefore not currently receive a U.S. income tax benefit against U.S. income and also reduce their capital gains tax through the Ecological Gifts program.

Because the Ecological Gifts program involves application and review(s) by government, timing issues become even more sensitive if this procedure is added to a cross-border gift, since the Internal Revenue Service requires appraisals to be current to within 60 days of the transfer of interest. Careful considerations of the sequence and timing of steps will be crucial in meeting all the various U.S. and Canadian tax law requirements and deadlines.

For background on the appraisal requirements for Ecological Gifts, please see *Section 3.2 Income Tax Issues*.

Summary of Canadian Capital Gains Tax Considerations

Where the donee is a registered Canadian charity: Where the donor has Canadian-source income, the donor can make an election under Section 118.1(6) to reduce the disposition value of property donated (and thereby reduce capital gains tax liability), or alternatively, may donate the gift through the Ecological Gifts program, to maximize tax benefits. In most cases (if the donor does not have other Canadian-source income), there is no need for either option because the charitable credit will more than offset the capital gains tax.

Where the donee is a U.S.-based charity with prescribed donee status under the Income Tax Act: No Canadian charitable tax credit will be available, and therefore the election under Section 118.1(6) will be the only way to avoid Canadian capital gains tax.

Where the donee is a U.S. charity other than a U.S.-based charity recognized as a prescribed donee in Canada: There is no mechanism to avoid Canadian capital gains tax.

See examples of these various scenarios under Appendix 4: Sample Tax Calculations.

3.2.2 U.S. Charitable Donation Considerations

For the U.S. resident who has no Canadian-source income, a Canadian charitable gift will not create an income tax benefit. To receive such a benefit, the gift must be made to a U.S.-based charitable organization. The U.S. charity does not issue a “charitable receipt” as Canadian charities do, but issues a written acknowledgement of the gift. The value of the gift must be substantiated by the taxpayer, according to very strict Internal Revenue Service rules²³.

U.S. tax law limits how much income can be offset by charitable gifts in any tax year. No matter how much a donor gives, it is impossible to eliminate all federal income tax with charitable gifts alone. Where a U.S. resident has Canadian-source income, a deduction will be available for gifts made to Canadian registered charities up to a percentage of that income, subject to the deduction limits as apply to gifts to U.S. charities²⁴.

Generally, a donor to a U.S. charity can deduct cash gifts up to 30% of adjusted gross income for the year in which the gift is made, or 50% if the contribution is made to an organization that is recognized as a *publicly-supported charity* by the Internal Revenue Service (i.e. not a private foundation).

For gifts that have appreciated in value since they were acquired (such as land), the deduction limit is lowered to 20% (and 30% if the contribution is made to an organization that is recognized as a publicly-supported charity by the Internal Revenue Service). Unused deductions can be “carried forward” and used as a deduction for the next five years, subject to the same annual limits as gifts to U.S. charities.

For gifts of conservation easements, special tax rules apply for the years 2006 and 2007²⁵. For conservation easements meeting the requirements of *qualified conservation contributions* made during this time period, the deduction limit has been raised to 50% (from 30%), and the carry-forward is extended to 15 years. It is hoped that this tax benefit for conservation easements will be changed permanently, but at this time it is only for a two-year period. **Note: Because this special tax benefit (increasing the deduction to 50% of adjusted gross income and increasing carry-forward to 15 years) generally does not appear to apply to donations of land in fee simple, a donor whose income is modest compared to the value of their conservation land may want to consider donating a conservation easement instead, if the more favourable tax deduction is important²⁶. The remainder of the donor’s remaining interest in the land could be donated at a later date, with the donation being subject to ordinary deductions for capital property (i.e. deduction limit of 30% adjusted gross income and carry-forward of five years).**

Canadian charities can take steps to be recognized as a *qualified donee* by the Internal Revenue Service. Such a designation means that the charity is recognized as being publicly-supported (i.e. is not a private foundation). Doing so increases the gift's deductibility limits, as noted above.

Note: Canadian charities must apply for this designation to hold conservation easements with U.S. resident donors, in order to meet Internal Revenue Code income and estate tax requirements for *qualified conservation contributions*. Otherwise the value of the gift may not be deducted, and donors could face gift tax on their gift, and their estate taxes could be assessed without regard to the conservation easement and its restrictions on the land.

Based on past gifts of Canadian real estate to *prescribed donees* by U.S. donors, it may be acceptable to elect a reduced value for the donation for Canadian tax purposes and also to report the fair market value for U.S. tax purposes, or vice versa. The tax rules in each country operate independently of each other (i.e. the donor may be able to use the lower adjusted cost base value on their Canadian tax return for the purposes of reducing capital gains tax in Canada if the gift is to a Canadian charity or *prescribed donee*, while claiming the higher, fair market value, on their U.S. income tax return to receive the highest possible U.S. income tax deduction).

Note: The donor will have to “run the numbers” to see the impact of Canadian capital gains tax versus U.S. income tax savings, to determine how best to structure the gift.

Special Considerations for Gifts of Partial Interest in Land

Under U.S. tax law, a gift of a conservation easement or remainder interest is not deductible for U.S. income tax purposes, unless such gifts are carefully structured to meet the requirements of a *qualified conservation contribution*²⁷, including some specific wording in the instrument of conveyance, and the qualifications of the donee. See further discussion under section 3.7 *Qualified Conservation Contributions (U.S.)* and Section 5: *Canadian Land Trusts and U.S. Publicly-Supported Charity Status*.

Deductibility of Expenses

For gifts to U.S. charities, many of the costs and fees (legal, survey etc.) associated with a conservation gift may be deductible in calculating U.S. income tax to the extent that they exceed 2% of adjusted gross income (when added to certain other “miscellaneous” deductions). For gifts to Canadian charities, some such expenses may be used to offset the capital gains tax owing on the gift.

3.3 Estate Tax Issues

Summary of Estate Tax Issues

High U.S. estate taxes mean that in some cases land not be passed intact onto the next generation.

Giving children the land now to avoid estate taxes can be an option, but is complicated by limits to passing land on to children during a donor's lifetime without triggering gift tax consequences.

Donors may receive estate tax benefits for certain qualifying lifetime gifts of remainder interests and conservation easements to U.S. charities, and to Canadian charities certified as *qualified donees* under U.S. tax law.

Testamentary gifts (by will) to Canadian charities may provide the same U.S. estate tax deduction as testamentary gifts to U.S. charities.

A gift of conservation easement that does not meet U.S. income tax deductibility requirements for *qualified conservation contributions* (in terms of the status of the donee, wording of the conservation easement, etc) could result in significant estate tax problems (where such restrictions are ignored in valuing estate taxes owing), and/or gift tax problems, where the gift is treated as non-charitable, and hence gift taxable.

Donating a conservation gift to a U.S. charity with *prescribed donee* status in Canada (rather than any other U.S. or Canadian charity) may provide the very best tax situation: potential for relief from Canadian capital gains tax, plus U.S. estate, income, and gift tax benefits.

Millions of acres of U.S. family land are lost to forced sale and development because landowners do not know about the estate tax problems they face. They want to keep things simple and to pass the land on to their children, as the family has done for generations. Unfortunately, with the increasing value of land, this may no longer be possible. Estate taxes can be high. They must generally be paid within nine months after death of the landowner. Taking no action or making no special plan for the property could very well mean that the children lose the property – it may have to be sold to pay the estate taxes owing on it. U.S. attorney Stephen J. Small has written three books providing excellent background on these issues and options for creatively crafting appropriate estate plans for land²⁸.

While estate taxes only apply where the net estate worth exceeds a certain threshold, the marginal estate tax rate is generally higher than the income tax rate (e.g. in 2006, the maximum estate tax rate is 46% and only 35% for federal income taxes)²⁹. The donation of property during the decedent's lifetime or in their will may reduce this tax. A testamentary gift of land, a remainder interest, or conservation easement may provide a deduction in computing U.S. estate tax.

From an estate tax planning perspective, donors will generally wish to ensure that a conservation gift in Canada provides the most effective estate tax benefit, whether by decreasing the value of the estate (and estate tax owing), or by providing an estate tax deduction for a testamentary gift. Note: Recent additional estate tax benefits made available for conservation easements (made by the donor's estate) now available in the U.S. do not apply to lands outside of the U.S.³⁰

3.3.1 Gift of Land

If land is gifted to any U.S. or Canadian charity, there is an estate tax benefit in that the value of the gift is no longer a part of the estate and hence is not taxed. There should generally be no gift tax if the donee is a U.S. charity or a registered charity in Canada.³¹

3.3.2 Conservation Easement

A conservation easement is a tool that can assist a landowner in passing on important conservation land to heirs. It can lower the fair market value of a property, in some cases greatly reducing or even eliminating any estate taxes owing on an inherited property. If a conservation easement, for example, lowers the fair market value of a property by one half of its value, and if the owner passed away immediately, the estate value of the land would be reduced by half. The remaining value in the estate may be low enough to escape estate taxes altogether, allowing the family to inherit the land subject to the conservation easement untaxed.

A gift of a conservation easement must be made to a U.S. charity or to a Canadian charity recognized as a *qualified donee* and must meet certain U.S. tax law requirements for the gift to provide an estate tax benefit. Otherwise, the value of the estate could include the value of the property without regard to the value of the restrictions and the estate would be taxed as if the conservation easement did not exist³². This could be devastating for a landowner and result in a very large and unexpected tax burden for the donor's heirs.

3.3.3 Remainder Interest

A donation of a remainder interest subject to a reserved life estate ensures that a donor, or other named beneficiaries, can enjoy certain access to or rights on a property for their lifetimes, while assuring that the property will pass on to a named conservation organization on the donor's death.

If the life estate is retained by the donor (the typical case), on the death of the donor, the remainder interest will be included in the donor's estate for U.S. estate tax purposes (see Internal Revenue Code Section 2036(a)). However, as long as the requirements for a *qualified conservation contribution* are met, the estate would receive a corresponding estate tax charitable deduction, such that there would effectively be no estate tax inclusion of the property.³³ If the life estate is given to other individuals, rather than being retained by the donor, then on death of the donor the remainder interest will be excluded from the donor's estate for U.S. estate tax purposes. Internal Revenue Code section 2036(a) would NOT apply and such a gift may raise other tax issues.

It should be noted that in some cases tax benefits may be maximized by first donating a conservation easement to one conservation organization and then a remainder interest of the property to another. The donation of the conservation easement and the remainder interest would provide an income tax benefit and, in addition, their value would effectively be excluded from the estate. The cross-border implications of such a strategy are beyond the scope of this guide.

3.3.4 Testamentary Gifts (Gifts by Will)

Land may also be given in a donor's will as a testamentary gift. Whether donated to a qualified Canadian or U.S. charity, the value of the property is included in the estate, with an estate tax charitable deduction for the value of the charitable bequest (a donation by will)³⁴. In effect, it is as if the property was given away before death and kept out of the estate.

A testamentary gift of a partial interest in land (such as a conservation easement) must be made to a U.S. charity, or a Canadian charity that is recognized as a *qualified donee* by the Internal Revenue Agency, and must meet certain U.S. tax law requirements for *qualified conservation contributions* for the gift to give rise to a deduction for U.S. estate tax purposes.³⁵

Testamentary gifts of conservation easements must also be drafted and executed following specific criteria required by U.S. tax law mentioned above, and certain additional procedures are recommended. For instance, it is important to have the donee organization informed of a donor's intentions and to cooperate in drafting an acceptable conservation easement for incorporation into the testamentary provisions. Unless the conservation easement itself (or a very detailed, concept draft) is attached, the estate may have little guidance as to the expected terms. In such a case, the expectant heirs of the land may attempt to thwart the donor's intention or seek to reduce restrictions since they will inherit only the rights reserved to the landowner in the conservation easement. In some jurisdictions, even the estate may be unable to consent to high value restrictions unless they are clearly imposed in the will.

With a testamentary gift, the donor must forgo the potential income tax benefits of a lifetime gift. However, the potential income tax benefit for a lifetime gift is relative to the person's taxable income. For some donors (those who are land rich, cash poor), the estate tax benefit of removing the value of the land from the estate is the only meaningful tax benefit.

Where the testamentary donor of land directs the executor to place restrictions in the deed of distribution, it will generally not have any adverse impact on estate taxes, since the entire value of the land is deducted from the taxable estate. Only if the testamentary donor reserves use rights for the benefit of living heirs is the value of those rights taxed in the estate (such as in a gift by will of a remainder interest reserving lifetime rights for a family member that will survive beyond the donor's lifetime).

3.3.5 "Give it to the Kids?"

Passing land to one's children today may seem ideal for avoiding the estate tax issues altogether, but it does not guarantee that the land will be protected unless a conservation easement is put in

place before the disposition. Gifts to children may also trigger a U.S. gift tax. The issues involved in passing land (and other wealth) along to children or grandchildren and keeping the land within a family are complex. Professional guidance and careful planning are critical.

Other Special Inter-generational Wealth Transfer Techniques

There are specialized wealth-transfer techniques – such as trusts, partnerships, limited liability companies, and corporations – that can own the land used by a family for many generations, to keep land in the family in the most tax-effective way. There is a generation-skipping tax (with an exemption equal to the estate tax exemption) that could be beneficial in some situations.

Charitable remainder trusts, charitable lead trusts, and wealth replacement trusts are other ways to combine charitable gifts with gifts to family members. Different wealth transfer and charitable giving tools can be combined to meet conservation goals, provide income or land to the family, and maximize income and estate tax benefits. Consultation with an experienced financial advisor and estate planner and careful consideration of all options are important.

3.4 Gift Tax Issues

Summary of Gift Tax Issues

There is generally no U.S. gift tax imposed on gifts of conservation land or gifts of partial interest in land that meet the requirements of *qualified conservation contributions*, given to U.S. charities or to Canadian charities recognized as *qualified donees* in the U.S.

A gift of conservation easement or remainder interest that does not qualify for a U.S. income tax deduction could theoretically trigger a U.S. gift tax.

Transferring land now to a donor's children may be an option, but can be complex. There are limits on how much land can be passed on to individuals other than a spouse, during a donor's lifetime, without triggering a U.S. gift tax.

Donating a conservation gift to a U.S. charitable organization with *prescribed donee* status in Canada may provide the best tax solution. Such a donation could provide relief from capital gains tax as well as U.S. income tax benefit, U.S. estate and U.S. gift tax relief.

All lifetime gifts, charitable or otherwise may be subject to U.S. gift tax. The key issue in conservation gifts is whether the gift is eligible for an offsetting charitable deduction such that, after the deduction, there is no gift tax. Although theoretically possible, a gift tax on a charitable donation is unlikely.

3.4.1 Gift of Land

If properly structured, lifetime donations of land to qualified U.S. or Canadian charities should be eligible for a deduction in calculating U.S. gift tax.

3.4.2 Conservation Easement

Where the gift is a conservation easement, in order to be eligible for a gift tax charitable deduction it must meet the requirements of a *qualified conservation contribution* as discussed in 3.7 *Qualified Conservation Contributions (U.S.)*.

3.4.3 Remainder Interest

To be eligible for a gift tax charitable deduction, the gift of the remainder interest (other than remainder interests in residences or agricultural land which are not discussed in this guide) must meet all the requirements of a *qualified conservation contribution*. If the donor gives the life estate to other individuals, that transfer could be subject to gift tax.

3.5 Additional Tax Issues Relevant to Specific Donees

The donor must decide which donee (if there is a choice) best suits their particular conservation gift. Independent professional advice is essential for the donor to assess which donee might be preferable to work with from a tax planning perspective. This section is intended as a summary of tax consequences related to different donee options. The detailed tax discussion of the previous section will not be re-iterated.

3.5.1 U.S. Charity Recognized as a Prescribed Donee in Canada

In most cases, the greatest tax advantages to U.S. donors seem to result from gifts to a U.S.-based charity recognized in Canada as a *prescribed donee* (whether the gift is land, a conservation easement, or a remainder interest). Such donations allow the donor to claim both a U.S. income tax deduction against their U.S. income for the gift and to avoid Canadian capital gains tax. As noted previously, however, there are currently no *prescribed donees* active in cross-border conservation in Canada. Further, U.S.-based charities may not be authorized to hold conservation easements in some provinces under present legislation, and in some cases may be limited in holding land. Donors should consult the law in the province where the land is situated to determine if there are any restrictions on who may own land or other property interests.

3.5.2 Other U.S. Charities

With a gift of Canadian land or an interest in land to a registered U.S. charity (not recognized as a *prescribed donee* in Canada), the donor receives a U.S. income tax deduction but cannot avoid Canadian capital gains tax. Such gifts also do not provide an income tax deduction against Canadian-source income. Where there is no significant capital gain on a gift (i.e. the land has not increased in value much since it was acquired), it may be more advantageous to donate the gift to a U.S. charity and receive the U.S. charitable gift income tax deduction for the full fair market value of the gift, than to avoid the Canadian capital gain (by donating to a Canadian charity). Availability of this option may be limited because there are few U.S.-based charities that would agree to hold conservation land or a conservation easement on Canadian land (based on their own conservation priorities and charitable purposes, and concern by the Internal Revenue Service about charities operating outside of these parameters).

3.5.3 Canadian Charities

When a gift of Canadian land or interest in land is made to a Canadian conservation charity, the donor can avoid Canadian capital gains tax altogether but cannot receive a U.S. income tax deduction against U.S. income. Where there is significant capital gain on a property (the land has appreciated in value since it was acquired), a gift to a Canadian charity, combined with an election to value the disposition at adjusted cost base (or to put the gift through the Ecological Gifts Program), may have better tax consequences than donating the land or interest in land to a U.S. charity. Gifts to Canadian registered charities will also generally be eligible for a charitable deduction for U.S. gift and estate tax purposes, subject to limitations discussed above. The donation will not, however, create an income tax deduction on the U.S. tax return unless the

donor has Canadian source income. The deduction limits depend on the status of the charity (*see discussion in Section 5: Canadian Land Trusts and U.S. Publicly-Supported Charity Status*).

3.5.4 Gifts to U.S. Charity Transferred to a Canadian Charity

In some situations a donor is keen to work with a Canadian land trust and, ultimately, hopes that the land trust will become stewards of the property (either as managers or conservation easement holder/ property owner). However, they also wish to gain the income tax benefits of making the donation to a U.S. charity. Such an arrangement may be possible, subject to certain restrictions (*see discussion in Section 2.4 Potential Donees*).

The tax benefits for the donor are the same as discussed above, depending on whether the U.S. donee has *prescribed donee* status in Canada or not. When the property is ultimately transferred from the U.S. donee to a Canadian land trust, there is not likely to be much capital gain. In the case where there is a capital gain, the U.S. donee may be able to receive an exemption from Canadian income tax (i.e. capital gains tax) on this transfer under the U.S.-Canada Tax Treaty.³⁶

Table 2: Potential Impact of Donee on Tax Consequences

Donee	Advantages	Disadvantages
Canadian charity (U.S. <i>qualified donee</i>)	Reduce/eliminate capital gains tax (Canada) U.S. estate tax benefit Tax deduction for Canadian-source income Deduction at highest level No U.S. gift tax	No income tax deduction against U.S. income
Other Canadian charity	Reduce/eliminate capital gains tax (Canada) U.S. estate tax benefit (for gift of land only) Tax deduction for Canadian-source income Lower deduction limit	No income tax deduction against U.S. income Potential U.S. gift tax on easement or remainder interest Potential U.S. estate tax issues for a gift of remainder interest or a lifetime or testamentary gift of conservation easement
U.S. charity (<i>prescribed donee</i> in Canada)	Income tax deduction on U.S. income Deduction at highest level Avoid Canadian capital gains tax U.S. estate tax benefit No U.S. gift tax	There may not be a <i>prescribed donee</i> willing to accept the gift May not be eligible to hold conservation easements in some provinces at present or land in other jurisdictions
Other U.S. charity	Income tax deduction on U.S. income Deduction at highest level U.S. estate tax benefit No U.S. gift tax	Triggers Canadian capital gains tax. No option to reduce/eliminate this tax. May not be eligible to hold conservation easements or land in some jurisdictions at present. No benefit against Canadian-source income

Note: All gifts of conservation easement and conservation remainder interests must meet the criteria required by U.S. tax law for *qualified conservation contributions* to be eligible for U.S. income and estate tax benefit.

3.6 Additional Tax Issues for Specific Conservation Tools

The specific conservation tool used to protect land has tax implications for a U.S. donor. The following section summarizes specific issues relevant to various conservation tools. The detailed tax implications provided in the previous section will not be reiterated.

3.6.1 Lifetime Gifts of Land

Restricted Gifts: There are some important considerations if the donor wishes to donate land but wants to restrict future use of the property (and ensure that their wishes are met in perpetuity). It is best not to make a gift of land and include restrictions in the same deed. From a legal perspective, such deed restrictions have limited enforceability unless the gift is made in trust. For donors taking advantage of a U.S. income tax benefit (i.e. who gift the property to a U.S. charity), the deduction for such a restricted gift of land is limited to the restricted value of the land, which may be significantly lower than its unrestricted value³⁷. A better alternative is to first place a qualifying conservation easement on the land and then donate the land itself to a different charity. The conservation easement then ensures that the donee is bound to certain restrictions on use and care of the land.

Retained Rights: Similarly, if the donor wants to donate land but retain the right to use the property, generally the gift will not qualify for a U.S. income tax deduction nor reduce the value of the land for U.S. estate tax purposes unless the donor retains a life estate. A conservation easement that qualifies as a *qualified conservation contribution* can offer tax benefits and assure a donor of the right to future use of the land.

3.6.2 Testamentary Gifts of Land (Donated in a Will)

It is important that the donor work out details for a testamentary gift with the intended donee. This ensures that the donor's wishes can in fact be honoured (i.e. that the gift will be accepted and the accompanying restrictions and stewardship responsibilities honoured). The donor should document their wishes in specific and detailed language, imposing particular restrictions and permitted uses, worked out with the donee organization, to take effect at death. Language needs to be included to allow an executor to take the necessary steps to complete the transaction.

Canadian/U.S. income tax benefit: A testamentary gift of land does not provide an income tax benefit during the donor's lifetime, but instead reduces the value of the taxable estate which will reduce or possibly eliminate estate taxes.

Canadian capital gains tax: A testamentary gift of Canadian land to a U.S. charity that is not recognized as a *prescribed donee* in Canada will create a Canadian capital gain and a capital gains tax that must be paid by the donor's estate on the donor's final income tax return for the year of death. For such gifts to a Canadian charity or a U.S. charity recognized as a *prescribed donee* in Canada, there are particular steps that must be followed to avoid a Canadian capital gains tax on the gift.

Income and Estate tax optimization: If a donor's will provides that the land will be deeded to a conservation organization at his/her death, a lifetime gift of a conservation easement, combined with a testamentary gift of the fee interest in the land, may provide the best income tax and estate tax benefits and assure that the donee will be required to protect the land's conservation values.

3.6.3 Gift of Remainder Interest for Conservation Purposes

The cross border tax implications of a remainder interest gift for conservation purposes under section 170 (h) of the Internal Revenue Code are more complex than a fee simple donation.

U.S. income tax benefit: To be deductible for U.S. income tax purposes, a gift of a remainder interests must either be a remainder interest in a residence or agricultural land under Internal Revenue code Section 170(f)(3)(B), or a "conservation remainder" (i.e. a *qualified conservation contribution*). If the gift is made for conservation purposes (as distinguished from a gift intended for resale by the charity to fund its operations – known as a "trade land"), it is highly advisable (and common practice in the U.S) for a donor to first place a conservation easement on the property and then donate the remainder interest. The remainder interest may be donated to the same organization that holds the conservation easement or to another organization. It may be open for the donee organization to hold the remainder interest or to sell the restricted property. For the donor to benefit from income tax savings, and to avoid estate tax problems and gift taxes, instruments of conveyance for remainder interest should be drafted and executed following the specific criteria required by U.S. tax law under Section 170(h).

If the gift of a remainder interest is to a U.S. charity, the donor can receive a U.S. income tax deduction against U.S. income for the present value of the remainder interest in the year of the donation provided it meets the requirements of a *qualified conservation contribution*. The present value of the remainder interest is calculated by Internal Revenue Service actuarial tables that discount the full value of the land based on the life expectancy of those who have the reserved life estate. For example, if the life estate rights are reserved for the original donor only, his or her age at the time of the gift will determine the value of the remainder interest for U.S. income tax deduction. If several life beneficiaries are named by the donor, their ages and their joint life expectancies will be used to determine the present value of the remainder interest and the corresponding income tax deduction. See Appendix 4: Sample Tax Calculations.

U.S. estate tax benefit: If life beneficiaries, other than the donor, are named in the remainder interest deed, which can be done during the donor's lifetime or under the donor's will, the donor's estate will include the value of the life estates granted to those named life beneficiaries just like any other non-charitable gift under a will. That value is based on the beneficiaries' joint life expectancies. The estate will get a charitable gift deduction for the value of the remainder interest portion of the gift. If only the donor retains the life interest, it expires upon his or her death and the value of the land is not included in the estate at all since it is already owned by the charity.

U.S. Gift tax: A gift of remainder interest must also meet certain Internal Revenue Code requirements to ensure that it does not create gift tax³⁸.

Canadian income tax consequences: A gift of a remainder interest to a Canadian registered charity will trigger a disposition of the remainder interest for tax purposes. This disposition will be subject to capital gains tax, which can generally be eliminated by the charitable credit and/or election to reduce gain under Canadian tax law. A gift of a remainder interest to a U.S. charity will trigger a disposition of the entire property (i.e., the life interest and the remainder interest for tax purposes)³⁹. In such a case, if the charity is a Canadian charity or *prescribed donee* in Canada, an election can be made to reduce the value of the remainder interest donated thereby eliminating the capital gains tax on the gift of the remainder interest, but not reducing the capital gains tax on the deemed disposition of the life estate. For gifts to other U.S. charities (i.e. not a *prescribed donee*), Canadian capital gains tax will be payable on the fair market value of the entire property.

3.6.4 Gift of Conservation Easement

Income Tax: If the gift is to a U.S. charity, the donor can receive a U.S. income tax deduction for the value of the conservation easement in the year of the donation provided it meets the requirements of a *qualified conservation contribution*. If the gift is to a Canadian charity, it would be deductible only if the donor had Canadian-source income and the donee is recognized as a *qualified donee* in the U.S.

U.S. Gift Tax: For the conservation easement to be eligible for a gift tax deduction (and thereby avoid triggering gift tax), the conservation easement would also have to meet the requirements of a *qualified conservation contribution* in Internal Revenue Code Section 170(h), with one important exception, which is that the conservation purpose test need not be met.⁴⁰ The gift tax deduction would generally be available for gifts to Canadian organizations recognized as *eligible donees* in the U.S., as well as U.S. charities.

Estate Tax: A testamentary or lifetime gift of a conservation easement may qualify for a charitable deduction for U.S. estate tax purposes⁴¹ if it constitutes a *qualified conservation contribution* in Internal Revenue Code Section 170(h).⁴² The estate tax deduction would generally be available for gifts to Canadian as well as U.S. charities but only if the Canadian charity is a *qualified donee* in the U.S.

3.6.5 Bargain Sale

A bargain sale or split-receipt donation is a transfer of conservation (or other) property at less than fair market value. This could be a useful technique for properties which Canadian land trusts want to secure, but where full donation is not an option for the donor.

A U.S. resident can donate Canadian land to a U.S. charity as a split-receipt donation. The donor would be liable for the full amount of their Canadian tax (i.e. tax on the difference between the adjusted cost base for the property and the disposition value of the property), but would have a U.S. income tax benefit to offset a portion of their U.S. income or Canadian-source income for the same year.

If the land is transferred as a split-receipt donation to a Canadian charity, the donor receives a Canadian tax receipt for the difference between the amount paid to secure the property and the fair market value of the land. This may be used to reduce or eliminate any Canadian capital gain realized by the transfer of the property. This procedure is also available under the Ecological Gifts Program, and provides a greater opportunity to reduce capital gains taxes owing on the gift, and greater tax benefits to offset Canadian-source income.

See further discussion about bargain sales or split-receipt donations in *Section 2.2 Conservation Tools*.

3.7 Qualified Conservation Contributions (U.S.)

To be eligible for U.S. income and/or estate tax benefits, and to avoid potential gift and estate tax problems, all gifts of partial interest in land (i.e. conservation easements or remainder interests) must meet the requirements for *qualified conservation contributions* under *Internal Revenue Code Section 170(h)(1)* and *Section § 1.170A-14* of the Treasury Regulations to Internal Revenue Code Section 170.

The following provides a summary of key points relevant to cross-border gifts. Unlike in Canada, U.S. tax law provides very specific requirements for recipients of the gift, and conservation easement wording, content, property documentation and appraisals. While some requirements parallel common practices in Canada, others are likely new and unfamiliar to Canadian land trusts. See also the conservation easement template prepared as an accompaniment to this guide for sample wording to be included in cross-border conservation easements⁴³.

A *qualified conservation contribution* means a contribution of a “qualified real property interest” to a *qualified donee*, “exclusively for conservation purposes,” under which the conservation purpose must be protected in perpetuity.

3.7.1 Qualified Real Property Interest

A qualified real property interest is the donor’s entire interest in the property; a remainder interest or conservation easement granted in perpetuity (if all other requirements for *qualified conservation contributions* are met), or a donation in fee simple with reservation of mineral interests.

3.7.2 Qualified Donee

As more specifically defined in the *Internal Revenue Code Section 170(h)(3)(b)*, the gift must be given to a *qualified organization*, which is defined to include a “publicly-supported” charity described in *Internal Revenue Code 501(c)(3)* that meets a public support test in the *Internal Revenue Code 509(a)(1)* or *Internal Revenue Code 509(a)(2)*. In general terms, this test would be met by a foreign charity if it is an *Internal Revenue Code 501(c)(3)* organization that normally receives more than 1/3 of its support each year from a combination of gifts, grants, contributions or membership fees from individuals who are not substantial contributors to the organization (i.e. an organization that receives funding from a broadly based public, rather than a private foundation which may receive support only from a few sources).

To be deemed a *qualified organization* a Canadian charity must therefore take the additional step of applying to the Internal Revenue Service for a public support determination (see discussion of application requirements in *Section 5: Canadian Land Trusts and U.S. Publicly-Supported Charity Status*). This determination can be gained and lost but must be met at least in the year of the conservation gift. The donee should have an Internal Revenue Service “determination letter” that clearly states the charity’s tax-exemption and foundation classification (i.e. status as a *qualified donee/publicly-supported charity*) prior to completing a cross-border conservation gift

of partial interest in land (i.e. a conservation easement or remainder interest). There may be significant consequences for cross-border conservation donors if these conditions are not met (i.e. loss of income and gift tax benefits, and potential estate tax liability which essentially ignores the conservation easement for valuation of the estate tax liability).

To be a *qualified organization*, the donee must have a commitment to protect the conservation purposes of the conservation easement and have the resources to enforce its conditions. Canadian land trusts with a conservation purpose as listed below, should meet these requirements. There is not necessarily a need for the donee to have set aside funds to enforce the restrictions of the gift to meet this requirement.

Transfers by Donee

The instrument of conveyance must prohibit the donee from transferring the conservation easement or property (in the case of a conservation remainder interest), unless to another *qualified donee* and unless the donee requires, as a condition of transfer, that the conservation purposes be protected. The *qualified donee* status is therefore critical for the Canadian land trust even if the conservation easement is first donated to a U.S. organization, then transferred to a Canadian land trust. The conservation easement must always be held by a *qualified donee* to avoid estate problems for the donor.

3.7.3 Exclusively for Conservation Purposes

Conservation Purposes

The gift must be given exclusively for conservation purposes. Any benefit to the donor must be incidental only.

The conservation easement must meet one or more conservation purposes tests⁴⁴:

1. Preservation of land areas for outdoor recreation by, or for the education of, the general public
2. Protection of a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem
3. Preservation of open space, including farmland and forest land, where such preservation is
 - a. providing a significant public benefit and pursuant to a clearly delineated state and local governmental policy
 - b. for the scenic enjoyment of the general public

The Internal Revenue Code provides further detail on requirements for public benefit, public access and government policy. Generally, the more significant the property the more the gift adds to the “public good” and the less development the conservation easement or remainder interest permits, the greater the likelihood that the gift will meet the test. If in doubt, the donor and the donor’s advisors may seek an advance ruling from the Internal Revenue Service to determine whether a specific gift will be qualified (significance, level of development, degree of

public access etc.). See the *Regulations 1.170A-14* and Stephen J. Small's treatise, *The Federal Tax Law of Conservation Easements*⁴⁵ for further discussion. The latter includes specific references such as Internal Revenue Service Private Letter Rulings, Revenue Rulings, and Congressional Committee Reports, that are helpful in illustrating how the law has been interpreted in specific instances. It is important to determine what will or will not qualify when crafting the conservation easement, if a tax deduction is important to the donor.

Retained Rights and Enforceability in Perpetuity

The conservation purpose must be protected *in perpetuity*. A term easement (e.g. 10 or 50 years) is not acceptable. Perpetuity is not achieved if there is a mortgage on the property unless the mortgage holder "subordinates" their interests under the mortgage to the terms of the conservation easement. The lender must agree that if it forecloses on the mortgage, it will take the land subject to the conservation easement. The holder must have the right to enforce the conservation purposes of the gift in perpetuity.

The owner's land use rights (whether under a conservation easement or as a reserved life estate) must be subject to legally enforceable restrictions that protect the conservation purposes in perpetuity and prevent inconsistent uses. The conservation easement must be registered (recorded) in the local registry of deeds. Since it may be difficult to effectively meet enforcement requirements for a remainder interest, it is standard practice with most U.S. land trusts to combine a gift of remainder interest with a conservation easement.

The Internal Revenue Code requires that the donor provide documentation sufficient to establish the property's condition prior to the time of the gift. Such documentation serves to protect the conservation values of the property that could be adversely affected by exercise of the retained rights. Such "baseline" documentation may include: topographical or survey maps, scale map showing human-made improvements, vegetation, identification of flora and fauna, land use history, and distinct natural features, aerial photographs and on-site photographs. If a particular natural resource is to be protected (e.g. a rare plant species or water quality), the condition of this resource must be documented.

The donor and donee must both sign a statement clearly referencing the documentation and indicating that this inventory is an accurate representation of the property's condition at the time the gift is made.

The donor must agree in the conservation easement to notify the donee in writing before exercising any reserved right that may have an adverse impact on the conservation values of the property. The terms of the gift must provide the donee with a right to enter the property at reasonable times to inspect the property to confirm compliance with the restrictions. The terms must also provide the donee the right to enforce the restrictions by appropriate legal proceedings, including the right to require restoration of the property to its condition prior to the time of any violation.

Inconsistent Use

Unless there are special circumstances, the gift does not qualify if the contribution would accomplish certain of the listed conservation purposes but permit destruction of other significant conservation values. For instance, if there is an endangered species on the property and there are no restrictions to protect it, the gift will not qualify as a conservation contribution.

Extinguishment

If later, unexpected change makes enforcement of the conservation easement impossible or impractical, the perpetuity requirements of the Internal Revenue Code will be met if the document requires that:

- The restrictions may be extinguished only by judicial proceeding, or by government powers of eminent domain.
- The donor must agree that the donation of a perpetual conservation restriction gives rise to a property right owned by the donee organization, with a fair market value at least equal to the proportionate value that the restriction bears to the value of the property as a whole (immediately prior to the restriction). That proportionate value must remain constant. If a restriction is extinguished, the donee has a right to receive at least that proportion of the proceeds of the sale or exchange of the property after extinguishment.
- Some land trusts have donors sign a statement about proceeds separately from the conservation easement. It is recommended to include such clauses directly in the conservation easement. It is also worthwhile to use the actual appraised value to state the proportionate value of the conservation easement with certainty (subject to revision if Internal Revenue Service disagrees with the owner's appraisal).
- The donee must agree to use the proceeds from subsequent sale or exchange for its conservation purposes.

Surface Mining

The conservation purposes test also requires that no surface mining can be permitted. If a conservation easement does not prohibit extraction or removal of minerals by any surface mining method, the gift does not qualify. In jurisdictions such as Nova Scotia where the Crown owns mineral rights, this condition may be met if there is a clear statement by an authoritative professional that the possibility of surface mining occurring on the property is so remote as to be negligible. This can likely be satisfied with a geologist's report establishing either that there are no potentially valuable minerals on or near the property or that, if there are, it simply isn't worthwhile as an economic matter to extract them. Relevant factors considered include: geological, geophysical or economic data showing the absence of mineral reserves, or lack of commercial feasibility at the time of the gift.

In some cases, a conservation contribution may qualify if certain mining methods are permitted that have only a limited, localized impact on the real property but that are not irremediably

destructive of the conservation interests. The mineral interest rules are quite technical and may require advice of an experienced advisor.

Appraisal

See discussion of appraisal requirements for *qualified conservation contributions* in *Section 3.8 Appraisal Requirements (U.S. and Canadian)*.

Other

Careful consideration must also be given to the degree of development permitted, and rights retained by the donor. In some cases, the donor may wish to seek advance ruling on the deductibility of an easement from the Internal Revenue Service. Also, U.S. case law indicates that vagueness in a conservation easement could mean that an easement is not accepted as a *qualified conservation contribution*. A good background on relevant case law and Internal Revenue Service rulings is found in Stephen Small's *The Federal Tax Law of Conservation Easements*.

Note: Donors must also submit Form 8283 and other specific information with their tax return (see 4.2 Overview of Procedures and Documentation.)

3.8 Appraisal Requirements (U.S. and Canadian)

3.8.1 Common Elements in U.S. and Canadian Appraisal Requirements

Both Canadian and U.S. tax law require appraisals to support substantial conservation gifts. All appraisals should conform to the requirements of the Canadian Uniform Standards of Professional Appraisal Practices, or in Quebec, Les Normes De Pratique Professionnelle Des Evaluateurs Agrees. Depending on how the cross-border conservation gifting is pursued, there may be two Canadian and one U.S. agency involved in establishing and administering appraisal criteria and in reviewing appraisals: the Canada Revenue Agency, the Ecological Gifts Program of Environment Canada, and the Internal Revenue Service of the U.S. Department of Treasury. The Internal Revenue Service administers very specific requirements for appraisals, particularly for conservation easement donations. In Canada, the requirements are not as specific, except for appraisals for donations made through the federal Ecological Gifts Program.

Because of the complexity of cross-border conservation gifts, and the potential tax implications on both sides of the border, it may be prudent to use an appraiser with designation as an Accredited Appraiser Canadian Institute (AACI) from the Appraisal Institute of Canada, and one who has taken appraisal training through the Ecological Gifts Program. It may also be prudent to address the key appraisal requirements of both the Internal Revenue Service and the Ecological Gifts Program for all cross-border conservation gift appraisals.

In most cases, a cross-border conservation gift should be supported by a full-narrative appraisal. The appraisal should include consideration of the following factors: cost or selling price, comparable sales, replacement cost and/or opinions of experts. The appraisal may not contain any unsupported assumptions or conclusions. Hypothetical conditions must be identified, and are only accepted where necessary for a reasonable analysis of the property.

To meet both Canadian and U.S. appraisal requirements, a qualified appraisal should include the following components:

1. Description of the property (location, physical features, condition, dimensions, property use, zoning and permitted uses, potential use for other higher and better uses, name and address of present owners, legal description, declaration of the interest(s) being valued);
2. Purpose and scope;
3. Terms of any agreement or understanding which restricts the donee's use or disposal of the property, such as a copy of the conservation easement (or equivalent document). The document does not have to be registered at the time of the valuation;
4. Terms of any agreement or governmental control relating to use, sale or disposition of the donated property;
5. Methods of valuation and process used to determine the fair market value;
6. Specific basis for the valuation, such as specific comparable sales transactions or statistical sampling;

7. Copy of title to the property;
8. Information about the appraiser and his or her qualifications (name, address, type of business, tax identification number (U.S.), background, experience, education, membership in professional associations);
9. The appraiser's conclusions, with references to attached exhibits and appendices;
10. Statement that the appraisal was prepared for income tax purposes;
11. Appraised fair market value of the property on the date (or expected date) of contribution;
12. Effective date of the appraisal;
13. Appraiser's signature.

Note: For cross-border conservation gifts being donated through the Canadian federal Ecological Gifts Program, all appraisals must be reviewed by a national appraisal review panel, and the value substantiated by the federal Minister of the Environment. Additional documentation is required in the application.

Key Differences between Canadian and U.S. Appraisal Requirements:

U.S. Requirements

- To ensure tax deductibility for the donor, the Internal Revenue Service requires that **the appraisal must be commissioned by the donor, not the donee**⁴⁶
- Timing -- Appraisal must be completed no earlier than 60 days before the donation and no later than the due date of the donor's U.S. tax return for the year of the gift⁴⁷.
- Appraisal fee arrangements—Certain fee arrangements are prohibited⁴⁸ such as fees based on a percentage of appraised value or what is allowed as a deduction.
- The donor must submit an appraisal summary, signed by the appraiser and the donee of the gift, on Internal Revenue Service form 8283 along with their U.S. tax return. On this form, the appraiser must make certain statements including that he or she may be subject to penalties for significant misstatement (see discussion below).
- For gifts over \$500,000 in value, the full appraisal must be attached to the form.
- The donor must retain records of the property appraisal⁴⁹

Canadian Ecological Gifts Program Requirements*

- For conservation gifts being donated through the federal Ecological Gifts Program, all appraisals must be reviewed by a national appraisal review panel, and the value substantiated by the federal Minister of the Environment
- Definition of fair market value must be included in the appraisal
- Copy of property title must be attached to the appraisal
- Currency must be stated in the appraisal
- Timing – The appraisal must be completed no more than six months prior to the application. If the gift has already been made, the donor has three years to request a valuation, where the effective date of the appraisal must be no more than six months prior to the date of the gift (or the date of the gift if the appraisal is completed after the date of the gift).

- Certification Statement for Ecological Gifts (included in the “Guidelines for Appraisals”) must be attached
- Appraisals for Ecological Gifts must be submitted to Environment Canada with an ***Application for Appraisal Review and Determination***
- An indication of whether the appraiser has completed the Ecological Gifts Program’s Appraiser Training Workshop must be included
- Letter of transmittal must be attached, including information about the appraiser and the appraiser’s conclusions with references to attached exhibits and appendices

**Note: There are few specific guidelines in Canada for appraisals on gifts (including conservation easements), which are not made through the federal Ecological Gifts Program. The Canada Revenue Agency has taken inconsistent positions regarding the value of a conservation easement which is not an Ecological Gift, at times holding that easements have nominal value. It is assumed that donors will err on the side of caution and meet the appraisal requirements of both the Canadian Ecological Gifts program and the Internal Revenue Code for cross-border conservation gifts.*

3.8.2 Additional U.S. Appraisal Requirements

Qualified Appraiser

U.S. tax law requires a “qualified appraisal” whenever a taxpayer claims a U.S. federal income tax deduction for charitable gifts having a value of five thousand dollars (\$5,000) or more. A qualified appraisal means an appraisal that is: treated as a qualified appraisal under regulations or other guidance prescribed by the Internal Revenue Service; and conducted by a qualified appraiser⁵⁰ in accordance with generally accepted appraisal standards and any regulations or other guidance prescribed by the Internal Revenue Service. A qualified appraiser must meet the following general criteria:

1. The individual regularly performs appraisals for which the individual receives compensation;
2. He or she demonstrates verifiable education and experience in performing appraisals of the type of property being appraised (i.e. conservation easements or gifts of conservation land);
3. He or she has earned an appraisal designation from a recognized professional appraiser organization or has otherwise met minimum education and experience requirements set forth in regulations prescribed by the Internal Revenue Service;
4. The appraiser must be “independent”, meaning he or she may not have any personal or financial interest in the property being appraised nor have any personal or business relationship with the prospective donor or donee other than the contracted appraisal assignment. Additionally, the appraiser’s fee may not be based upon a percentage of appraised value or upon the donor’s tax deduction amount; and

5. He or she must not be prohibited from practicing before the Internal Revenue Service under Section 330 of Title 31 of the Internal Revenue Code at any time during the 3-year period ending on the date of the appraisal.

It is important to note that in 2006, changes to U.S. tax law gives the Internal Revenue Service the power to issue new regulations on appraiser qualifications. As such, appraisers will have to show donors that they are qualified under the new law and any new Treasury regulations or guidance that may follow from it, in addition to meeting existing regulation requirements.

Penalty Provisions

Significant penalties exist for appraisers, donors and charities involved in misstatements of appraised value. Section 1219 of the U.S. Pension Protection Act adds new penalty provisions as of 2006. If the claimed value of property based on an appraisal results in a substantial or gross valuation misstatement, a penalty is imposed on any person who prepared the appraisal and who provides an overstatement of value⁵¹ (see Internal Revenue Code § 6659A). There are also penalties for anyone who knew, or reasonably should have known, the appraisal would be used in connection with a return or claim for refund. There are also penalties for a donor who underpays taxes as a result⁵².

Internal Revenue Service Form 8283

Form 8283⁵³ is a summary form filed with the donor's U.S. federal income tax. Its purpose is to document that a noncash charitable contribution has been made, the details of which are included in a full narrative appraisal. It must be signed by the donor, the appraiser and donee organization (indicating that the donee has received the gift). For gifts worth more than \$500,000, the entire appraisal must be attached to the donor's U.S. tax return.

Key components of the Form 8283 include the following:

Section B for Donated Property over \$5,000. Part I Information on Donated Property

1. 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);
2. Description of the property;
3. Brief summary of the physical condition of the property;
4. Appraised fair market value of the property interest on the date of contribution;
5. Manner of donor's acquisition of the property (purchase, gift, etc.) and the date of donor's acquisition;
6. Donor's cost or adjusted basis (adjusted cost base) in the property;
7. For bargain sales, the amount of consideration received by the donor;
8. Amount claimed as a deduction; and
9. Date the donee received the property or interest in property.

Part III Declaration of Appraiser

1. Name, address and tax identification number of the appraiser;
2. Certain declarations by the appraiser pertaining to interests in the transaction and the fee arrangement (with signature, business address and identifying number). Statements to be included:
 - a. The appraiser is not the donor, donee, a party to the transaction, employed by or related to the donor or donee. If regularly used by the donor, donee or party to the transaction, he or she performed the majority of appraisals for other persons during the tax year;
 - b. The appraiser holds him or herself out to the public as an appraiser or performs appraisals on a regular basis;
 - c. Because of his or her qualifications (as described in the appraisal), the appraiser is qualified to make appraisals of the type of property being valued;
 - d. The appraisal fees were not based on a percentage of the appraised property value or amount of donor's deduction;
 - e. He or she understands that a false or fraudulent overstatement of the property value may subject him or her to the penalty under Internal Revenue Code Section 6701(a) (aiding and abetting the understatement of tax liability); and
 - f. The appraiser is not barred from presenting evidence or testimony by the Office of Professional Responsibility.

Part IV Donee Acknowledgement

1. Name, address and tax identification number of the donee;
2. Signature of donee, acknowledging receipt of the gifted property and making certain declarations (the acknowledgement does not mean the donee agrees with the claimed fair market value):
 - a. It is a *qualified organization* under the Internal Revenue Code Section 170 and that it received the donated property (including date of donation);
 - b. If it sells, exchanges or otherwise disposes of the property within 2 years, it will file Form 8282 and give donor a copy; and
 - c. It does not intend to use the property for unrelated use.

Donor Attachment to Form 8283: The donor must attach a statement that:

- a. Identifies the conservation purposes further by the donation;
- b. Shows, if before and after valuation is used, the fair market value of the underlying property before and after the gift;
- c. States whether the donor made the donation in order to get a permit or other approval from a local or other governing authority and whether the donation was required by a contract; and

- d. If the donor (or related person) has any interest in other property nearby, and if so, a description of that interest.

3.8.3 Additional Canadian Appraisal Requirements

Appraisal Requirements for the Ecological Gifts Program

There are fewer specific guidelines or requirements for appraisals for gifts of land or conservation easements in Canada, compared to requirements in the U.S.

The Income Tax Regulations s.3501 include specific requirements relating to issuing charitable receipts, which include some information to describe the property, the date it was donated, and the name and address of the appraiser. Recent more detailed rules on receipts are to come into effect, as well. While limited, these still do provide general requirements for valuations.

Since conservation easements and cross-border conservation gifts are a relatively new tool in Canada, and neither appraisers nor the Canada Revenue Agency have extensive experience in their use, it may also be prudent to use the guidelines for appraisals under the Ecological Gifts program (see below).

Because of the complexity of cross-border conservation gifts, and the potential tax implications on both sides of the border, it may be prudent to use an appraiser with designation as an Accredited Appraiser Canadian Institute (AACI) from the Appraisal Institute of Canada, and also one who has taken training for the Federal Ecological Gifts program. Such training includes appraisal issues related to the specific and unique aspects of conservation easements.

For Ecological Gifts, either the donor or the donee may acquire an appraisal, but the appraiser must be at arm's length from the parties to the transaction. In provinces that require a license to establish the fair market value of real property, such as in Nova Scotia, appraisers must have that license. Furthermore, appraisals for ecological gifts must conform with the requirements of the Canadian Uniform Standards of Professional Appraisal Practice (or in Quebec, Les Normes de Pratique Professionnelle des Évaluateurs Agréés).

Three colour copies must be submitted along with an ***Application for Appraisal Review and Determination of the Fair Market Value***. The appraisal may not contain any unsupported assumptions or conclusions.

Category I gifts (gifts of a value less than \$25,000 and that are straightforward as to value), the appraisal may be prepared using a Summary Report⁵⁴ along with a brief narrative to provide reasoning and support for conclusions drawn. For Category II gifts (all other ecological gifts), the appraisal must be a full narrative report (two reports may be necessary for conservation easements to verify the “before and after” values), and the appraiser must have a specific designation that qualifies the individual to value the specific ecological gift⁵⁵. For more information, see Environment Canada's publication, “*Ecological Gifts Program Guidelines for Appraisals*” or the Ecological Gifts Program website (www.cws-scf.ec.gc.ca/egp-pde/).

3.8.4 Conservation Easement Valuation

U.S. Tax Law Perspective

Gifts of conservation easements and conservation remainder interests in Canada by U.S. residents will most likely be structured to meet requirements of a *qualified conservation contribution* under the Internal Revenue code to ensure proper tax benefits for the donor. Sections 170(h) of the Internal Revenue Code and U.S. Treasury Regulations 1.170A(14) provide background on such gifts and related appraisal considerations.

According to U.S. tax law, the value of a conservation easement is its fair market value. In cases where there are substantial sales of restricted land or comparable easements, the value of the conservation easement may be substantiated with such sales. Otherwise, conservation easements are appraised on a “before and after” basis. The general rule is that the value of a conservation easement is the difference between the fair market value of the property it encumbers (“before” value), and the fair market value of the property after the conservation easement is in place (“after” value). In other words, the fair market value of the conservation easement is the difference between what the property would sell for if it were put to the most valuable economic use possible, without the easement restrictions in place, and what it would sell for when certain uses are restricted. However, each appraisal problem and assignment has unique circumstances that have to be considered on an individual basis.

If a conservation easement covers a portion of a contiguous property, again, the value is the difference between the fair market value of the entire property before and after the conservation easement. If the conservation easement increases the value of any other property (contiguous or not) owned by the donor or related persons, the amount of the tax deduction is reduced by the increase in the value of the other property.

The objective assessment of the “before” value of the property must take into consideration both the current use of the property and the likelihood (whether remote or immediate) that the property may be developed in the future. Further consideration must also be given to any effect from zoning, conservation, historic preservation or other laws that already restrict the potential use of the property. If the conservation easement has no material effect on the value of the property, or if it increases the value of the property, then no tax deduction is permitted.

If a conservation easement allows for any development, any objective assessment of the “after” value of the property (e.g. the value of the property *after* the easement is put in place) must take into account the effect of the development. In some cases, an easement permitting development might allow for higher use than is currently available on the property, but is less than the potential highest and best use of the property.

The value of a conservation easement is not reduced because of special requirements for transferring of the easement (i.e. if the easement must be transferred to an *eligible donor* as defined by Section 170(h) of the Internal Revenue Code). Such restrictions are intended solely to ensure that the easement will remain dedicated to conservation purposes, and thus further the rationale behind a *qualified conservation contribution*.

Canadian Tax Law Perspective

Subsection 118.1(1) of the Canadian Income Tax Act states that the fair market value of a conservation easement under the Ecological Gifts program (there is no such clarification for non-Ecological Gifts easements) is the difference between the fair market value of the land and the amount that value is reduced by making the gift. The value of the gift of a conservation easement (Ecological Gift) is the difference between the fair market value of the land “before and after” the easement. The value will vary considerably depending on the property, and the relative value of activities or land uses that are restricted and those that are permitted.

In most cases, the Canada Revenue Agency will require verification of the conservation easement’s adjusted cost base (as well as fair market value) as part of the cross-border conservation gift process. The adjusted cost base is essentially the cost of acquiring the property (typically purchase price and certain acquisition expenses).

Determining the adjusted cost base of land may be simple and can be supported by documents such as deeds, purchase and sale agreements, real estate or tax records. However, such determination is not simple where an easement has been placed on the property. It may be difficult to place a value on what an easement may have been worth in the past when the property was acquired (i.e. the adjusted cost base of the easement itself).

Recognizing this challenge, Section 43 of the Canadian Income Tax Act attributes to a disposition of part of a property, the adjusted cost base “as may reasonably be regarded as attributable to that part” (i.e. a proportional value method). The appraiser determines the current fair market value of the entire property and of the conservation easement. The proportionate value of the conservation easement is then determined. In other words, if the conservation easement today is determined to be worth 1/3 of the fair market value of the property, then the conservation easement’s adjusted cost base can be considered to be 1/3 of the land’s adjusted cost base (see Appendix 4.1 *Sample Calculation for Determining Adjusted Cost Base of a Conservation Easement*). The donor and donee should assess this proportional value and be sure it seems reasonable. Ultimately, the Canada Revenue Agency determines whether to accept this value or not. Alternatively, the conservation easement can be appraised as of the time the land was purchased, but this can be more challenging for an appraiser and may cost more, particularly where the property was acquired many years prior.

Valuation of Remainder Interests

With a gift of remainder interest, even though the gift of interest in land is made currently, the donee’s full enjoyment of the gift is postponed until a later date, when the person with a life interest dies. When they die, their remaining interest in the land becomes the property of the donee. Under U.S. tax law, the value of the remainder interest for income tax purposes is determined by taking the current fair market value of the interest and reducing or discounting it based on life-expectancy tables and interest-rate-assumption tables. More specifically, according to Internal Revenue Code Section 170(f)(4) and Treasury Regulations 1.170A-12, to determine the value of a remainder interest in real property, depreciation (computed on the straight line method) and depletion of such property must be taken into account. Multiply the fair market

value of the property on the date of the gift by the appropriate factor (see Publications 1457 and 1458). Make an adjustment for depreciation or depletion using factors shown in Publication 1459.

For a remainder interest for conservation purposes, the current fair market value of the property (against which the limitations of Section 1.170A-12 are applied) must take into account any pre-existing or contemporaneously recorded rights that limit, for conservation purposes, the use to which the subject property may be put.

Good sources on valuation of conservation easements and remainder interests include *Appraising Easements* by the Land Trust Alliance, the Internal Revenue Service *Publication 526: Charitable Contributions*, and *Publication 561: Determining the Value of Donated Property*.

3.8.5 Appraisal Timing

U.S. tax law requires that the appraisal and Internal Revenue Service Form 8283 be completed within the period between 60 days prior to the date of contribution and the filing of the donor's federal income tax returns for the year in which the charitable contribution is made. The Canada Revenue Agency advises that the appraisal should be completed no more than six months before the effective date of the donation for Canadian tax purposes.

For Ecological Gifts, an appraisal review (by the national Ecological Gifts Program appraisal review panel) is required before the gift is accepted into the program. Where the donor submits an *Application for Appraisal Review and Determination* to Environment Canada before making the gift, the appraisal's effective date may not be more than six months prior to application. If the donor has already made a gift, the donor has three years to request a valuation.

If any of these timing requirements are not met, the appraiser must verify in writing that there has been no material change in use of the property, and no material change to the market value. Alternatively, a new appraisal may need to be completed, or the appraisal updated. The written confirmation, or updated or new appraisal must be submitted with the Ecological Gifts application and with any tax return filing.

3.9 Gifts of Cash or Securities from U.S. Donors to Canadian Land Trusts

In many cases, Canadian land trusts may encourage or require an endowment contribution to accompany a conservation gift to help cover stewardship and enforcement costs. In other cases, U.S. residents may provide financial support to a Canadian land trust for specific projects or initiatives. Since the Canadian land trust is not based in the U.S., the donor does not receive a U.S. income tax benefit against their U.S. income. The donor, however, can use the value of the gift as a tax deduction against Canadian income on their U.S. tax return, as long as the donee is a registered Canadian charity.

If the charity has taken certain steps to qualify as a public charity in the U.S. (as discussed in *Section 5: Canadian Land Trusts and U.S. Publicly-Supported Charity Status*), the deduction limits are enhanced. A cash donation may be deductible for up to 50% of the donor's Canadian-source income (rather than the default limitation of 30% if the charity does not take the steps to qualify) and any unused amount can be carried forward for five years. For gifts of appreciated securities held by the donor in excess of one year, the deduction limit is 30%, rather than the default 20%.

It may be possible in some situations, particularly where there is U.S. land trust partner in the transaction, to have the funds donated to the U.S. charity, which enables an income tax deduction against U.S. income for the donor. There would be certain restrictions on how such a donation is handled if the funds might ultimately be transferred to a Canadian land trust. It is hoped that the *American Friends of Canadian Land Trusts* will be able to facilitate cross-border gifts of funding, as well as land and conservation easements (see discussion in 2.4 *Potential Donees*).

Donors can also be encouraged to donate endowment funding as a testamentary gift. Fortunately, U.S. tax law allows a deduction in calculating U.S. estate tax for donations to foreign charities that are made in a will. The value of the gift is in effect excluded from the donor's estate. When a gift is made by will, there are no percentage-of-income limitations on deductions as there are on income tax deductions for lifetime charitable gifts.

Note: Gifts of cash and securities donated to a U.S.-based charity (and potentially transferred to a Canadian land trust in future) would offer the U.S. donor tax deductions against their U.S. income, subject to typical deduction limits for U.S. charitable gifts.

Section 4: Process and Documents

4.1 Introduction

The following section outlines the procedures and documents required for a U.S. citizen to donate Canadian conservation real estate. It includes both Canadian tax law requirements for such a gift, including Canada Revenue Agency clearance and tax forms, and U.S. tax law requirements for appraisal, status of donee, and tax forms, as well as special requirements for gifts of conservation easements and remainder interest. It is assumed that all gifts will be structured to meet both sets of tax law, to provide the maximum tax benefit to the donor and to avoid potential tax problems as outlined in *Section 3: International Tax Issues* and *Section 3.7 Qualified Conservation Contributions (U.S.)*.

It is assumed that prior to completing these steps, the donee has completed preliminary work to ascertain that the property is of interest to the organization's Board of Directors (assuming all requirements are met, steps completed and documentation provided), and that the donor's intent matches the donee's interests. It is also assumed that where a Canadian land trust has sought partnership with a U.S. organization for a cross-border gift, that the partners have already confirmed roles and steps required in addition to those general steps outlined here.

The particular procedures and sequence required varies somewhat depending upon the donee and the conservation tool (donation of land, conservation easement, or conservation remainder) used to protect the property. Several steps may take place simultaneously, and there may be additional steps involved in such transactions beyond those described here, unique to the donee, such as board or committee approval at various stages, or fund-raising requirements prior to a property closing. We have erred on the side of caution and assumed donors will take all steps suggested by both Canadian and U.S. tax authorities to avoid *potential* income, gift and estate tax problems and to provide certain potential benefits.

Timing – Conservation transactions may take longer than anticipated by all parties. Cross-border gifts are particularly complex and lengthy. Many factors, from land trust resources and availability of qualified, knowledgeable advisors, to the timetables of the Canada Revenue Agency and Internal Revenue Service, and availability of family members for consultation, may all affect timing of a transaction. Be sure everyone involved understands that the transaction will take time.

Independent Professional Advice – This Guide does not, and cannot, anticipate or provide direction on all issues that can arise for individual donors and properties. Nor can the donors rely on the donee or this guidebook for tax or other advice. Seeking independent professional advice is an essential step in the process for the donor. Donors should ensure that such advisors clearly understand both the Canadian and U.S. income tax, and U.S. estate and gift tax issues and legal implications of the transaction. This guide and accompanying fact sheets may be helpful for advisors. Other professional services that may be required include a land planner, surveyor and qualified appraiser.

4.2 Overview of Procedures and Documentation

4.2.1 Appropriate Designations/Qualifications for Donee

U.S. Requirements for Conservation Easement and Remainder Interest Donees

U.S. tax law requires that for gifts of partial interest in land (such as conservation easements or remainder interests), meet certain requirements for *qualified conservation contributions*, to be eligible for U.S. income tax deductions and to avoid gift and estate tax issues (see discussion in *Section 3: International Tax Issues* . Such gifts must be comprised of a *qualified real property interest*, made to a *qualified organization*, and made exclusively for *qualified conservation purposes*.

A Canadian land trust planning to accept such a gift must take steps to be deemed a *qualified organization* (also called a *qualified donee*) in the U.S. The process entails applying for an employer identification number with the Internal Revenue Service, then applying for recognition as a *public-supported charity* (as opposed to the default classification as a private foundation. The application can be made on *Form 8784-Support Schedule for the Advance Ruling Period* (see *Section 5: Canadian Land Trusts and U.S. Publicly-Supported Charity Status*). Such an application may take several months or more to be processed by the Internal Revenue Service. The transfer of property interest to the Canadian donee should not take place until such designation is granted (most U.S. land trusts would already have such a designation).

(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 could be disallowed, and the easement may be ignored in assessing estate tax, creating a potential devastating estate tax problem for the donor’s heirs). Recognition as a publicly-supported charity also increases the deductibility of the gift (against either the donor’s U.S. or Canadian income).

Canadian Requirements for Land Ownership or Conservation Easement Holding

Canadian conservation easement or other legislation may restrict who is entitled to hold conservation easements in a specific jurisdiction. No U.S. organization, for example, is currently designated to hold conservation easements in Nova Scotia⁵⁶. A U.S. donee may need to take steps to apply for designation as an easement holder or to encourage changes to local legislation to enable them to hold conservation easements. This process may require additional steps such as registering with a local registry of joint stock companies.

In some jurisdictions, such as Prince Edward Island, there may also be restrictions on or special procedures for “foreign” ownership of land. A U.S. donee may need to take steps to ensure it is able to hold land in the respective area of Canada where it wishes to protect land.

4.2.2 Confirmation of Donor Intent

A letter of intent is written confirmation that the donor intends to proceed with a conservation gift. It should acknowledge that acceptance by the donee will be subject to completion of certain procedures and documentation (such as satisfactory title, review of ecological significance of property, environmental screening, Canada Revenue Agency clearance for non-resident disposition of land). This is usually required to give all parties a level of common understanding on their intention to proceed with the gift. Once the letter of intent is signed and delivered and the parties are satisfied that the land will qualify for acceptance by the organization, then the remainder of the process can proceed.

Where the gift is to a U.S. charity, it may also acknowledge that the donee may elect not to hold title to the property or conservation easement forever, if it is more appropriate to transfer ownership to a Canadian conservation organization with similar objects.

4.2.3 Site Assessment/Baseline Study

Typically in Canada, the donee gathers and documents information on the site, the proposed real estate transaction and the natural features or conservation values. According to U.S. tax law, the donor is responsible for providing the baseline information to the donee. Such information is needed to confirm whether or not the donee will accept the proposed donation, to identify the conservation priority of the property, to ensure that it meets U.S. and Canadian tax program criteria, and to identify any potential environmental, liability or management issues. Where the gift is to a U.S. charity, a local Canadian conservation organization may likely assist in gathering and documenting such information.

Such an assessment often takes place in two phases: an initial assessment to verify significance of property and identify any major management or other issues, and a more detailed assessment, in the form of a baseline study, after it is confirmed that the gift is to proceed. A baseline study is required to provide a baseline against which to compare future changes on the property. It provides a solid base for legally enforcing compliance with the restrictions, and ensuring that natural values are protected and that the purpose of the conservation easement are met. It is also used to create a management/stewardship plan for the property, and is required to meet U.S. tax law (see specific requirements for baseline in *Section 3.7.3 Exclusively for Conservation Purposes*). U.S. tax law also requires the donor and donee to sign a statement indicating that the baseline is an accurate reflection of the property conditions at the time of the gift. The baseline assessment also helps document ecological sensitivity for Ecological Gifts qualification (if the gift is to be made through the Canadian Ecological Gifts Program—see below) and may help to support fundraising and to meet land trust standards and practices.

Most land trusts have a standard environmental assessment form that must be completed (which may be included as part of a baseline study). The purpose of such screening is to identify and describe any environmental hazards or contaminants on the site. This is required to minimize risks such as acquiring contaminated real estate and associated clean-up costs. It is an essential part of due diligence in the property acquisition.

4.2.4 Title Search

A lawyer conducts an initial title search and requests a municipal tax certificate confirming that municipal taxes are paid to date. A title search early in the process is required to identify ownership issues, boundary issues or lot severances that may require surveys or planning applications prior to closing. Other research on matters such as planning issues, unregistered utility easements, and access issues may also be required. The lawyer will provide a final title opinion on closing or arrange for a Title Insurance Policy on the recipient organization's behalf. This is to ensure good, clear and marketable title to the property, to the satisfaction of the organization, with no liens or encumbrances affecting the property. Additional steps may be required related to title and property registration, but such issues are beyond the scope of this guide.

Mortgage Subordination

U.S. tax law (Internal Revenue Code Section 170(h)) requires that any mortgage be subordinated to the conservation easement terms. The same is true under the Canadian Ecological Gifts program. There is a need to determine if the property is encumbered early in the process, as Canadian financial institutions may not accept this condition for subordination. This may affect timing, since the mortgage may need to be paid down before the gift can be completed.

4.2.5 Survey

The boundaries of the property and/or the conservation easement (and "zones" of use within the easement) need to be clarified and clearly defined. A property survey may be required. There are currently no specific Canadian or U.S. requirements for a survey under conservation tax law, however other factors may make a survey necessary such as relevant provincial or territorial legislation, land registration or recording requirements, the need for certainty of boundaries or encroachments, and trust standards and practises, or the policies of the land trust(s) involved in protecting the property.

4.2.6 Deed Drafting/Negotiation

A lawyer prepares the transfer documentation. For conservation easements, remainder interests and other complex agreements, there may be a lengthy process of negotiation, discussions with family members, and redrafting to create a document that both meets the donor's and recipient organization's intent and satisfaction, and provides a strong legal basis for protection of the property long after the transaction has been completed.

The documents may be executed by the donor and held by the donor's lawyer, pending satisfactory completion of some of the other steps (particularly the Certificate of Compliance described below). Alternatively, the donor may wait until documentation is all in place to sign the deed or conservation easement document.

Special Requirements for Conservation Easements

The conservation easement must be worded and structured to meet both local conservation easement and/or tax legislation requirements, and the requirements of Internal Revenue Code Section 170(h) for *qualified conservation contributions*.

Most jurisdictions in Canada have conservation easement or equivalent legislation, with specific requirements (Newfoundland and Nunavut do not have specific legislation at this time). These requirements must be combined in the document with U.S. tax law requirements.

U.S. tax law sets specific criteria for the wording of the instrument of conveyance if the gift is to be deductible and if certain tax issues are to be avoided. Such specific requirements relate to the following: the donee, easement term, conservation purpose, inconsistent uses, transferability of the easement, donor notice regarding exercise of reserved rights, enforceability, the donee's right to enter the property for compliance monitoring, requirements for restoration, subordination of mortgages, documentation on condition of property, extinguishments, and proceeds of disposition. All these requirements must be included in the conservation easement document (preferable) or in other, separate documents, as long as they are valid in the context of U.S. tax law requirements.

For further information on the specific requirements for conservation easements see *Section 3.7 Qualified Conservation Contributions (U.S.)*, the sample cross-border conservation easement template prepared to accompany this guide⁴³, Section 170(h) of the Internal Revenue Code, Treasury Regulations 170A(14), and Stephen Small's *The Federal Tax Law of Conservation Easements* which provides background on rulings related to conservation easement deductions.

For conservation easements to qualify as a *qualified conservation contribution*, the donor is also required to demonstrate that the likelihood of surface mining on the property is so remote as to be negligible. Where the donor does not own or control mineral interests, the donor should obtain a letter from a geologist or other expert indicating that this is the case (usually based on either geological reasons or economic feasibility).

Where the conservation easement is to be signed in the U.S., it is important to note certain changes that may need to be made to a standard Canadian conservation easement template in addition to the U.S. tax law requirements for *qualified conservation contributions*. The conservation easement may be signed by a notary public (not a lawyer as in Canada), and such a signatory is required to include the date his/her commission expires. There may also be differences related to specific sections of the conservation easement and appendices such as the matrimonial affidavits.

Remainder Interest

For U.S. tax law purposes, a gift of remainder interest must also meet the requirements of a *qualified conservation contribution* (or be a remainder interest in a residence or agricultural land in accordance with Internal Revenue Code Section 170(f)((3)(B))). Because of technical and practical difficulties in meeting such requirements for remainder interests, it may be beneficial to

combine a gift of remainder interest with a conservation easement (which may be donated to a different charity). The landowner living out life on the property would be subject to restrictions on use (dictated by the easement) to ensure that the conservation values would be protected.

Testamentary Gifts

Language needs to be included in documentation for a testamentary gift of a conservation easement to allow an executor to take the necessary steps to complete the transaction, especially since a conservation easement would reduce the value of the estate and could be contested by heirs.

4.2.7 Appraisal

U.S. and Canadian tax regulations (and most land trust policies) require that a fair market value appraisal (a “qualified appraisal”) by a qualified appraiser be completed to substantiate the value of all gifts over \$5,000 and \$1,000 respectively. To ensure the appraisal is acceptable to all parties, it would be prudent to meet all Internal Revenue Service requirements as well as Canadian tax law requirements (under the Ecological Gifts Program) for all cross-border gifts⁵⁷ (see discussion under *Section 3.8 Appraisal Requirements (U.S. and Canadian)*).

To be accepted under U.S. tax law as a *qualified conservation contribution*, the appraisal must include specific information. While there are few specific requirements for appraisals in Canada, it is advisable to follow the guidelines provided for Ecological Gifts. Because of the complexity of cross-border conservation gifts and the potential tax implications on both sides of the border, it may be prudent to use an appraiser designated as an Accredited Appraiser Canadian Institute (AACI) for any cross-border conservation easements, and an appraiser who has taken specific training through the Canadian Ecological Gifts program.

It is important to note that certain appraisal fee arrangements are prohibited by U.S. tax law. For example, the appraisal fee generally cannot be based on a percentage of the appraised value or what is allowed as a deduction. Further, in most circumstances, the appraisal must be commissioned by the *donor*, not the donee.

A fully completed appraisal summary including information on the donee, appraiser and property, must be included on Internal Revenue Service Form 8283 (Section B) and must be attached to the donor’s U.S. tax return. The appraiser and donee organization must sign the form (indicating that the donee has received the gift). For gifts worth more than \$500,000 the entire appraisal must be attached to form 8283. The donor must maintain records of the appraisal.

For Canadian tax law purposes, a copy of the appraisal must be submitted with the application for Ecological Gift Certification and/or for obtaining a Certificate of Compliance for non-resident disposition of land (see below).

Note: Overvaluation penalties may apply if the amount claimed is more than the correct value.

Appraisal Timing

Care needs to be taken to ensure the appraisal is obtained within the appropriate time limits to satisfy Internal Revenue Service and Canada Revenue Agency requirements. The Internal Revenue Service requires that the appraisal is completed no earlier than 60 days before effective date of donation and no later than the due date of the donor's U.S. tax return (including extensions) for the year of the gift. The Canada Revenue Agency advises that the appraisal should be completed no more than six months before the effective date of the donation, although in certain cases where real estate values are particularly dynamic, the acceptable period may be shorter. For Ecological Gifts there are additional timing issues for the appraisal (*see Section 3.8 Appraisal Requirements (U.S. and Canadian)*)

It is critical to carefully plan the sequence of procedures to ensure that timing requirements for the appraisal are met. With the time delays likely in completing all the steps necessary for cross-border gifts, it is likely that an appraisal update will be required. A letter from the appraiser verifying either that the property value has not changed may suffice, or an appraisal update, or reappraisal may be required.

4.2.8 Ecological Gifts Program Certification

In certain circumstances, particularly where a U.S. donor has significant Canadian-source income and the gift meets certain ecological criteria, it may be advantageous to use the Ecological Gifts Program to reduce the capital gains tax liability for the donor for gifts to a Canadian land trust (see discussion of the Ecological Gifts Program). This option is only available if the donee is a Canadian charity or government.

Certificate for Donation of Ecologically Sensitive Land. The Minister of the Environment (or designate) must certify that the land is ecologically sensitive, by completing this certificate.

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***.

The donor submits this with the Certificate for Donation of Ecologically Sensitive Land and the charitable donation receipt issued by the Canadian donee with the Canadian tax return for the year in which the gift is made.

4.2.9 Certificate of Compliance

Where the donor is a U.S. resident disposing of Canadian real estate (whether through sale or gift), the Income Tax Act Section 116 (1), includes provisions for the Canada Revenue Agency to secure payment of tax on capital gains. The donor must notify the Canada Revenue Agency of

a planned or completed property disposition (before they dispose of the property or within ten days after the disposition) and provide payment of a portion of the capital gains tax, or security for the payment of tax. The Canada Revenue Agency then issues a Certificate of Compliance to dispose of land in Canada. Without the Certificate, the donee, by accepting real estate from a non-resident, may be liable for the payment of Canadian capital gains taxes arising from the disposition of the real estate⁵⁸.

Application – CRA Form T2062

To obtain a Certificate of Compliance, the donor must submit a completed Form T2062⁵⁹ with the required supporting documents (listed on the form) to the Canada Revenue Agency office in the area where the property is located.

Payment of Capital Gains Tax or Provision of Security

Before issuing a Certificate of Compliance, the Canada Revenue Agency must receive either payment of portion of the capital gains tax, or “security acceptable to the Minister.”

For gifts to a U.S. charity which is not recognized as a *prescribed donee* in Canada, the donor has no option to reduce their capital gains tax liability and therefore must pay the required portion of the capital gains tax up front. Final settlement of the tax liability is made when the donor submits their Canadian tax return.

If the donee is a Canadian charity or a U.S.-based *prescribed donee*, the donor may elect to reduce the disposition value and therefore reduce or eliminate the capital gains tax on the gift, under Section 118. Alternatively, if the gift is to a Canadian conservation charity and it is accepted under the Canadian Ecological Gifts program, the donor may be able to eliminate their capital gains tax through this program (see discussion about Section 118 and Ecological Gifts under 3.2 *Income Tax Issues*).

In either case, the donor must provide security acceptable to the Minister indicating why the capital gains tax is not payable. The donor should provide the Canada Revenue Agency with a letter setting out their intention to proceed with the gift and to make the election/designation under paragraph 118.1 (6) (a) or (b). The letter must provide proof that the organization is registered as a charity for income tax purposes and that the charity will issue a tax receipt corresponding to the disposition value reported to the Canada Revenue Agency.

Proceeds of Disposition

Form 2062 (E) asks for a description of the property including a statement of the “Estimated or Actual Amount of Proceeds of Disposition”. A standard, acceptable approach to completion of this part of the Form does not appear to have been achieved across Canada, and in all tax services offices. However, it is suggested that where the donor is electing to reduce their capital gain under Section 118 of the Income Tax Act (see discussion in 3.2 *Income Tax Issues*), the stated amount of capital gain may be shown as zero (or whatever the gain will be, based on the

elected “disposition value”), with a footnote to explain that the transfer is a gift and that the donor will be making the election under the Income Tax Act Section 118.1 (6) (b).

On the basis of discussions with the Canada Revenue Agency, it is also understood that the Certificate of Compliance issued by the Canada Revenue Agency will indicate that the “proceeds of disposition” and the “certificate limit” are equal to the fair market value of the property. The Certificate may also note that despite this certificate limit, it is understood that the donor will file a tax return to designate the proceeds of disposition as equal to the adjusted cost base (or some value between adjusted cost base and fair market value) under paragraph 118.1 (6) (a) or (b).

Where the donor is not able to elect to dispose of the property at a value other than fair market value (i.e. where the donee is not a Canadian charity or *prescribed donee*), the stated amount of the capital gain should reflect the actual capital gain as indicated by the adjusted cost base and current fair market value of the gift.

Timing

It is advisable that completion of Form T2062 precedes the actual transfer of the gift, otherwise the donee may be liable for capital gains tax liability on the gift. It therefore occurs before the donor will have a charitable gift receipt or file an income tax return.

If the donor wishes to submit a Notice of Proposed Disposition under ITA Section 116, the donor should send the notice at least 30 days before the property is donated. The Canada Revenue Agency will issue a Certificate T2064-Proposed Disposition of Property by a Non-Resident of Canada. The donor should then notify the Canada Revenue Agency by letter when the donation is complete and a Certificate T2068-Certificate-Disposition of Property by a Non-Resident of Canada will be issued.

Certificate T2068

If the application is accepted, the Canada Revenue Agency will issue a Certificate T2068 to the donor confirming clearance of the disposition. The Certificate should be issued before the transfer of title is accepted or registered. The disposition must also be indicated on a Canadian income tax return.

Substantiation of Value

Although there is not a clear Canada Revenue Agency policy on substantiation requirements for Form 2062(E), an appraisal or other documentation is likely required to verify the amount claimed, not only as fair market value, but also as the adjusted cost basis on this form. In the experience of some land trusts to date, even where the donee is using the adjusted cost basis as disposition value (i.e. so no capital gain is deemed and therefore no capital gains tax is owing), the Canada Revenue Agency has required proof of adjusted cost base and fair market value, simply for the purpose of completing Form 2062. In some cases the donor may be able to make a strong enough case to support these values using various sources such as records of the recent

purchase of the subject property, similar sales, or historic tax records. Where documentation is not available or acceptable, an appraisal may be required to establish adjusted cost base.

U.S.-based Charity Undertaking (if gift is to a *prescribed donee*)

If the donee is a U.S.-based charity recognized in Canada as a *prescribed donee* under the Income Tax Act, an undertaking must be submitted to the Canada Revenue Agency to the effect that the property “will be used for conservation purposes” and “held for use in the public interest”. This undertaking does not imply public access to the property or general public involvement in the management of the site but is intended to imply that the property will not be used for private gain. It is unclear exactly what the Canada Revenue Agency’s related requirements will be.

It is understood that this undertaking should not prevent the U.S.-based charity from later donating the property to a Canadian land trust if satisfied that such a donee could properly assume the long-term property stewardship responsibilities. It is also understood that the U.S.-based charity should exercise a degree of control over such a transaction (i.e. a transfer first to a U.S. charity, then to a Canadian land trust) and not be a mere conduit or agent for the Canadian land trust organization.

Starting in 2002, the Canada Revenue Agency may require an executed undertaking before the Certificate of Compliance is issued. At the same time, the charity will not want to accept the transfer of title until the Certificate is issued. Accordingly, the undertaking could include a proviso that it will only become effective after the Certificate is issued and the charity takes title to the property.

4.2.10 Completing the Transfer

Once the preceding steps have been completed to the satisfaction of the parties and a copy of the Clearance Certificate received by the donee, the lawyer may be instructed to complete any other sub-searches and investigations regarding the status of the title, to issue a title certificate or title insurance, and to ensure that taxes are paid. The lawyer may then complete the transfer (e.g. deed for title or conservation easement) and have it registered at the appropriate Registry of Deeds.

Note: This guide does not cover information on land conveyance, which will require the assistance of qualified legal counsel and will vary among provincial jurisdictions.

4.2.11 Tax Forms and Returns

Internal Revenue Service Form 8283 and Donor Acknowledgment Letter

Once the deed or conservation easement document is registered and the gift is complete, the donor must complete the Internal Revenue Service *Form 8283*⁶⁰ “*Noncash Charitable Contributions*” signed by the appraiser and the donee (Part B, Section III and IV respectively). The form and other supporting documentation (see below) must be attached to the donor’s U.S.

tax return for the year in which the gift is made. (*Note: The donor's appraiser and other professional advisors should be aware of recently amended rules for Form 8283.*)

Key components of Form 8283 include the following (See *Appendix 3: Sample Attachment to Form 8283* for sample language).

Section B (for Donated Property over \$5,000). Part I *Information on Donated Property*

1. 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);
2. Description of the property;
3. Brief summary of the physical condition of the property;
4. Appraised fair market value of the property interest on the date of contribution;
5. Manner of donor's acquisition of the property (purchase, gift, etc.) and the date of donor's acquisition;
6. Donor's cost or adjusted basis (adjusted cost base) in the property;
7. For bargain sales, the amount of consideration received by the donor;
8. Amount claimed as a deduction; and
9. Date the donee received the property or interest in property.

Part III *Declaration of Appraiser*

1. Name, address and tax identification number of the appraiser;
2. Declarations by the appraiser pertaining to interests in the transaction and the fee arrangement (with signature, business address and identifying number):
 - a. The appraiser is not the donor, donee, a party to the transaction, employed by or related to the donor or donee. If regularly used by any of the foregoing parties, he or she performed most appraisals for other persons during the tax year;
 - b. The appraiser holds him or herself out to the public as an appraiser or performs appraisals on a regular basis;
 - c. Because of his or her qualifications (as described in the appraisal), the appraiser is qualified to make appraisals of the type of property being valued;
 - d. The appraisal fees were not based on a percentage of the appraised property value or amount of donor's deduction;
 - e. He or she understands that a false or fraudulent overstatement of the property value may subject him or her to the penalty under Internal Revenue Code Section 6701(a) (aiding and abetting the understatement of tax liability); and
 - f. The appraiser is not barred from presenting evidence or testimony by the Office of Professional Responsibility.

Part IV *Donee Acknowledgement*

1. Name, address and tax identification number of the donee;
2. Signature of donee, acknowledging receipt of the gifted property and making certain declarations (acknowledgement does not mean the donee agrees with the claimed fair market value):
 - a. It is a *qualified organization* under Internal Revenue Code and that it received the donated property (including date of donation);
 - b. If it sells, exchanges or otherwise disposes of the property within 2 years, it will file Form 8282 and give donor a copy;
 - c. It does not intend to use the property for unrelated use

Note: The form specifically notes that such acknowledgement by the donee does not imply that the donee agrees with the value of the appraisal.

Donor Attachment to Form 8283: The donor must attach a statement that:

- a. Identifies the conservation purposes further by the donation (as outlined in Section 170(h) of the Internal Revenue Code and Treasury Regulations 170A(14));
- b. Shows, if before and after valuation is used, the fair market value of the underlying property before and after the gift;
- c. States whether the donor made the donation in order to get a permit or other approval from a local or other governing authority and whether the donation was required by a contract; and
- d. If the donor (or related person) has any interest in other property nearby, and if so, a description of that interest.

For conservation easements to meet U.S. tax law requirements (see discussion in *Section 3.7 Qualified Conservation Contributions (U.S.)*), the donor must also attach a statement clearly defining the gift, and clarifying that the gift meets Section 170(h) requirements of the Internal Revenue Code for *qualified conservation contributions* including the conservation purpose furthered by the gift. It should include the method used for the appraisal and the fair market value of the gift (before and after the easement).

For gifts over \$500,000, a copy of the appraisal must be attached. Under U.S. tax law, the donor must maintain records of the appraisal.

Charitable Gift Receipt

Subsequent to registering the deed or conservation easement, the Canadian donee issues a Canadian charitable gift receipt as required by the Canada Revenue Agency, to confirm the gift. The value listed on the receipt depends upon the disposition value elected by the donor (i.e. the donee does not issue the receipt for the land or conservation easement's fair market value if the donor deems its disposition value at adjusted cost base or a value between adjusted cost base and fair market value).

U.S. donees issue a letter acknowledging receipt of the gift (as opposed to a “tax receipt”). For cross-border gifts, it may be prudent for such a letter to include 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*

In addition, U.S. tax law requires that the letter acknowledging receipt of the gift include the donee’s status as a tax exempt charity, the tax identification number, whether the donee provided any goods or services in consideration, in whole or in part, for the gift, and a description and good faith estimate of such value of such goods or services provided by the donee (if any) (Internal Revenue Code section 170(f)(8)). It would be prudent for a Canadian donee to provide the same type of letter, in addition to a standard Canadian tax receipt, to ensure U.S. tax law requirements are met.

File Canadian and U.S. Income Tax Returns

The U.S. donor must complete a Canadian income tax return for the year in which the gift is made. That tax return may need to be completed for the sole purpose of designating the proceeds of disposition as equal to the adjusted cost base for the property pursuant to Section 118 of the Income Tax Act or claiming their capital gains tax elimination through the Ecological Gifts Program, if applicable. The donor should attach their Canadian tax receipt (or letter from U.S. donee). If capital gains taxes are owing, the donor then pays final payment of capital gains tax or makes the 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. 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.

If the U.S. donor must also file a U.S. tax return for the year in which the gift is made, he or she needs to report the gift to a Canadian charity if there is Canadian-source income against which to claim a charitable tax deduction. A donor claiming a Canadian charitable contribution deduction against Canadian-source income on their U.S. return, pursuant to the Treaty, may need to disclose this position on their U.S. income tax return for the year of the gift⁶¹.

Internal Revenue Service Requirements upon Disposal of a Conservation Gift

If the donee sells, exchanges or otherwise disposes of a property for which the donor was required to sign a **Form 8283: Non-Cash Charitable Contributions** within two years after receiving the gift, Section 6050L of the Internal Revenue Code requires the charity to file Internal Revenue Service **Form 8282: Donee Information Return**. On the form it must report

the proceeds of the disposition, the date the property was received and the date it was sold, and the new owner. The donee must also send a copy to the donor.

Gifts of partial interest in land (i.e. conservation easements and remainder interests) should not be transferred unless the new donee is qualified to accept conservation gifts under Section 170(h) of the Internal Revenue Service Code (i.e. a *qualified donee*) See discussion in *Section 3.7 Qualified Conservation Contributions (U.S.)*.

Section 5: Canadian Land Trusts and U.S. Publicly-Supported Charity Status

5.1 Introduction

There is an important step that Canadian land trusts involved in cross-border conservation gifts should take in order to maximize tax benefits for donors and to eliminate potential tax problems for donors.

5.2 U.S. Income Tax Benefits

When a U.S. resident donates a gift to a Canadian charity, whether cash or real estate, they may *not* claim a U.S. tax deduction against U.S. income. The recipient organization must be a U.S. charity, based in the U.S., to result in a U.S. income tax deduction against U.S. income.

However, the Income Tax Treaty between Canada and the U.S. provides for deduction of cross-border charitable contributions and reciprocal recognition of charitable status for Canadian and U.S. charities⁶². This allows U.S. residents to secure income tax deductions against their Canadian-source income reported to the Internal Revenue Service on their annual tax return. There are special rules relating to such gifts.

In the U.S., there are various types of charitable organizations (501(c)(3) organizations) based on a number of criteria, predominantly sources of funding and geographic location. Notice 99-47 states that all Canadian charities automatically receive recognition of exemption under Section 501(c)(3) of the U.S. Tax Code. There is no need for these Canadian organizations to apply for charitable tax status in the U.S. (using Form 1023) with respect to deductions on Canadian-source income (*note—this does not mean Canadian charities can issue U.S. receipts usable against U.S. income. Only “domestic charities” actually based in the United States can do so*).

5.3 Making Donations More Attractive to U.S. Donors

However, despite the Treaty recognition as equivalent to a 501(c)(3) organization, Canadian charities are assumed to be “private foundations⁶³” under U.S. tax-exempt law, unless further steps are taken by the organization to secure a different type of tax-exempt status, i.e. classification as a *publicly-supported charity*. The default classification as a private foundation limits benefits to donors and may cause problems for cross-border gifts.

Classification as a private foundation creates certain deduction limitations for the donors. U.S. residents may claim charitable deductions for gifts to such organizations but they are subject to a 30% of adjusted gross income limit (30% of the donor’s Canadian-source income or 20% for gifts of capital property)⁶⁴. Donors can carry forward excess contributions and deduct them in the five subsequent taxation years, subject to the same limitation. As a private foundation, the organization is not listed in the Internal Revenue Service Publication 78, *Cumulative List of Exempt Organizations*, and is not able to accept gifts of partial interest in land (i.e. conservation easements and remainder interests).

To provide greater benefit to their U.S. donors, a Canadian charity could apply to the Internal Revenue Service for determination that it is a **publicly-supported charity** and not a private non-operating foundation. With such status, the ceiling for deductions is raised from 30% to 50% of adjusted gross income for gifts of cash and from 20% to 30% of adjusted gross income for capital property (or 50% for capital property for which the claimed deduction is limited to the donor's adjusted basis⁶⁵) or, under a special, temporary, tax benefit program, a conservation easement meeting the requirements of a *qualified conservation contribution*.

With such status, the charity will also be listed in Publication 78, Cumulative List of Exempt Organizations (as a foreign organization), which may help donors to feel more confident about making gifts. The charity is then able to accept gifts of partial interest in land (see discussion below).

The donor should submit the charitable gift receipt from the Canadian charity with their tax return, and must also provide evidence of the organization's charitable status, usually a copy of the charity's Notification of Registration letter from Canada Revenue Agency as well as their determination letter from the Internal Revenue Service.

Note: Classification as a *publicly-supported charity* and application for an employer number may also be beneficial in helping Canadian land trusts to secure funding support from certain U.S. conservation foundations.

5.4 Enabling Cross-Border Gifts of Conservation Easements and Conservation Remainders

For outright gifts of **land** from U.S. donors, as long as the donee is a registered charity in Canada, the donor is eligible for income tax benefits on Canadian-source income, the gift should be exempt from U.S. gift tax, and the land will be out of the donor's estate, so estate taxes are lowered as would be expected.

For testamentary gifts of land, the gift provides the same U.S. estate tax deductions, regardless of whether the donee is Canadian or American.

U.S. law, however, does **not** allow a deduction for a gift of partial interest in property, such as a conservation easement or remainder interest, unless the gift qualifies as a *qualified conservation contribution* (see discussion of special requirements for such gifts in *Section 3.7 Qualified Conservation Contributions (U.S.)*). To meet the criteria for *qualified conservation contributions* in the U.S., the Canadian charity receiving the gift must be a registered charity in Canada, eligible for recognition by the U.S. under the Income Tax Treaty, and it must meet the "public support test" described above (i.e. status as a publicly-supported charity).

If a Canadian charity is not eligible to accept *qualified conservation contributions*, U.S. donors of conservation easements and conservation remainder interests may not only lose income tax benefits, they may face serious estate tax liability³². The reduction in land value attributable to a gifted conservation easement may not be considered in determining the value of the donor's estate. Estate tax can be imposed on the entire unrestricted value of the decedent's property as if there are no restrictions on use and enjoyment of the property. Such a high value for estate tax

purposes could mean that heirs would have to sell a cherished conservation property to pay the estate taxes. And, since the restrictions would still be legal under Canadian real estate laws even though not recognized under the U.S. estate tax laws, the resale value would be far lower than the estate tax value. ***Canadian land trusts must be aware of this very serious potential problem for their donors.***

5.5 Securing and Maintaining U.S. “Publicly-Supported Charity” Status

To receive status as a *publicly-supported charity* and therefore to be recognized as a *qualified donee* for *qualified conservation contributions*, the charity must provide certain details of its funding sources, program availability, and governing officials to the Internal Revenue Service. It must be able to demonstrate that it has a broad base of public financial support as opposed to a private foundation, which is generally funded by a small group of individuals, a family or even one person. A public charity normally receives more than 1/3 of its support each year from a combination of gifts, grants, contributions or membership fees from individuals who are not substantial contributors to the organizations.

The application process involves two steps: obtaining an employer identification number by completing Internal Revenue Service Forms SS-4,⁶⁶ and completing the support schedule for the advance ruling period on Form 8734,⁶⁷ which provides a record of funding sources. If the organization meets the required criteria, it will receive an Internal Revenue Service “determination letter” that clearly states the charity’s tax-exempt status and foundation classification.

There is an annual requirement to maintain charitable status or operating foundation classification if the charity’s U.S. gifts surpass \$25,000 per year. The charity must file Form 990⁶⁸ with Internal Revenue Service. The charity is also obliged to provide the Internal Revenue Service with a statement, in a timely manner, indicating any other material change in the organization’s operations that may affect charitable status.

Note: It is ***not*** necessary for a Canadian land trust to apply for actual 501(c)(3) charity status in the U.S. As discussed above, such status is already granted automatically to registered Canadian charities under the Tax Treaty. Only the organization’s foundation classification is a concern for cross-border conservation gifts, and hence the Canadian land trust may only need to file Form 8734. Full U.S. charitable status (and the ability to provide full tax deductibility against the donor’s U.S. income) can only be obtained if a charity is actually based in the U.S.

Appendices

Appendix 1: Glossary of Terms and Acronyms

CRA-Canada Revenue Agency

IRS-Internal Revenue Service

Adjusted Cost Base (Canada) - has the meaning assigned by section 54 of the Income Tax Act; the cost of the capital property plus any expenses to acquire it, including commissions and legal fees

American Friends of Canadian Land Trusts - This refers to a new U.S. organization which is being set up to facilitate cross-border conservation gifts of Canadian real estate owned by U.S. residents. The organization plans to open a program to support Canadian land trusts and U.S. landowners wishing to work together to protect important conservation lands in Canada.

Bargain Sale (U.S) – See Split Receipt

Capital Gain (Canada) - has the meaning assigned by section 39 of the Canadian Income Tax Act; that amount when the fair market value of the property exceeds its adjusted cost base as a result of the disposition of the property

Capital Gains Tax (Canada) - Capital gains are deemed for all dispositions of capital assets (including land, conservation easements and remainder interests) even where a property disposition is a gift to charity and no proceeds are actually received by the donor. Generally, and subject to various tax planning options, a portion of capital gains is included into income and thus subject to tax.

Capital Property (Canada) - includes depreciable property, and any property which, if sold, would result in a capital gain or a capital loss.

Canada Revenue Agency (Canada) - federal agency which administers tax laws for the Government of Canada and for most provinces and territories

Conservation Easement - This guide uses the term conservation easement as a general term for all similar conservation tools such as covenants and servitudes which are legal agreements registered on the land title or deed and which protect conservation interests on private or public land. A conservation easement is binding against all future owners of a property and is enforced by the holder of the conservation easement (a conservation charity or government body qualified to hold conservation easements within the particular province or territory where the easement is located).

Conservation Purpose (U.S.) - has the meaning assigned by Section 170 (h) (4) of the Internal Revenue Code; defined as: the preservation of land areas for outdoor recreation, by or the education of, the general public; the protection of a 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, OR pursuant to a clearly delineated Federal, State, or local governmental conservation policy, AND will yield a significant public benefit; OR the preservation of an historically important land area or a certified historic structure.

Disposition (of property) (Canada) - an event or transaction where a person gives up possession, control, and all other aspects of ownership of all or a portion of a property interest (including a donation of title or donation of a conservation easement, covenant or servitude).

Easement - see conservation easement

Ecological Gifts Program (Canada) - is a federal program which, under the Income Tax Act, provides favourable tax treatment for the disposition of ecologically sensitive land to qualified recipients prescribed, including elimination of capital gains realized on the disposition of ecologically sensitive land and the provision of a tax credit or a deduction to donors of up to 100% of their net income.

Donee - The donee is the recipient charity of a gift (i.e. the organization that receives the charitable donation).

Ecological Gift or EcoGift (Canada) - is a donation of land or an interest in land (such as a conservation easement, covenant or servitude) to a qualified recipient that has been certified as “ecologically sensitive” and the value of which has also been certified by the federal Minister of the Environment or the Ministers’ designate in accordance with the provisions of the federal Income Tax Act and that otherwise meets the requirements of the Act that give rise to special tax benefits under the Ecological Gifts program.

Ecologically Sensitive Land (Canada) –a term used by the Ecological Gifts program for areas or sites that are currently, or could in the future, significantly contribute to the conservation of Canada’s biodiversity and environmental heritage as determined against the national or relevant provincial eco-sensitivity criteria and as certified by the federal Minister of the Environment.

Election Under Section 118.1 (6) (b) (Canada) - Where a non-resident makes a gift of real property situated in Canada to a Canadian charity, certain other organizations or a *prescribed donee*, and the fair market value of the property exceeds its adjusted cost base, the donor may choose (elect) an amount, not greater than the fair market value and not less than the adjusted cost base, to be the fair market value of the gift made by the individual. Under section 118.1 of the Income Tax Act, an individual may elect to use this value as the disposition value of the property, thereby reducing the disposition value to which capital gains tax may apply. Such an election must be made on a Canadian Income Tax return and be supported by an appraisal or other documentation acceptable to the Canada Revenue Agency.

Eligible Donee (U.S.) - has the meaning assigned by § 1.170A-14 (c) (1) of the Treasury Regulations to Internal Revenue Code section 170 (h); an eligible donee must be a qualified organization in addition to having a commitment to protect the conservation purposes of the donation and have the resources to enforce the restrictions.

Fair Market Value (Canada) - is the most probable price that a property should bring in a competitive and open market as of the specified date under all conditions requisite to a fair sale, with the buyer and seller each acting prudently and knowledgeably and independently of each other

Income Tax Act (Canada) - federal Canadian legislation governing income tax payable on income for each taxation year including the disposition of taxable Canadian property; note that there are also provincial income tax statutes

Internal Revenue Code (U.S.) - Federal Statute governing the Internal Revenue Service and American internal revenue laws

Internal Revenue Service (U.S.) - federal bureau of the United States Department of Treasury which administers and supervises the execution and application of the Internal Revenue Code

Inventory Land (Canada) - land held as inventory of a business and which is typically bought and sold (such as by a developer), and not as a capital property from which income is earned.

Mortgage Subordination – Where a mortgage already exists on a property and then a donor enters into a conservation easement, if the bank foreclosed on the property they could basically eliminate the conservation easement’s effect. It is recommended (and required for gifts to be deductible as *qualified conservation contributions* under U.S. tax law), that the mortgage holder issues written confirmation that the mortgage is subordinated to the conservation easement. The effect is that the conservation easement would then remain in effect, and its requirements would be enforceable, even if the bank has to foreclose on the mortgage and take over possession of the property.

Remainder Interest (IRS) - also known as a gift of land with a reserved life estate; this is an interest in an estate that has been conveyed to a land trust where the donors and their beneficiaries reserve the right to continue to live on and use the property during the specified lifetimes but at the end of the specified life interests, full title and control of the property automatically transfers to the land trust

Prescribed Donee (Canada) - those organizations, as listed under section 3504 of the Income Tax Act Regulations (the only prescribed donee to date is The Nature Conservancy of the United States). Corporations or individuals not resident in Canada may make a gift of capital property to a prescribed donee and the donor can elect to eliminate their capital gains tax owing of gifts of land or conservation easements to such organizations.

Proceeds of Disposition (CRA) - that amount received (or to be received, or deemed to be so) for property which, in most cases, refers to the fair market value of the property at the time of disposition, but could also include compensation received for property that has been destroyed, expropriated, or stolen.

Qualified Conservation Contribution (U.S.) - has the meaning assigned by section 170(h)(1) of the Internal Revenue Code, further qualified by § 1.170A-14 (a) of the Treasury Regulations

to Internal Revenue Code section 170 (h); defined as a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes

Qualified Donee (IRS) - has the meaning assigned by section 170(h)(3) of the Internal Revenue Code, further qualified by § 1.170A-14(c)(1) of the Treasury Regulations to Internal Revenue Code section 170 (h). The definition includes: a governmental unit described in section 170(b)(1)(A)(v) of the Internal Revenue Code; an organization described in section 170(b)(1)(A)(vi) of the Internal Revenue Code; a charitable organization described in section 501(c)(3) of the Internal Revenue Code that meets the public support test of section 509(a)(2); OR a charitable organization described in section 501(c)(3) of the Internal Revenue Code that meets the requirements of section 509(a)(3) and is controlled by an organization described in paragraphs (c)(1) (i), (ii), or (iii) of § 1.170A-14 of the Treasury regulations to Internal Revenue Code section 170 (h).

Qualified Mineral Interest (IRS) - has the meaning assigned by section 170 (h) (6) of the Internal Revenue Code; defined as subsurface oil, gas, or other minerals and the right to access to such minerals

Qualified Organization (IRS) - See “Qualified Donee”

Qualified Real Property Interest (U.S.) - has the meaning assigned by section 170 (h) (2) of the Internal Revenue Code; defined as the following interests in real property: the entire interest of the donor other than a qualified mineral interest, a remainder interest, and a restriction (granted in perpetuity) on the use which may be made of the real property.

Remainder interest - Also known as a gift of land with a reserved life estate, this is an interest in an estate that has been conveyed to a land trust where the donors (and possibly certain beneficiaries) reserve the right to continue to live on and use the property during the specified lifetimes (reserved life estate). The remainder of their interests in the property are donated to a charity, and this gift may be a charitable contribution. At the end of such specified life interests, full title and control of the property automatically transfers to the land trust. The estate gets the tax benefit of this second charitable contribution.

Reserved Life Estate – see Remainder interest.

Section 170 (f) (U.S) - Section of the U.S. Internal Revenue Code which disallows income tax deduction in certain cases and under special rules.

Section 170 (h) (U.S) - – Section of the U.S. Internal Revenue Code defining requirements for *qualified conservation contributions*.

Section 501(c) (3) (U.S) - - list of organizations/corporations exempt from taxation under the Internal Revenue Code.

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. This type of donation with consideration is called a “bargain sale” in the U.S.

The Nature Conservancy (U.S.) - An American charitable conservation organization (not the same as the Nature Conservancy of Canada), and the only organization currently having *prescribed donee* status under the regulations to the Income Tax Act of Canada.

Appendix 2: Useful Resources

2.1 Canada Revenue Agency Documents

Guide, 5013-G, “General Income Tax and Benefit Guide for Non-Residents and Deemed Residents of Canada” (2005) online: Canada Revenue Agency
<<http://www.cra-arc.gc.ca/E/pub/tg/5013-g/5013-g.pdf>>.

T1 General 2005 - Income Tax and Benefit Return
<<http://www.cra-arc.gc.ca/E/pbg/tf/5000-r/5000-r-05e.pdf>>

Pamphlet P-113(E) Rev. 05, “Gifts and Income Tax” (2005) online: Canada Revenue Agency
<<http://www.cra-arc.gc.ca/E/pub/tg/p113/p113-05e.pdf>>.

Information Circular, IC-72-17R5, “Procedures Concerning the Disposition of Taxable Canadian Property by Non-Residents of Canada - Section 116” (15 March 2005) online:
<<http://www.cra-arc.gc.ca/E/pub/tp/ic72-17r5/ic72-17r5-e.pdf>>.

Interpretation Bulletin, IT-110R3, Gifts and Official Donation Receipts. 1997.
<<http://www.cra-arc.gc.ca/E/pub/tp/it110r3/README.html>>

Interpretation Bulletin, IT-171R2, “Non-Resident Individuals-Computation of Taxable Income Earned in Canada and Non-Refundable Tax Credits” (March 1992) online:
<<http://www.cra-arc.gc.ca/formspubs/prioryear/it171r2/it171r2-e.html>>.

Interpretation Bulletin, IT-176R2, “Taxable Canadian Property-Interest in and Options on Real Property and Shares” (23 April 1993) online: Canada Revenue Agency
<<http://www.cra-arc.gc.ca/E/pub/tp/it176r2/it176r2-e.html>>.

Interpretation Bulletin IT-288R2, “Gifts of Capital Properties to a Charity and Others” (16 January 1995) online: Canada Revenue Agency <<http://www.cra-arc.gc.ca/E/pub/tp/it288r2/it288r2-e.html>>.

Interpretation Bulletin IT-420 Non-Residents – Income Earned in Canada: C.R.A., Interpretation Bulletin IT-420R3SR, “Non-Residents - Income Earned in Canada” (20 February 1995).
<<http://www.cra-arc.gc.ca/E/pub/tp/it420r3sr/it420r3sr-e.html>>

Guide, T4058(E) Rev. 05, “Non-Residents and Income Tax” (2005) online: Canada
<<http://www.cra-arc.gc.ca/E/pub/tg/t4058/t4058-05e.pdf>>.

Form, T2062 E, “Request by a Non-Resident of Canada for a Certificate of Compliance Related to the Disposition of Taxable Canadian Property” (2004) online: Canada Revenue Agency
<<http://www.cra-arc.gc.ca/E/pbg/tf/t2062/t2062-04e.pdf>>.

Income Tax Technical News, No. 26, Dec. 24, 2002. “Proposed Guidelines on Split Receipting”.
<<http://www.cra-arc.gc.ca/E/pub/tp/itnews-26/itnews-26-e.pdf>>

2.2 Relevant Canadian Income Tax Act Sections and Regulations

Income Tax Act

Section 43.1: Income Tax Act, R.S.C. 1985 (5th Supp.), c.1, s. 43.1 (*Capital Gains for Life Estates/Remainder Interests*)

<http://laws.justice.gc.ca/en/I-3.3/66191.html#section-43.1>

Section 115: Income Tax Act, R.S.C. 1985 (5th Supp.), c. 1, s. 115. (*Taxable Gain on Disposition of Real Property and Election to Reduce Capital Gains Taxes*)

<http://laws.justice.gc.ca/en/I-3.3/67729.html>

Section 116: Income Tax Act, R.S.C. 1985 c.1. s 116. (*Disposition of property by non-resident*)

<http://laws.justice.gc.ca/en/i-3.3/67729.html>

Section 118.1: Income Tax Act, R.S.C. 1985 (5th Supp.), c. 1, s. 118.1. (*Tax credits and the election to dispose of property between adjusted cost base and fair market value*)

Section 118.1(6): Income Tax Act, R.S.C. 1985 (5th Supp.), c. 1, s. 118.1(6).

Section 118.1(6)(a): Income Tax Act, R.S.C. 1985 (5th Supp.), c. 1, s. 118.1(6)(a).

Section 118.1(6)(b): Income Tax Act, R.S.C. 1985 (5th Supp.), c. 1, s. 118.1(6)(b).

<http://laws.justice.gc.ca/en/I-3.3/67763.html#section-118.1>

Section 248(1): Income Tax Act, R.S.C. 1985 (5th Supp.), c. 1, s. 248(1). (*Taxable Canadian property*)

<http://laws.justice.gc.ca/en/I-3.3/70749.html>

Income Tax Act Regulations

3501: Income Tax Regulations, C.R.C., c. 945, s. 3501. (*tax receipt requirements*)

<http://laws.justice.gc.ca/en/i-3.3/c.r.c.-c.945/text.html#section-3501>

3504: Income Tax Regulations, C.R.C., c. 945, s. 3504. (*Prescribed Donees*)

<http://laws.justice.gc.ca/en/i-3.3/c.r.c.-c.945/text.html#section-3504>

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*)

<http://www.intltaxlaw.com/treaties/canada/treaty.htm>

2.3 Other Canadian Publications

Cross-Border Conservation

Attridge, Ian "Canada and the U.S.: Cross-Border Donations and Taxes", *National Rally '96 Workbook* (Washington: Land Trust Alliance, 1996)

Bonnie Sutherland, Nova Scotia Nature Trust. Cross-Border Conservation Tool Kit. 2006.

Cross-Border Conservation Easement Template. 2006

Cross-Border Conservation Gifts: Fact Sheet for Appraisers. 2006.

Cross-Border Conservation Gifts: Fact Sheet for Donors. 2006.

Cross-Border Conservation Gifts: Fact Sheet for Donor Advisors. 2006.

Cross-Border Conservation Gifts: Fact Sheet for Land Trusts. 2006.

Other

Attridge, Ian. *Conservation Easement Valuation and Taxation in Canada* (Ottawa: North American Wetlands Conservation Council (Canada), 1997)

Attridge, Ian "Securement Options" and "Land Valuation and Taxation" chapters, in: Ontario Nature Trust Alliance, *Land Securement Manual* (Toronto: Ontario Nature Trust Alliance, 1999)

Environment Canada. Ecological Gifts Program website. <http://www.cws-scf.ec.gc.ca/egp-pde/>

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

Environment Canada. Ecological Gifts Program. *The Canadian Ecological Gifts Program Handbook* 2005.

Environment Canada. Ecological Gifts Program. *Confirmation that Ecological Gifts are Eligible for Split-Receipting*.

Hillyer, Ann and Atkins, Judy. *Giving it Away: Tax Implications of Gifts to Protect Private Land*. 2004.

Silver, Thea; Attridge, Ian; MacRae, Maria; Cox, Ken. *Canadian Legislation for Conservation Covenants, Easements and Servitudes: The Current Situation* (Ottawa: North American Wetlands Conservation Council (Canada), 1995)

2.4 Internal Revenue Service Publications

U.S. Department of the Treasury Forms

Form 8282 Donee Information Return
<<http://www.irs.gov/pub/irs-pdf/f8282.pdf>> (form)

Form 8283 Noncash Charitable Contributions
<<http://www.irs.gov/pub/irs-pdf/f8283.pdf>> (form)
<<http://www.irs.gov/pub/irs-pdf/i8283.pdf>> (instructions)

Information on the United States-Canada Income Tax Treaty (Publication 597) (February 2006) online: Internal Revenue Service <<http://www.irs.gov/pub/irs-pdf/p597.pdf>>.

Form 8833 Treaty-Based Return Position Disclosure
<<http://www.irs.gov/pub/irs-pdf/f8833.pdf>>

Form SS-4 Application for Employer Identification Number (February 2006) online: Internal Revenue Service
<<http://www.irs.gov/pub/irs-pdf/fss4.pdf>> (form)
<<http://www.irs.gov/pub/irs-pdf/iss4.pdf>> (instructions)

Support Schedule for Advance Ruling Period (Form 8734, OMB No. 1545-1836) (January 2004) online: Internal Revenue Service <<http://www.irs.gov/pub/irs-pdf/f8734.pdf>>.

U.S. Department of the Treasury Publications:

Guidance Relating to Article XXI of the United States-Canada Income Tax Convention (Notice 99-47) online: Internal Revenue Service
<<http://www.irs.gov/pub/irs-tege/n99-47.pdf>>

Notice 2006-96. Guidance Regarding Appraisal Requirements for Noncash Charitable Contributions.
<<http://www.appraisersassoc.org/appraise1900/images/1174notice200696.doc>>

Publication 78 Cumulative List of Organizations
<<http://www.irs.gov/charities/article/0,,id=96136,00.html>> (search engine)

Publication 526 Charitable Contributions (December 2005) online: Internal Revenue Service
<<http://www.irs.gov/pub/irs-pdf/p526.pdf>>.

Publication 561 Determining the Value of Donated Property (October 2005) online: Internal Revenue Service
<<http://www.irs.gov/pub/irs-pdf/p561.pdf>>.

Publications 1457, 1458 and 1459 Actuarial Values (for valuing remainder interest)

<<http://www.irs.gov/pub/irs-pdf/p1457.pdf>> (*Book Aleph*)

<<http://www.irs.gov/pub/irs-pdf/p1458.pdf>> (*Book Beth*)

<<http://www.irs.gov/pub/irs-pdf/p1459.pdf>> (*Book Gimel*)

Internal Revenue Service Revenue Rulings:

Revenue Ruling 63-252

<<http://www.taxlinks.com/rulings/1963/revrul63-252.htm>>

Revenue Ruling 66-79

<<http://www.taxlinks.com/rulings/1966/revrul66-79.htm>>

Revenue Ruling 82-105

<<http://www.taxlinks.com/rulings/1982/revrul82-105.htm>>

Revenue Ruling 85-99

<<http://www.taxlinks.com/rulings/1985/revrul85-99.htm>>

2.5 U.S. Statutes and Regulations

Internal Revenue Code

Section 170(f)(3)(B) (2004). (Donations of partial interest in land)

Section 170(f)(4) (2004). (Valuation for Remainder Interests)

Section 170(f)(11). (2004). (Appraisers and Appraisals, Reporting/Substantiation)

Section 170(h) (2004). (*Qualified Conservation Contributions/Conservation Easements*)

<http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+26USC170>

Section 501 (2004). (*Publicly-supported charity*)

<http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+26USC501>

Section 509 (2004). (*Public support test*)

<http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+26USC509>

Section 2031 (2004). (*Gross Estate-Special Estate Tax Deductions for Conservation Easements within U.S.*)

<http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+26USC2031>

Section 2036 (2004). (*Estate Taxes*)

<http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+26USC2036>

Section 2055 (2004). (*Estate Taxes*)

<http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+26USC2055>

Section 2522 (2004). (*Gift Taxes*)

<http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+26USC2522>

Section 2703 (2004). (*Estate Taxes*)

<http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+26USC2703>

Section 6050L. (*Transfer of qualified conservation contributions within 2 years of gift*)

<http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+26USC6050L>

Section 6114 (2004). (*Treaty-based return positions*)

<http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=browse_usc&docid=Cite:+26USC6114>

Sections 6662, 6695, 6700, 6701, 6694 (*Valuation misstatements and penalties*)

Treasury Regulations

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

1.170A-13 (2003). (*Appraisal Requirements*)

<http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/cfr_2003/aprqr/26cfr1.170A-13.htm>

1.170A-14 (2003). (*Qualified Conservation Contributions*)

<http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/cfr_2003/aprqr/26cfr1.170A-14.htm>

20.2055-1 (2003) (*Estate Taxes*)

<http://a257.g.akamaitech.net/7/257/2422/14mar20010800/edocket.access.gpo.gov/cfr_2003/aprqr/26cfr20.2055-1.htm> (link is to index of Part 25)

25.2522-1 (2003) (*Gift Taxes*)

<http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=fb1d81ec0d3eb313c95efbf9f9033c7f&tpl=/ecfrbrowse/Title26/26cfr25_main_02.tpl> (link is to index of Part 25)

25.2703-1 (2003) (link is to index of Part 25) (*Estate Taxes*)

<http://ecfr.gpoaccess.gov/cgi/t/text/text-idx?c=ecfr&sid=fb1d81ec0d3eb313c95efbf9f9033c7f&tpl=/ecfrbrowse/Title26/26cfr25_main_02.tpl> (link is to index of Part 25)

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

http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=109_cong_public_laws&docid=f:publ280.109.pdf

2.6 Other U.S. Publications

Land Trust Alliance. *Land Trust Standards and Practices*. 2004.

Land Trust Alliance and the National Trust for Historic Preservation. *Appraising Easements; Guidelines for Valuation of Land Conservation and Historic Preservation Easements*, 3d ed. (Washington, D.C, 1999).

L. Byers, et. al. *The Conservation Easement Handbook*, Second Edition. 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).

Stephen J. Small, *The Federal Tax Law of Conservation Easements* (Washington, D.C.: Land Trust Alliance, 1995).

Appendix 3: Sample Attachment to Form 8283

A statement that includes the information contained in this sample must be attached to the Internal Revenue Service Form 8283 the donor files with their income tax return for the year of the gift. The form must also be signed by the donee organization (the recipient of the gift) and the appraiser.

The statements regarding (1) collection of baseline data, (2) ownership data for nearby land owned by the donor or a related person, and (3) the existence of any regulatory approval or contractual obligation that may have prompted this gift, have been added by the Internal Revenue Service for gifts made on or after 2005 to identify non-deductible conservation easements. The donor's appraiser and other professional advisors should be aware of new rules for Form 8283, <http://www.irs.gov/pub/irs-pdf/i8283.pdf>

Attachment to Form 8283, Section B, Part 1, Line 5

Donor's Name: _____

Donors SS -EIN#: _____

Date: _____

\ The donated property is a conservation easement donated as a "qualified conservation contribution" under Internal Revenue Code § 170(h). It was donated to _____, EIN# _____, which is a qualified donee under Section 170(h), on _____, and is recorded at the _____ County, State of _____, Registry of Deeds at Book _____ and Page _____.

The conservation easement controls future land uses for conservation protection on a [INSERT: coastal land, farmland, forest land, an entire island, a saltwater farm, mountain property, lakeside land, other description,] approximately _____ acres [ADD IF APPLICABLE: with approximately _____ feet of road frontage / shore frontage on _____], located on _____ in the Town of _____, County of _____, and State of _____; (hereafter the "Protected Property"). The Protected Property") remains in a substantially natural and undeveloped state and provides [[CHOOSE AS APPROPRIATE: scenic enjoyment to the public when viewed from _____, / relatively natural habitat of fish, wildlife, and plants, including _____, / a buffer of undeveloped land for the nearby _____ preserve/forest/national park, in an area with dense development- experiencing significant development pressure. (please describe what's important about this land and the restrictions...ADD OTHER STANDARDS THAT TRACK THE Internal Revenue Service REGULATIONS § 1.170A-14 Qualified conservation contributions)

The "conservation purposes" furthered by this gift are the

(CHOOSE and MODIFY FROM CHOICES BELOW,

- (1) preservation of land areas for outdoor recreation by, or for the education of, the general public.
- (2) protection of a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem.
- (3) preservation of open space, including farmland and forest land, providing a significant public benefit, pursuant to a clearly delineated state and local governmental policy.
- (4) preservation of open space for the scenic enjoyment of the general public, providing a significant public benefit. [[HISTORIC PRESERVATION EASEMENT criteria not included here due to changes in rules for façade easements]]

NOTE: For easements other than those meeting purpose 2 (above), additional criteria not discussed in this guidebook must be met for the easement to be deductible for tax purposes in the U.S.

State the method used for the appraisal: _____(comparable easement sales/ before and after value of land/ income method) _____

If the appraisal for the conservation easement was based on the “before and after” value of the protected property, provide the following:

Fair Market Value of Property Before Gift of Easement	\$ _____
Fair Market Value of Property After Gift of Easement	\$ _____
Fair Market Value of Conservation Easement	\$ _____

NOTE: If the FMV of the Conservation Easement exceeds \$500,000.00, the full qualified appraisal is attached to the Form 8283, along with this statement.

Additional Statements by Donor:

1. The holder of the conservation easement, _____, has collected and maintains information about the condition of the protected property, including maps and a natural resources inventory, (the “baseline data”) sufficient to establish its condition as of the date of the gift, to enable holder to protect the conservation interests associated with the protected property. The donor and the holder have signed a statement certifying that the baseline data is an accurate representation of the condition of the protected property at the time of the transfer.

2. Does the donor or a related family member have any interest in real property near the protected property?:
 { } No.
 { } Yes: Describe that land, who owns it, and its proximity or relation to the protected property; and indicate the conclusion of the appraiser as to whether and to what degree the conservation restrictions on the protected property may enhance the value of the donee’s or related person’s other nearby property.

3. Did the donor make the donation of the conservation easement in order to get a permit or other approval from a local or other governing authority?
 { } No.
 { } Yes. Please explain.

4. Was the donor required to make the donation of the conservation easement due to a requirement of a contract?
 { } No.
 { } Yes. Please explain.

Appendix 4: Sample Tax Calculations

Note: for simplicity in the following examples, adjusted cost base is assumed to be only the cost of acquiring the property, not associated expenses, and the currency is Canadian dollars.

4.1 Sample Calculation for Determining Adjusted Cost Base of a Conservation Easement

The fair market value and adjusted cost base for any gift of conservation land or conservation easement must be ascertained to complete Canada Revenue Agency requirements (i.e. for completing Canada Revenue Agency Form 2062 requesting a compliance certificate for disposition of Canadian property by a non-resident). The adjusted cost base can be ascertained by obtaining an appraisal of the conservation easement's current value and its value at the time the land was acquired, but this assessment can be difficult, especially where lands were acquired many years prior.

An alternative that has been acceptable to the Canada Revenue Agency is a proportional allocation, as follows:

<i>Current fair market value of land</i>	<i>\$500,000 (determined by appraisal)</i>
<i>Adjusted cost base of land</i>	<i>\$100,000</i>

<i>Current fair market value of conservation easement (value of land before/after conservation easement)</i>	<i>\$250,000 (determined by appraisal)</i>
--	--

Proportion of property's value assigned to easement $\$250,000/\$500,000 = 1/2$

Therefore, the conservation easement's adjusted cost base can be considered to be 1/2 of the land's adjusted cost base or 1/2 of \$100,000 = \$50,000.

4.2 Sample Calculations of Capital Gains Tax

1. Capital Gains Tax assuming no election to reduce capital gain and not an Ecological Gifts (i.e. a gift to a U.S. charity other than a *prescribed donee*)

<i>Current fair market value of land</i>	<i>\$100,000</i>
<i>Adjusted cost base</i>	<i>\$5,000 (cost of purchasing land)</i>
<i>Deemed proceeds of disposition of easement</i>	<i>\$100,000 (disposition at fair market value)</i>
<i>Capital gain on easement</i>	<i>\$95,000 (\$100,000-5,000)</i>

Result:

Donor pays capital gains tax on 50% of the \$95,000 capital gain (i.e. pays tax on \$47,500 at his/her personal rate of income tax).

Donor receives a charitable tax receipt for \$100,000 (which can be used to offset Canadian-source income)

2. Capital Gains Tax assuming the gift qualifies as an Ecological Gift:

The 2006 Canadian federal budget reduced the inclusion rate for capital gains on Ecological Gifts to 0. This option is only available if the donee is a Canadian charity qualified as an Ecological Gifts Recipient organization under the Ecological Gifts Program.

<i>Current fair market value of land</i>	<i>\$100,000</i>
<i>Adjusted cost base</i>	<i>\$5,000 (cost of purchasing land)</i>
<i>Deemed proceeds of disposition of easement</i>	<i>\$100,000 (disposition at fair market value)</i>
<i>Capital gain on easement</i>	<i>\$95,000 (\$100,000-5,000)</i>

Result:

Donor pays 0 capital gains tax.

Donor receives a charitable tax receipt for \$100,000 (which can be used to offset Canadian.-source income)

3. Capital gains tax assuming donor elects to reduce capital gains tax under ITA Section 118 (assuming gift if to a Canadian charity)

Under Section 118, the donor can “dispose” of the land (or conservation easement) at the same value for which they acquired it (or any value between their adjusted cost base and the current fair market value). There is therefore no capital gain (or a reduced gain, depending on the disposition value chosen) and therefore no capital gains tax owing or reduced tax. The tax receipt, however, is issued for the deemed disposition value, so the tax benefit against Canadian-source income is also reduced. Note: This option is only available if the donee is a Canadian charity or a *prescribed donee* under the Canadian Income Tax Act.

Donor elects disposition value equal to adjusted cost base.

<i>Current fair market value of land</i>	<i>\$100,000</i>
<i>Adjusted cost base</i>	<i>\$5,000</i>
<i>Deemed proceeds of disposition</i>	<i>\$5,000 (disposition value at adjusted cost base)</i>
<i>Capital gain</i>	<i>\$0 (\$5,000-5,000)</i>

Result:

Donor pays no capital gains tax.

Donor receives charitable tax receipt for \$5,000 (which can be used to offset Canadian-source income)

4. Capital gains tax assuming donor elects to reduce capital gains tax under ITA Section 118 (assuming gift if to a U.S. charity qualified as a *prescribed donee* under the Canadian Income Tax Act):

Again, there is therefore no capital gain (or a reduced gain, depending on the disposition value chosen) and therefore no capital gains tax owing or reduced tax. The U.S. donor can use the full amount of the fair market value of the gift to offset U.S.-source income.

Donor elects to disposition value equal to adjusted cost base.

<i>Current fair market value of land</i>	<i>\$100,000</i>
<i>Adjusted cost base</i>	<i>\$5,000</i>
<i>Deemed proceeds of disposition</i>	<i>\$5,000 (disposition value at adjusted cost base)</i>
<i>Capital gain</i>	<i>\$0 (\$5,000-5,000)</i>

Result:

Donor pays no capital gains tax.

Donor receives charitable tax receipt for \$100,000 (which can be used to offset U.S.-source income)

Donor elects disposition value between fair market value and adjusted cost base. Donee is a Canadian charity.

<i>Fair market value</i>	<i>\$100,000</i>
<i>Adjusted cost base</i>	<i>\$5,000</i>
<i>Deemed proceeds of disposition</i>	<i>\$50,000</i>
<i>Capital gain</i>	<i>\$45,000</i>

Result:

Donor pays capital gains tax on 50% of \$45,000 (i.e. pays tax on \$22,500 at donor's personal income tax rate).

Donor also receives charitable tax receipt for \$50,000 (which can be used to offset Canadian-source income)

4.3 Sample U.S. Tax Calculations for Gifts of Remainder Interest

The following sample demonstrates the difference in U.S. tax deduction between a regular gift of remainder interest and a remainder interest for conservation purposes within the U.S. tax context.

Non-conservation remainder interest under Internal Revenue Code, Section 170(f)(3)(B) (i.e. remainder interest that does not meet “conservation purposes” test)

<i>Property value</i>	<i>Factor (from Internal Revenue Service tables based on donor’s age etc.)</i>	<i>RI value (Tax Deduction) (property value x factor)</i>
\$2,500,000	0.35576	\$889,400

Remainder Interest for Conservation Purposes (meeting “conservation purposes” test)

<i>Property value</i>	<i>Factor (from Internal Revenue Service tables based on donor’s age etc.)</i>	<i>RI value (Tax Deduction) (property value x factor)</i>
\$2,500,000	0.39656	\$991,400

ENDNOTES

¹ **U.S. Easement “Climate”**—Recent years have seen unprecedented scrutiny by the U.S. government of conservation easements, appraisals, tax deductions and land trust activity. Tax laws affecting easements and land trusts have changed recently, and are likely to become even more specific and involved in future.

² **Capital Gains Tax Relief in 2006 Budget (Canada)**—It is important to note that the reduction of the inclusion rate for capital gains from 25% to 0% for Ecological Gifts made in the May 2006 Federal Budget in Canada has not yet been enacted in law. For the purposes of this guide, the provisions in the budget are taken as announced by the Federal Government.

³ **Gifts of Real Property**--Unless otherwise specified, reference in this document to a “gift” may include an outright gift of land (fee simple) or to granting a conservation easement or some other interest in land (such as a remainder interest)

⁴ **Conservation Easement**—This guide uses the term conservation easement as a general term for all similar conservation tools such as covenants and servitudes which are legal agreements protecting conservation interests on public or private land. Conservation easements are not the same as common law easements. Conservation easements are binding against future owners of the property and are enforced by the holder of the conservation easements (a conservation charity or government body qualified to hold conservation easements within the particular province or territory).

⁵ **Remainder interest**--Also known as a gift of land with a reserved life estate, this is an interest in a property that has been conveyed to a land trust where the donors (and possibly certain beneficiaries) reserve the right to continue to live on and use the property during the specified lifetimes. At the end of such specified life interests, full title and control of the property automatically transfers to the land trust. In this guide it is assumed that remainder interests will be for conservation purposes, not agricultural purposes or residential which are beyond the scope of this guide.

⁶ **Donee**—this term refers to the organization that is the recipient of the conservation gift (i.e. the organization to which the land or conservation easement is given). Tax benefits of cross-border conservation gifts depend on the type of organization and its tax status on both sides of the border. See further discussion in *Section 3.5 Additional Tax Issues Relevant to Specific Donees*.

⁷ **Capital Gains Tax (Canada)**—Capital gains are deemed for all dispositions of capital assets (including land, conservation easements and remainder interests) even where a property disposition is a gift to charity and no proceeds are actually received by the donor. Capital gains tax is payable on a portion of the gain. Advice should be sought from an appropriate professional if the land is “inventory” rather than “capital” property. Such gifts are not included in this guide.

⁸ **Prescribed Donee (Canada)**—this refers to 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.).

⁹ **American Friends of Canadian Land Trusts**—A recently created U.S. organization with a mission of facilitating cross-border conservation gifts of Canadian real estate owned by U.S. residents. The organization plans to open a program to support Canadian land trusts and U.S. landowners wishing to work together to protect important conservation lands in Canada. It is hoped that the organization can successfully secure appropriate qualifications with the Internal Revenue Service and Canadian Revenue Agency to enable donors of cross-border conservation gifts to benefit from both U.S. income tax deduction, and avoidance of Canadian capital gains taxes.

¹⁰ **Testamentary Gift**—The term means a gift by will. The term “bequest” refers to gifts of money, and the term “devise” refers to gifts of land. Though the term “bequest” is popularly used to refer to all gifts made through a will, the term “testamentary gift” will be used in this document.

¹¹ **Sale of Easement (Canada)**—Few Canadian land trusts purchase easements at this time. Most easements are donated.

¹² **Fair market value**—this term refers to the most probable price that a property should bring in a competitive and open market as of the specified date, under all conditions requisite to a fair sale, with the buyer and seller each acting prudently and knowledgeably and independently of each other.

¹³ **Bargain Sale (US)**—Calculation of the tax outcome of a bargain sale is explained in Internal Revenue Service *Publication 526*. The charitable contribution is the property's fair market value at the time of sale minus the amount the donor received for the property. If the donor is using the adjusted basis to increase the deduction limit of their donation to 50%, the contribution amount is based on the adjusted basis of the entire property multiplied by the fair market value of the contributed part divided by the fair market value of the entire property.

¹⁴ **U.S. Partner Requirements (US)**—A U.S. partner organization must seek legal counsel on the issues of controlling the transactions and not acting as a mere conduit or agent for Canadian land trusts. See Rev. Rul. 63-252 and 66-79.

¹⁵ **Qualified Donee (US)**—an eligible donee must be a *qualified organization* in addition to having a commitment to protect the conservation purposes of the donation and have the resources to enforce the restrictions (§ 1.170A-14 (2) (c) of the Treasury Regulations to Internal Revenue Code section 170 (h)). To apply for designation as a *qualified organization*, donees (including Canadian recipients of cross-border gifts by bequest or any partial interest in land) must apply to the Internal Revenue Service. See *Section 5: Canadian Land Trusts and U.S. Publicly-Supported Charity Status* for more information.

¹⁶ **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. Background on the requirements for such gifts is provided in *Section 3.7 Qualified Conservation Contributions (U.S.)*. 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.

¹⁷ **Adjusted Cost Base (US and Canada)**-- the cost of the capital property plus any expenses to acquire it, including commissions/legal fees

¹⁸ **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 easement, and the adjusted cost base, in order to eliminate or reduce any capital gains tax owing on a gift.

¹⁹ **Canadian Tax Receipt**—Donors receive a tax receipt for donations of land, conservation easements, remainder interests, cash, securities or other property to a Canadian charity.

²⁰ **Ecological Gifts Program**--An Ecological Gift is a donation of land or an interest in land (such as a conservation easement, covenant or servitude) that has been certified as "ecologically sensitive" by the federal Minister of the Environment or the Ministers' designate, in accordance with the provisions of the federal Income Tax Act, that is donated to a Canadian charity eligible to accept Ecological Gifts, and that otherwise meets the requirements of the Act, that give rise to special tax benefits. 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.

²¹ **Tax Benefits of Ecological Gifts (Canada)**—Section 118.1(1) "total gifts" (d) of the Income Tax Act. 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. Zero percent of the capital gain is taxed instead of the usual 50%. 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 (usually the original purchase price). This designated amount is also used to calculate the tax benefit.

²² **Ecological Gifts Inclusion Rate**-- 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 (although this is not yet enacted in law). This eliminates capital gains tax on Ecological Gifts retroactive to May 2, 2006. 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.

²³ **Substantiation of Value for U.S. Gifts**--Real property must be appraised by a "qualified appraiser" and reported on Internal Revenue Service Form 8283. A qualified appraiser is defined in the Internal Revenue Code Regulation 1.170A-13(c)(5) and Internal Revenue Service Notice 2006-96. See *Section 3.8 Appraisal Requirements (U.S. and Canadian)* and *Internal Revenue Service Notice 2006-96* for more on requirements for appraisals including recent amendments to U.S. tax law relating to appraisals (made August 2006).

²⁴ **Canada-US 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 the laws of the U.S. 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. See below for special deductions for conservation easements. Claiming such treaty benefits may be subject to the taxpayer to reporting requirements on Form 8833, pursuant to Internal Revenue Code 6114.

²⁵ **New Conservation Easement Tax Benefits (US)**—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 Internal Revenue Service 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.

²⁶ **Enhanced Tax Benefits for Conservation Easements over Land Donations (U.S.)**—Under new tax law in the U.S. (Pension Protection Act, 2006, Section 1206.), it may be more tax advantageous to donate a conservation easement rather than an outright gift of land if the gift is made in 2006 or 2007.

²⁷ **Tax Benefit 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 easements by U.S. residents must first be recognized by the Internal Revenue Service as a *qualified donee*. See section 3.7 *Qualified Conservation Contributions (U.S.)* and Section 5: *Canadian Land Trusts and U.S. Publicly-Supported Charity Status*.

²⁸ **Stephen J. Small. Resources for Estate Planning**—Three excellent books provide background on U.S. estate tax issues and options: *Preserving Family Lands: Essential Tax Strategies for the Landowner*, *Preserving Family Lands: Book II. More Planning Strategies for the Future* and *Preserving Family Lands: Book III*. Visit www.stevesmall.com.

²⁹ **Estate Tax Limits (U.S.)**--The value of assets permitted to pass estate tax free will increase from its current level to \$3.5 million as follows: \$2 million in 2006, \$3.5 million in 2009, without limit in 2010, and then back to \$1 million in 2011. These amounts are for individuals. Couples may establish estate plans to increase these exemptions. In conjunction with these estate value tax free increases, the top estate and GST (“generation-skipping transfer”) tax effective January 1, 2002 will be 50% (a 5% decline from its current rate) on estates valued at over \$2.5 million. This rate will decrease by one percentage point each year until 2007 when it reaches 45%, where it will stay until 2009. In 2010 there is no estate tax. A big change is that the estate and gift tax system is no longer unified. The gift tax will not be reduced or eliminated. The lifetime gift tax exemption increases to \$1 million on January 1, 2002, and will remain at that level indefinitely. The top gift tax rate on taxable gifts over \$2.5 million will also be 50% effective January 1, 2002, and will decline at the same pace as the estate tax rate through 2009. By 2010, the top gift tax rate will be equal to the top income tax rate (currently planned to be 35%).

³⁰ **Internal Revenue Code Section 2031 Additional Estate Tax Benefits (US)**— § 2031 (c)(8)(A)(i) of the Internal Revenue Code provides additional estate tax benefits for conservation easements, but this only applies to land located in the U.S.

³¹ **Gift Tax (US)**—Internal Revenue Code section 2522(a) allows a gift tax charitable deduction for donations to foreign charities under rules that parallel those in Internal Revenue Code section 2055 for estate tax purposes.

³² **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. See section 3.7 *Qualified Conservation Contributions (U.S.)*.

³³ **Revenue Ruling 82-105 (US)**—In this ruling, the Internal Revenue Service held that property transferred to a charitable remainder annuity trust was included in the donor’s estate under Internal Revenue Code Section 2036(a), but then eligible for a charitable deduction in calculating U.S. estate tax for the same amount, thus effectively excluding the property from the estate. The same result should apply for a transfer of a remainder interest that is a *qualified conservation contribution*.

³⁴ **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.

³⁵ **Estate Tax Deductions for Qualified Conservation Contributions (US)**—Under Internal Revenue Code 2055(e)(2), no deduction will be allowed for estate tax purposes for gifts of partial interest in land unless the gift constitutes a *qualified conservation contribution* within the meaning of Internal Revenue Code Section 170 (h)(1) and Internal Revenue Code section 170(f)(3)(B). The qualifications for this are discussed further in Section 3.7 *Qualified Conservation Contributions (U.S.)* and Section 5: *Canadian Land Trusts and U.S. Publicly-Supported Charity Status*.

- ³⁶ **Tax Treaty Capital Gains on Transfer**—Even if this exemption were unavailable under the Canada-U.S. Income Tax Convention--Article XXI(1), there would likely be no capital gain unless the property increased in value during the time it was held by the U.S. charity.
- ³⁷ **Restricted Gifts of Land (IRS)**—Internal Revenue Service Revenue Ruling 85-99 illustrates that the deduction for a restricted gift of land is limited to the restricted value of the land. This may be significantly lower than its unrestricted value.
- ³⁸ **Remainder Interest and Gift Tax (US)**—Where the donor retains an interest in the property, Internal Revenue Code Section 2522(c)(2) serves to disallow the gift tax deduction unless the gift constitutes a *qualified conservation contribution* within the meaning of Section 170(h). The requirements under Section 170(h) are discussed in *Section 3.7 Qualified Conservation Contributions (U.S.)*.
- ³⁹ **Capital Gains on Remainder Interest (Canada)**—ITA Section 43.1(1) provides that the transfer of a remainder interest triggers a disposition of the life interest as well, unless the transferee is a *qualified donee* (generally speaking, this means a Canadian registered charity or *prescribed donee*).
- ⁴⁰ **Internal Revenue Code Section 2522(d) (US)**— a gift tax deduction shall be allowed for transfers of easements which meet the requirements of Section 170(h) without regard to paragraph (4)(A) thereof.
- ⁴¹ **Internal Revenue Code Section 2703 (US)**— the value of property for U.S. estate tax purposes shall be determined without regard to any restrictions on the right to sell or use the property, unless certain stringent requirements are met. 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 purposes.
- ⁴² **Internal Revenue Code Section 2055(f)(US)**— an estate tax deduction shall be allowed for transfers of easements which meet the requirements of Section 170(h) without regard to paragraph (4)(A) thereof.
- ⁴³ **Cross-Border Conservation Easement Template**—The Nova Scotia Nature Trust has prepared a sample easement template integrating components required to meet Internal Revenue Service requirements under the Internal Revenue Code Section 170(h). Available through www.nsnt.ca or by calling 1-902-425-5263.
- ⁴⁴ **Conservation Purposes Test** – Only those purposes related to protection of ecologically important natural areas are discussed in this guide. Easements for other purposes, such as historic preservation are beyond the guide’s scope.
- ⁴⁵ **Small, Stephen J.** *The Federal Tax Law of Conservation Easements*. 4th Edition. Washington D.C: Land Trust Alliance, 1977.
- ⁴⁶ **Appraisal Commission by Donee (US)**—Treasury Regulations 1.170A – 13(c)(3)(iv)(c) state that the appraisal must be commissioned by the donor, not the donee.
- ⁴⁷ **Appraisal Timing (US)**—An appraisal must be completed no earlier than 60 days prior to the effective date of the donation and no later than the due date of donor’s U.S. tax return (including extensions) for the year of the gift. See Treasury Regulations 1.170A – 13(c) (3)(A)
- ⁴⁸ **Appraisal Fees (US)**—Certain appraisal fee arrangements are prohibited under U.S. tax law. See Regulations Section 1.170A 13(c)(6)
- ⁴⁹ **Retention of Appraisal Information (US)**—The donor must maintain records of the appraisal. See Treasury Regulations 1.170A – 13 (c)(2)(C)
- ⁵⁰ **Qualified Appraisal/Appraiser Requirements (US)**—Revisions were 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). These revisions redefine who is a “qualified appraiser” and give 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).
- ⁵¹ **Valuation Penalties for Appraisers (US)**—Appraisers will now be subject to penalties under the new Internal Revenue Code Section 6659A. Penalties are imposed if the appraiser knew or reasonably should have known that an appraisal would be used in connection with a tax return and the claimed value of the property which is based on the appraisal results in a substantial or gross valuation misstatement. The penalty is equal to the greater of \$1000 or 10% of the amount of tax attributable to a substantial or gross valuation misstatement, up to a maximum of 125% of the gross income received by the appraiser. Recent provisions also threaten appraisers with potential disbarment from working on federal tax matters. The Internal Revenue Service intends to disallow all or any part of any improper deductions and may impose penalties under Section 6662. The Service intends to assess excise taxes under Section 4958 against donors receiving an excess benefit, and against organizations who knowingly participate in the transactions. The tax-exempt status of the organization may be challenged. Promoters, appraisers and other persons

involved in such transactions may be subject to penalties under Sections 6700, 6701 and 6694. See also www.lta.org for updated information and interpretations of the August 2006 tax law changes on appraisals for conservation gifts.

⁵² **Valuation Penalties for Donors (US)**— The penalty is 20% of the underpayment of tax related to a substantial valuation misstatement (that is if the value or ACB claimed is 150% (reduced from 200%) or more of the correct amount and the donor underpaid by more than \$5000 as a result) and 40% of the underpayment of tax related to a gross valuation misstatement (that is if the value or ACB claimed is 200% (reduced from 400%) or more of the correct amount and the donor unpaid tax by more than \$5000 as a result)

⁵³ **Appraisal Summary (US)** —The donor is required to complete an appraisal summary, including specific information about the property, the appraiser and the donee, signed by the appraiser and the donee on *Form 8283*, which must be attached to the donor's tax return. For gifts worth more than \$500,000, the entire appraisal must be attached to form 8283. See *Treasury Regulations 1.170A-13(c)(4) and 1.170A-12 (C)(2)(B)*.

⁵⁴ **Category I Ecological Gifts Appraisal Report (Canada)**—Appraisals for Category I gifts may be prepared using the Ecological Gifts Programs Summary Report (available at www.cws-scf.ec.gc.ca/ecogifts/con_e.cfm) along with a brief narrative.

⁵⁵ **Appraiser Qualifications (Canada)**—For Ecological Gifts, appraisers must be certified by one of the following: Appraisal Institute of Canada, American Appraisal Institute, Royal Institution of Chartered Surveyors, American Society of Appraisers, American Society of Farm Managers and Rural Appraisers, Canadian National Association of Real Estate Appraisers or L'Ordre des évaluateurs agréés du Québec.

⁵⁶ **Easement Holders (Nova Scotia)** – The provincial legislation authorizing conservation easements, The Conservation Easement Act, requires all easement holders to be accepted by the province as an “eligible body.” This Act has been amended to allow for U.S. organizations to apply for designation, but to date none have been designated.

⁵⁷ **Appraisal Requirements (US and Canada)**— See discussion of appraisal requirements under *Section 3.8 Appraisal Requirements (U.S. and Canadian)*, and also Internal Revenue Service *Publication 526: Charitable Contributions, Publication 561: Determining the Value of Donated Property and Appraising Easements* by the Land Trust Exchange and the National Trust for Historic Preservation.

⁵⁸ **Clearance Certificate and Capital Gains Liability for Donee (CRA)**—Unless a clearance certificate is received from the Canada Revenue Agency, the recipient of a gift of land from a non-resident must pay a portion of the capital gains tax owing. There is no apparent relief where the recipient is a charity accepting a donation of real estate. In the case of a purchase of land, the purchaser can deduct the capital gains tax paid from the purchase price.

⁵⁹ **Form T2062 (Canada)**— “Request by non-resident for a Certificate of Compliance related to the disposition of Taxable Canadian Property” (CCRA 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*.

⁶⁰ **Form 8283 (US)**—See Internal Revenue Service publication *Instructions for Form 8283* for details on completing this form. A sample template for the additional information requested on the form is included in *Appendix 3: Sample Attachment to Form 8283*.

⁶¹ **Tax Treaty (Deduction on US Tax Form)**—The Canada-US Income Tax Convention allows U.S. donors to deduct contributions to and for the use of registered Canadian charities. The donor generally must have income from sources in Canada to use the deduction. A donor claiming charitable contribution deductions pursuant to the Tax Treaty may need to disclose this position on their U.S. income tax return for the year of the gift (Form 8833 or an attached statement making reference to *Article XXI of the Treaty or Notice 99-47*).

⁶² **Tax Treaty (charity status)** – The Canada-United States Income Tax Convention (1980), paragraphs 5 and 6 of Article XXI. The Treaty, and *Notice 99-47* state that all Canadian charities are recognized under Section 501(c)(3), but are assumed to be a private foundation unless they receive an Internal Revenue Service determination otherwise (i.e. recognition as a *publicly-supported charity*).

⁶³ **Private Foundation (US)**--In general terms, a private foundation is an organization described in the Internal Revenue Code 501(c)(3) which does not meet the public support test of Internal Revenue Code 509(a)(2).

⁶⁴ **Contributions Under Tax Treaty** – Besides being subject to the overall limits applicable to all charitable contributions under U.S. tax law, charitable donations to Canadian organizations are subject to the U.S. percentage limits on charitable contributions, applied to the donor's Canadian source income.

⁶⁵ **Step-Down Election (US)**—Under the Internal Revenue Code Section 170(b)(1)(C)(iii), a U.S. donor may use a “step-down” election to reduce the amount of the contribution of a capital property to the taxpayer's basis in the property, in order to increase the percentage limitation (percentage of the donor's adjusted gross income for the year of the gift for which the donor can make deductions) from 30% to 50%. The basis is the acquisition cost plus capital improvement costs, or for inherited land, the value upon inheritance.

⁶⁶ **Employer Identification Number (US)** – To apply, the charity must submit *Form SS-4: Application for Employer Identification Number*. The Internal Revenue Service publication *Instructions for Form SS-4* is helpful in completing the application.

⁶⁷ **Application for Tax Exempt Classification (US)**-- To receive a determination that a charity is not a private foundation, and that it meets the requirements of the public support test for accepting conservation easements, the charity must complete *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.

⁶⁸ **U.S. Income Tax Filing Requirements (US)** – Charities receiving U.S. \$25,000 or more in a year must file *Form 990 Return of Organizations Exempt From Tax* for that year to maintain their status as a *publicly-supported charity*. Further information may be obtained by accessing the Internal Revenue Service website (www.irs.gov).

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