PART 4 - LAND VALUATION AND TAXATION

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LAND VALUATION AND TAXATION

At some point during the negotiation process, a land trust and the landowner will want to know what the property is worth. Determining the property's value is thus a critical element in a transaction. Income, property, and other taxes are inevitable costs of owning and transferring land, and their extent is largely related back to the value of the property.

Since no one likes to pay more taxes than necessary, being aware of tax mechanisms that levy or reduce taxes paid are important both to the land trust as property owner and also to encourage conservation and especially donation of land by landowners. The variety and availability of tax benefits will depend upon the type of conservation technique and owner involved. Accordingly, this chapter deals with how to value land and partial interests in land (such as conservation easements), and then with land-related tax measures. Besides taxes, additional fees involved in the land securement process may also include those for legal or tax advice, preparation of a survey or appraisal, and registering documents at the land registry office.

4.1 Determining the Value of Land

Each property and partial interest is a unique combination of characteristics, including location, features, size, history, current use, and permitted uses. Along with personal preference, these and other factors contribute to the value of land. Determining this value is a regular and fundamental activity in our society. Value is certainly much more than monetary or economic value; there are ecological, spiritual, and emotional aspects that may well determine a landowner's or land trust's decisions about land, much more than the property's sale value. Nonetheless, market value—the price a property would fetch on the open market after a reasonable period—is the main way purchases and tax aspects are assessed.

4.1.1 Appraisals and Opinions of Value

Determining the market and tax value of a property is most often done through preparation of an appraisal. An appraisal is a considered opinion by a qualified appraiser about the value of the land interest under consideration.

An appraisal is important or useful in several circumstances:

- to determine the purchase price you are prepared to pay or accept;
- to value a donation in order to issue and claim a charitable tax receipt;
- to propose a property tax reassessment;
- to report the asset value on financial statements;
- to substantiate acquisition costs to donors, grant makers, board members, the public, etc.;

- to maintain credibility and demonstrate responsibility in the conservation and broader community;
- to calculate, in some cases, the charity's "disbursement quota" relating to its required percentage of charitable expenditures under the *Income Tax Act*; and
- to set the bar for future acquisitions (i.e., if the land trust pays too much for the first property, other nearby landowners will expect the same price).

Appraised value is based on a wide range of factors. The fair market value is not limited to the current use of the land but involves a consideration of its potential "highest and best use," based on the notion that a buyer is prepared to pay for the potential value of the property. Thus, the determination of the most profitable, legal, and likely use is the key consideration. Introductions to how this is done and who can appraise land are found below.

Good appraisals will help to maintain landowner confidence, will provide answers to questions raised by legislators and the public, will withstand scrutiny by [tax authorities] in the case of land trust programs, and maintain integrity of a [conservation easement] or other land conservation program. To function at its best, the appraisal process requires competent appraisers and reviewers as well as an informed user of appraisal services.[1]

Appraisal Process

The appraiser may be hired by the landowner or by the land trust. Generally, it is the landowner's responsibility to report property values for tax purposes and thus this person may wish to hire the appraiser. The donor also will likely want to know in advance what the tax consequences will be. For a purchasing or donee land trust (the latter with responsibility to issue a tax receipt), there are several reasons why the organization would want to retain the appraiser itself: to control the quality of the appraisal and correct mistakes; as one way to regulate the timing of the appraisal (e.g., to follow the registration of the interest because landowners may cancel a deal if they do not like the appraisal numbers),[2] and to establish an ongoing relationship with an appraiser and help develop expertise, especially with new approaches like conservation easements.

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1 Patrick W. Hancock, *A Question of Value: Appraising for Farmland Preservation*, Farmland Preservation Special Report (Street, Maryland: Bowers Publishing, 1992),p.8. Reproduced As Appendix "C" in: Deb Brighton and Davis J. Cable, *Taxation of Land Subject to Conservation Easements in Vermont: A Lister's Guide* (unpublished report prepared for the 1992 "Taxing Conservation Workshops", available through the Vermont Land Trust, Montpellier VT).

2 However, donations are voluntary, and donee organizations will want to ensure contented donors. Another approach to that suggested in the text could be to structure within the agreement to acquire the property how the value will be determined, such as sharing an appraisal and then commissioning a second appraisal and averaging the two if there is no agreement. This gives the donor recourse should there be a problem or disagreement with the donee's appraisal. James Catterton, Walden Associates Inc., personal communication, 25 October 1996; Alan Ernest, Conservation Support Services, personal communication, 12 November 1996.

Regardless of who pays for and who retains the appraiser, one should expect analysis, not advocacy, on the part of their appraiser, who is bound ethically and legally to render a [thorough], disinterested, objective, supportable estimate of value.[3]

The timing of the property appraisal varies with the land securement option, but generally occurs earlier on in the negotiation process. Appraisals are usually carried out before you sign an Agreement of Purchase and Sale, or otherwise commit to a purchase; the land trust wants to know what is a reasonable price first or the landowner wants to know the value of the potential tax receipt. An alternative is to insert a condition in this agreement that the subsequent appraisal will support the purchase price. For fee simple donations or conservation easements, ideally the donor is acting on their desire to conserve the property, with the tax aspects of lesser consequence. In some cases, the appraisal can be completed after the donation or easement has been completed.

Involving an appraiser early in the process can prevent any financial surprises in a land transaction. Providing information to the appraiser can also save appraisal time and expense. Such information might include deeds, surveys, tax rolls, current zoning, comparable sales, or details of the property's features and capabilities.[4] An appraiser will often provide a draft opinion, and then follow this with a final opinion based upon the final arrangement. In the appraisal, the appraiser will typically provide an introduction and summary of important facts and conclusions, a description of the property and its neighbourhood,[5] analysis of highest and best use, approaches to value, and the final value reconciliation.[6]
Before selecting a local accredited appraiser to appraise a property's value, it may be useful to review the owner's municipal tax assessment notice. While tax assessments are not necessarily accurate reflections of market value, they can provide a ballpark value with which to begin discussions with landowners. In many cases, the land trust knows of local appraisers who have done previous work for the organization, or can ask other conservation organizations to recommend good appraisers in the area and then interview them and ask about their expertise. Reference can also be made to the Appraisal Institute of Canada's *Directory of Designated Members*, published annually.

[3] James L. Catterton, "Appraising Conservation Easement Gifts: a Primer for Landowners", Summer 1990 *Exchange* 4-7 at P.4, Reproduced in James L. Catterton, "Advanced Appraisal Issues" (Topic 6j), *National Rally '96 Workbook* (Washington, DC: Land Trust Alliance, 1996).

[4] James L. Catterton, note 3 above, at p.6.

[5] An appraiser may need help with identifying the existence, type, location, extent and significance of wetlands and other natural or cultural features affecting value, since they are not necessarily well-versed in these fields, but only in ascribing values once these features are known.

[6] National Trust for Historic Preservation and the Land Trust Alliance, *Appraising Easements: Guidelines for Valuation of Historic Preservation and Land Conservation Easements*, 2d ed. (Washington, D.C.: National Trust for Historic Preservation and the Land Trust Alliance, 1990), at p. 18. Also see USPAP Standard 2.

Appraisal costs will vary depending upon the detail and complexity of the transaction, the type and extent of land and buildings involved, and the availability of data to provide comparisons and calculations of value. The cost of an appraisal report prepared by an AACI accredited appraiser can range from $500 to perhaps $5,000 or more. While the land trust may wish to retain and direct the appraiser, the landowner might still be approached to pay for it by making a donation to the land trust. In some cases, the appraiser may be willing to be paid and then donate all or a portion of this fee back to the land trust.

The following outlines a recommended process for requesting appraisal services. Generally, at least two competitive bids should be solicited. Always discuss the appraiser's credentials and area of expertise before selecting an appraiser; this is especially important for appraisals of conservation agreements. Appraisers who have experience valuing expropriations, pipeline, or utility easements are familiar with the methodology required to appraise a conservation agreement (the "before and after" method). Often, experience costs more, and their bid may be higher than a competitor. Base the decision on which appraiser to use on all of these factors, not just the price.

Call the appraisers to be solicited, before sending out bids, to discuss the securement project and the appraiser's role (e.g., whether to determine the purchase price, value of a donation, value of a conservation easement, etc.). Ask if the appraisal can be completed within your estimated timelines, whether the appraiser offers discounts for charitable groups, how much time the appraiser will require to submit the bid, etc. The request for appraisal services can be faxed or e-mailed, with a hard copy following by mail, to speed up the selection process (for a model letter, see Appendices A and B). It is best to provide written authorization to proceed once the appraiser is selected. Notify the other appraisers in writing that while they were not selected this time, the land trust will keep their names on file for future projects.

Sometimes a full appraisal may not be required. An Opinion of Value is a less comprehensive analysis and is based on the person's detailed knowledge of the real estate market in the area or of the property. A land trust may choose to obtain an Opinion of Value in situations where:

- the value of the property is fairly low (for example, less than $25,000);
- minor changes in value must be taken into account for properties recently appraised (e.g., for a new use under a conservation easement);
- very similar properties are being considered in an area with an established and well-documented market;
- the appraiser has previously appraised the property;
- or the use of the Opinion of Value is for purposes which do not require a more detailed analysis of the property's value. An Opinion of Value is generally not used to substantiate a tax receipt.

Types of Persons Who Can Value Land

There are no specific requirements as to who can appraise property. So long as the data is supportable and the number is reasonable, people can conduct comparison sales research and determine the value themselves. However, having a professional designation carries more authority and credibility. Indeed, in tax appeals the tribunals have demonstrated their preference for appraisers who are expert in the particular interests and market under scrutiny. In an income tax appeal, the onus is on the taxpayer to prove that the Minister of National Revenue's valuation was incorrect.

For appraisals of gifts, Interpretation Bulletin IT-297R2 states:

> The person who determines the fair market value of the property must be competent and qualified to evaluate the particular property being transferred by way of a gift.[7]

Some real estate agents appraise the value of land, but the most qualified appraisers who are held to the highest professional standards are those who are full members of the Appraisal Institute of Canada and are designated as Accredited Appraiser Canadian Institute (AACI). Nonetheless, not every appraiser or member of AACI will be familiar with appraising conservation easements, life estates, or the local market, and thus a qualified, experienced appraiser should be sought.

If a property or interest such as a conservation easement is less than $1,000 in value, the appraisal can be carried out by the recipient land trust, and thus an independent person need not be hired.[8]

Nature Conservancy's Appraisal Thresholds

Nature Conservancy of Canada has adopted a policy with thresholds for determining whether an appraisal is required, and to what extent. These thresholds require an appraisal by an AACI-accredited professional in the following circumstances: for all properties and interests where an income tax receipt is to be issued; and where a purchase price or donated value is greater than $25,000. A second appraisal by an independent AACI-accredited appraiser is required for properties worth more than $1 million. An Opinion of Value from a local realtor may be used where the purchase price is likely to be less than $25,000.

[7] Revenue Canada, *Interpretation Bulletin IT-297R2*, para.6.

[8] Revenue Canada, "Gifts and Income Tax" (Who Should Appraise A Gift?), Publication P113(E) Rev. 96 1920, p.13.

Appraisal Approaches

The appraisal of the land's value, or a component such as a conservation easement, is an art practiced by following certain appraisal approaches. Different appraisers may come to different conclusions about a property's value using these approaches. This part of the chapter will introduce these approaches and emphasize the professional procedures and standards of the Appraisal Institute of Canada and the *Uniform Standards of Professional Appraisal Practice* (USPAP).[9] An appraisal by a qualified appraiser that follows such standards will be particularly important to substantiate claims to governments concerning income and property taxation.

Across North America, appraisers regularly use three traditional approaches to determining the market value of a property: the comparable sales, cost, and income approaches.[10] Each of these methods has its own strengths, weaknesses, and particular applications. An appraiser will determine the highest and best use for the property, then apply usually more than one of these approaches to a particular property, and then compare, appropriately weigh and reconcile the resulting values produced in order to report one final appraised value.

The **comparable sales** or market data approach examines recent sales of similar properties in the same or comparable markets as the land in question. This data may be available from property owners in the area, real estate brokers, lending institutions, declarations of value at title registry offices, property tax rolls, and appropriate land interest associations (e.g. farmers', hiking, or woodlot owners' associations). To compare properties, adjustments in value on a lump sum, per unit area or percentage basis can be made to take into account variations in comparable properties' characteristics. When making adjustments from comparable sales, it is important that the appraisal demonstrate that such factors were analyzed, that it focus on sales that were actually made (rather than on mere contracts or offers), and that comparable sales do not differ too greatly in price from the property under consideration. The comparable sales method is the most reliable approach when there are frequent sales and a well-established market for comparable properties, including those of somewhat superior and inferior quality.

The second method of valuing land, the **cost approach**, examines the cost to replace or reproduce the "improvements" on a site and adds to them the market value of the land. These improvements are usually structures, and thus this approach may not be very useful for open-space lands but could be important for buildings of historic or scenic interest.

[9] The Appraisal Foundation, *Uniform Standards of Professional Appraisal Practice* ("USPAP") (Washington, D.C.: The Appraisal Foundation, 1996), incorporating the 1996 USPAP Canadian Supplement provided by the Appraisal Institute of Canada.

[10] These three traditional approaches to value are reflected in the requirements to collect data under USPAP Standards Rule 1-4.

Third, the **income approach** involves an assessment of the net income that could be generated from a property, and reduces this amount to a present value using a discounting percentage. This approach is best applied to such properties as farms, resource or recreational lands, retail or commercial buildings, or rental dwellings, where income determinations are key and can be based upon reliable market data such as commodity production rates and prices, rents, occupancy rates, and operating expenses.[11]

Two methods can be used to calculate the tangible net income or return to the land under this approach.[12] The Cash Rental Approach analyzes cash rental rates paid for land. The more complex Build-Up Approach examines typical income potential (from crop rotations, yields, and commodity prices), minus variable and fixed expenses and management costs, to determine the net income. Accurate calculation and future projection of net income and determining an appropriate capitalization rate are two inherent yet challenging tasks using this method.[13] Thus, the income approach must be applied with care.

A fourth blend of the traditional cost and income approaches is the **subdivision or cost of development approach**. Here, the appraiser estimates all direct and indirect costs and entrepreneurial profit and deducts these from projected gross sales prices of finished lots for development.

4.1.2 Conservation Easements and Other Partial Land Interests

Over time, appraisal methodology has been developed and largely standardized; it applies to the estimate of the value of a conservation easement or other partial interest as much as it does to any other real property. Yet some adaptations or special considerations have been developed to deal with these interests. A brief overview is provided here.[14]

Appraising the value of a conservation easement remains difficult for several reasons. First, conservation easements are a new tool throughout Canada, and thus there are few examples of sold or donated easements, or lands subject to easements, with which to compare values. Second, easement terms will vary considerably depending upon the land's features, the extent of the restrictions, their effect on value, and owner and holder

[11] Lonnie Goldman, "Conservation Easement Appraisal Methodologies and Their Acceptance by the Courts", *The Back Forty*, Vol. 6(1), 1995, at p.5.

[12] Serecon Valuation and Agricultural Consulting Inc. (Edmonton), *Appraising a Conservancy Easement and a Profit à Prendre* (Stonewall, Manitoba: Ducks Unlimited Canada, 1995). at p.37. See also pages 14-20 which examine approaches to determining fixed costs and capitalization rates.

[13] Goldman, note 11 above, at p.5.

[14] For more detailed discussion, see: Ian Attridge, *Conservation Easement Valuation and Taxation in Canada* (Ottawa: North American Wetlands Conservation Council - Canada, 1997).

needs. Thus easements will be difficult to compare. Third, other interests (such as common law easements, covenants and leases, or utility rights-of-way) have often been used for different purposes with different conditions and value implications, thus frequently limiting their usefulness in providing comparable values. Fourth, and of considerable significance, there is rarely a conventional "market" for them, but rather easements are most often donated to governments or conservation charities. Finally, once easements are acquired, they are usually intended to be held in perpetuity and not subsequently transferred. As a consequence of these difficulties, appraisal methodology must be adapted to these circumstances.

The appraiser's analysis will necessarily pay careful attention to each of the terms in the conservation easement and their effects on value. Obviously, then, before obtaining a final appraisal, the negotiations with the landowner will need to progress to the point where the key components of the conservation covenant or easement are settled. The appraiser should also note the retained rights or what may be *allowed* by the easement, since this would accurately portray the manner in which the property would be marketed to potential buyers, with the seller or broker accentuating the positive.[15]

Because there is usually not a well-developed easement market to allow comparison sales, the indirect "before-and-after" method of determining value is often used. The before-and-after method is essentially two appraisals in one: it determines the value of the property before a conservation easement is put in place, and then assesses the value of the property subject to the easement. The difference is then taken to be the value of the easement itself. For each of the before and after values, the traditional approaches to appraising land are used.

In developing a real property appraisal, professional appraisers are directed to consider easements, restrictions, encumbrances, leases, reservations, covenants, contracts, declarations, special assessments, ordinances, or other items of a similar nature; [and] consider whether an appraised fractional interest, physical segment, or partial holding contributes pro rata to the value of the whole.[16]
Using the comparable sales method may be most appropriate for open space easements. While there may be limitations in direct comparison sales of easements, comparable sales with other physical or legal encumbrances can be used to estimate values of easement-encumbered lands. These restrictions can include rights-of-way, power line or other utility easements; lands with physical limitations due to topography, water supply, rockiness or flooding;[17] being landlocked or a poor configuration or size; or zoning, deed restrictions, and other legal controls which present similar constraints on development as those found in the easement's terms.

[15] Hancock, note 1 above.

[16] USPAP, Standards Rule 1-2, (c) and (d).

[17] While useful for comparisons, many physical constraints may not be permanent and can be overcome by current or future technology, whereas conservation easements are usually intended to be held in perpetuity. Brighton and Cable, at p.6.

In appraising an easement property, an appraiser must also consider any value enhancement or decrease that might occur on the "larger parcel," namely that portion of a property or properties with contiguity and unity of ownership and use. An easement on a portion of a larger parcel, or next to property owned by the same owner or her family, may enhance the value of this "larger parcel," such as by retaining open space, views, recreational access, privacy, and seclusion. It could also diminish the value by blocking access or utility easements, creating a nuisance from public access, or restricting some future use.[18] This is a particularly difficult and subjective aspect of the easement's value to assess.

Until 1997, there were some outstanding questions as to how conservation easements were to be valued for income tax purposes. The 1997 federal budget and later amendments proposed in 1999 have since clarified and simplified the method of determining the value of donated conservation easements. The legislation adopted the before-and-after method for those easements certified on ecologically sensitive lands. Note that other types of easements which are not ecological gifts (e.g., conservation easements on qualifying land but which are not donated through this program, or other types of easements for agricultural or heritage conservation purposes) will not have the benefit of these formal rules. It could well be argued that they should receive equivalent treatment, nonetheless.

As a rough estimate, a conservation easement may be worth between 25 to 50 per cent of the full title value. If public access is involved or there is a significant commercial resource base on the property that becomes restricted, the percentage may be much higher as a proportion of the full land value. Conversely, an easement on a part of a property or which mirrors current uses and restrictions may be worth a much smaller percentage.

It will be some time before the profession in Ontario becomes comfortable and experienced with appraising easements. Due to this limited experience with such specialized interests, a qualified appraiser to appraise the value of a conservation easement may be best found through recommendations from other conservation organizations and careful interviews.

4.2 Income Tax Considerations

A whole host of income tax considerations may affect a transaction in which a land trust is involved. Various creative arrangements for donating land may be attractive to the landowner or for the land trust to promote. In part, these may depend on whether the transaction is a true gift for income tax purposes. There are also substantial liabilities, such as capital gains tax, which are important considerations in dealing with land.

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[18] M. Eugene Hoffman, "Appraising Deductible Restrictions", in: Russell L. Benneman and Sarah M. Bates (eds.), *Land Saving Action* (Covelo, California: Island Press, 1984), p.203; and Catterton, note 3 above, at p.6.

Nonetheless, there may well be significant tax benefits from making donations, and thus landowners should be encouraged to explore tax issues early on in a transaction.

This chapter cannot hope to cover all of these issues and, in many cases, it is really the landowner's responsibility to deal with them. Accordingly, it is always wise to advise the other parties with whom you are dealing to get independent, professional advice about tax matters. If necessary, Revenue Canada can be approached to provide, for a fee, an advance tax ruling on a particular arrangement.

4.2.1 Characterizing Transactions: Gifts and Otherwise

Determining whether a particular transaction constitutes a gift or not has important implications for the donor and the land trust. For the donor, only the value of a true gift can be claimed for a tax credit or reduction. For the land trust, it can only issue a tax receipt for a true gift; it thus will usually seek to structure its transactions accordingly in order to provide this incentive to its donors. What technically constitutes a gift for income tax purposes is best explained through the following information, condensed from Revenue Canada's *Interpretation Bulletin IT-110R3.*

Generally, the term "gift" is not defined in the *Income Tax Act* and as such its common law definition is used. Thus, for purposes of sections 110.1 and 118.1 of the *Income Tax Act,* a gift is considered a voluntary transfer of property without valuable consideration. Generally a gift is made if all three of the conditions listed below are satisfied:

(a) some property is transferred by a donor to a registered charity;

(b) the transfer is voluntary; and

(c) the transfer is made without expectation of return. No benefit of any kind may be provided to the donor or to anyone designated by the donor, except where the benefit is of nominal value. A tax credit or tax deduction is not considered to be a benefit within this test.

There are certain exceptions and subtleties to this general rule. Generally, any legal obligation (such as a contract or condition of a governmental approval) on the payer to make a donation would cause the donation to lose its status as a gift. However, when a taxpayer honours a personal guarantee concerning a loan made to a charity or honours a pledge to make a donation, this act can be considered to be a gift if the obligation was entered into voluntarily and without tangible reward or "consideration." A charity also may not issue an official receipt for income tax purposes if the donor has directed the charity to give the funds to a nonqualified donee. For-profit organizations, individuals, and most foreign charities or foreign affiliates of Canadian charities are not qualified donees, and thus gifts directed to them are not eligible for an official receipt.

In some circumstances, a donor can both purchase something from a charity and make a gift (i.e. a bargain sale). There must be two separate transactions independent of each other. Where the donor can only purchase the item if a contribution is made, that contribution is not a gift and an official receipt may not be issued for it. Currently, the sale of property at less than fair market value is not considered a gift and must be structured in particular ways in order to qualify for a tax receipt (see the discussion of bargain sales in Section 2). The acceptable practice of using “split receipts,” being a receipt for the difference between the purchase price of a ticket to attend a "dinner, ball, concert or show" and the fair market value of the food or entertainment, is seen as one model for tax reform to streamline a bargain sale.

4.2.2 Capital Gains

The disposition of land, whether by sale, donation or conservation easement, by a private individual or corporation will likely involve tax considerations. Selling or donating capital property (such as most types of land) will be deemed a disposition under the *Income Tax Act (Canada)* (ITA, or the act) and therefore trigger capital gains tax liability for the landowner. With donations of land or conservation easements, capital gains tax may be a significant consideration as it can substantially erode the value of the tax credit or deduction. Where land is inventory of a business or an “adventure in the nature of trade” (such as property acquired by a real estate developer), then the property is considered inventory and not “capital” and is thus not subject to the capital gains rules described here.

Disposition of land by individuals may affect fixed income provisions, although with the sale of the land this may be less of an issue for vendors as they have received cash. Loss of fixed income to donors of land or conservation easements may, however, be a significant consideration. In all circumstances, land trusts should recommend that landowners seek independent tax and legal advice.

Capital gains are triggered whenever a capital asset, such as land, has appreciated (increased) in value over time and then are disposed of. Even when a property has been donated, the act treats it as a disposition of capital property at fair market value and the donor is subject to a capital gains tax. The gain is calculated based on the difference between the adjusted cost base (ACB) of the land and the proceeds of disposition (i.e., purchase price or value of the charitable receipt). The ACB is the value of the land as at December 31, 1971 (V-Day) or, if after V-Day, its value when acquired (generally, the price paid). The ACB also includes certain costs associated with the transaction or those for improving the property. Fifty per cent of the gain in value must be brought into income for the year of the disposition, usually resulting in tax payable.

An example of this type of calculation follows. Assuming a marginal tax bracket based on income level of 50 per cent, the current sale of a property for $100,000 with an original 1975 purchase price of $20,000 would result in the following capital gains tax:

Proceeds of disposition (sale price)	$100,000
Adjusted cost base (original purchase price)	$ 20,000
Capital gain ($100,000 - $20,000)	$ 80,000

Taxable capital gain (@50% inclusion rate)	$ 40,000
Tax payable (@50% combined tax rate)	$ 20,000

In a purchase scenario, this would mean that the vendor, for selling a $100,000 property, would be required to pay Revenue Canada $20,000 in income tax, but would net $80,000 in cash. Reducing the sale price (proceeds of disposition) will reduce the tax payable, but will also reduce the net cash received. If the property was donated to a land trust, the donor would still have to pay the $20,000 in tax (despite receiving no funds), but a tax receipt could be issued for $100,000 and used for claiming a tax credit or deduction (see the following section).

The current published interpretation by Revenue Canada regarding the calculation of capital gains tax on donations of conservation easements is that the entire value of an easement is deemed to be capital gain. However, this does not conform with Section 43 of the *Income Tax Act* which calls for a reasonable portion of the adjusted cost base for the whole capital property to be applied to a disposition of only part of the property. Accordingly, one is likely to succeed in arguing that the ACB of an easement is equal to the ACB of the whole property multiplied by the proportion of the entire property's current fair market value comprised by the easement. Thus, for a property worth $100,000 (FMV), originally acquired for $20,000 (ACB), and an easement valued at 60 per cent of the fee simple interest, the capital gain for the easement is: $60,000 - $12,000 = $48,000.

There are several means to reduce or adjust the capital gains tax payable on land, and a few will be noted here. One should always take a cautionary approach to tax planning and seek expert advice in doing so. First, a new formula in 1997 for calculating a tax credit ensures that a taxable capital gain will not overwhelm the tax credit for donors in the year of the donation. Second, for land gifts, the donor also has the option of claiming the gift at between the fair market value and the adjusted cost base. Thus, a donor can select the optimal value that represents lower capital gains and the correspondingly reduced value of the charitable tax receipt.

A third means to reduce capital gains is a person's principal residence which, if donated, is exempt from capital gains along with up to a half hectare (1.2 acres) of land surrounding it.

Fourth, certain other gifts can be totally exempt from capital gains or have received special capital gains treatment under Section 39(1)(a) of the *Income Tax Act*. Such properties include: certified cultural property (such as a building and the land immediately under it), a Canadian resource property, a foreign resource property, a timber resource property, a beneficiary's interest in a mining reclamation trust, as well as certain financial transactions such as life insurance, debt obligations and a financial institution's mark-to-market property disposition. These may become applicable in specialized situations, as defined in the act.

Fifth, new federal rules for donating publicly traded securities (such as shares) to charities reduce the tax payable by using a capital gains inclusion rate of only 37.5 per cent, rather than the standard 50 per cent rate. This opportunity may be useful to donors as an alternative to donating trade lands which a land trust would then resell. The donation of such shares in a company which holds lands may also be a creative way to transfer land ownership at a reduced capital gains rate. However, without a carefully structured transaction, this latter arrangement may attract the General Anti-Avoidance Rule in Section 245 of the *Income Tax Act*.

Sixth, owners of farm properties still have a lifetime capital gains exemption of $500,000 and thus can claim capital gains on a donation up to this amount as an exemption from taxation.

Seventh, in some transfers to family members (called a “roll-over”), farmers may be able to defer capital gains to the new owner so that the farmers do not pay the capital gains tax at the time of this transfer. This may increase the burden on the younger generation if they decide to sell the farm, but is an incentive for keeping the land in agricultural use. These methods of dealing with capital gains were intended for other purposes but may be considered in structuring a conservation transaction.

4.2.3 Donation Credits and Deductions

Most land trusts are registered charities and as such are exempt from federal income tax. Charities also have the ability to issue tax receipts to donors for gifts of property.[19] It is this latter ability which has encouraged donations of land and other property to charities. For example, a tax receipt can be given in each of the following circumstances where the donors:

- make a straightforward gift of land or a conservation easement;
- sell the land at full price, and then donate back some of the money (sometimes called a “bargain sale”; see Section 2.4.3 of this manual);
- give the land away, but reserve a “life estate,” meaning the landowners can continue to live on the property until they or specified family members die (see Section 2.4.2);
- give the property through a will rather than during their lifetime;
- donate land to the land trust, allow it to sell the property (perhaps after first protecting the land with a conservation easement), and then allow the group to use the proceeds for its conservation work (e.g. buying other land); or
- donate money, equipment, life insurance policies or other articles directly to the land trust to help with its conservation work.

Land trusts are often the most familiar with many of these techniques and can assist landowners with structuring other innovative arrangements.

[19] See the *Income Tax Act,* sections 110.1 (corporations) and 118.1 (individuals), for the detailed rules.

Changes to the *Income Tax Act* between 1995 and 1997 have allowed donors to claim the receipted value of their gifts against a larger portion of their annual income, increasing from the general limit of 20 per cent before to 75 per cent now. Where gifts are made of capital property such as land, the limit against which a tax credit may be claimed is the total of (a) 75 per cent of the donor's net income, plus (b) 25 per cent of the taxable capital gains, plus (c) 25 per cent of recapture of any capital cost allowance arising as a result of the gift (see Section 118.1(1) of the act). The 75 per cent net income limit is increased to 100 per cent for donations of "ecologically sensitive lands," where such lands are certified to contribute to the national environmental heritage by Environment Canada (see the following section).

When land or other property is given to a registered charity such as a land trust, the organization may issue the donor a one-time income tax receipt. The donor then attaches the receipt to their income tax return to substantiate a claim to a credit (for individuals) or deduction (for corporations) against their income tax. In appropriate circumstances, claiming such tax credits and deductions can result in significant benefits for donors.

For properties where capital gains tax is not an issue (e.g., they have not increased in value, have been recently purchased, or the owner has dealt with the gain through financial planning), generally the net value of the tax credit or deduction can be estimated at 50 per cent of the charitable receipt value. This is based on an average 50 per cent combined federal and provincial tax credits. Thus, a $100,000 gift of land would be worth $50,000 in tax savings to the donor. The resulting tax credit or deduction can be spread over a five-year period after the gift is made, until the value of the gift has been fully claimed. Any applicable capital gains liability would need to be subtracted to determine the net financial result of the donation.

4.2.4 Ecologically Sensitive Lands (Ecological Gifts)

In 1995, the federal government announced that for "ecologically sensitive lands" (also called "ecological gifts") the former 20 per cent annual income limit for claiming a gift's value for a charitable credit or deduction would be eliminated. This allowed donors of such lands to claim their charitable deduction against 100% of their income in the year of the gift and for a five-year carry-forward period after this. This partially removed a significant barrier to charitable gifts of land, as the previous 20 per cent of income limit usually resulted in capital gains tax payable in the year of donation. While capital gains tax may still be triggered on the donation of ecological gifts, no tax would now be payable by the donor since the capital gain is now offset by the charitable credit or deduction. Nonetheless, most ecological and other land gifts will still result in an economic loss to the donor compared with selling the property.

Ecological gifts must be certified by the federal Minister of Environment or a delegated authority of the minister. Also, any change in ownership or use of the donated property must be approved by the minister, otherwise a penalty equal to 50 per cent of its current value can be levied. In Ontario, this certification and approval authority has been given to the Ontario Regional Director of the Canadian Wildlife Service (CWS), currently Mr. Simon Llewellyn. No other organization has been delegated by the minister to certify ecological gifts in Ontario, although in rare circumstances a land trust could apply to the Director General of the Canadian Wildlife Service in Ottawa, currently Mr. David Brackett. The Ontario Ministry of Natural Resources and CWS have agreed on what specific categories of land qualify, as well as what other types of land might qualify as ecologically sensitive. These criteria can be found in Appendix 4C.

The certification process involves preparing background information on the property and a brief description of how it would meet the criteria noted above. This information is attached to the ecological gifts form, signed by both the land donor and the recipient donee organization, and then forwarded to the CWS Ontario Regional office in Toronto. The material is then assessed and a copy of the form is returned to the landowner to attach to their tax return, along with their donation receipt. The form and a detailed outline of the process are found at Appendices 4D and 4E. More detail on the program and Ontario criteria can be found in CWS's publication *Ecological Gifts: Implementing Provisions of the Income Tax Act of Canada*, by calling the program administrators, or on the program's website: www.ec.gc.ca/cws-scf/habitat/index_e.html.

4.2.5 Documentation Requirements and Penalties

Whether property is donated, purchased or sold, there are general rules for substantiating the value of property for income tax purposes. Certain penalties or other consequences can ensue should claims be unreasonable, and land trusts involved in conservation transactions need to be aware of such implications.

Reported values and calculations for property can be subject to audit and reassessment by Revenue Canada. Consequently, it is important to have sufficient evidence of property value and associated calculations prepared in advance of completing a tax return, such as by having a professional appraisal prepared. Where there has been a recent, previous purchase of property, this can be documented through agreements of purchase and sale or land transfer tax declarations from the time of purchase.
In order to obtain tax deductions or credits for donations under the ITA, proof of the gift must be made by filing a receipt containing prescribed information.[20] This information includes, for non-cash properties, the date the donation was received, a brief description of the property, and "the name and address of the appraiser of the property if an appraisal is done."[21]

A variety of consequences for misinterpreting or breaching income tax rules are specified in the *Income Tax Act*, and a comprehensive review of these is beyond the scope of this section. Nonetheless, a few should be highlighted. First and foremost for land trusts is that, as noted above, unauthorized changes in use or ownership of ecologically sensitive land donations can be subject to a penalty tax of 50 per cent of the current value of the land (see Section 207.31 of the act). Thus, seeking approval

[20] *Income Tax Act*, sections 110.1(2) and 118.1(2).
[21] *Income Tax Regulations*, C.R.C. 1978, c.945, paragraph 3501(1)(e.1).

from CWS for such changes is important. Such penalties also assure donors that there is a strong disincentive to inappropriate changes and that their lands will be supervised by a government agency.

Taxpayers who incorrectly determine or calculate their taxes can be reassessed or audited, bringing their affairs under close scrutiny. While ultimately it is the taxpayer's responsibility, donee organizations will want to assist donors in ensuring appropriate valuations and reporting of transactions. This will prevent any surprises of additional taxes for the taxpayer, and avoid resulting dissatisfaction with the donee organization and its conservation work.

In serious situations, the act provides for certain penalties. False or deceptive statements in a document, alteration or falsification of records, and willful evasion or attempt to evade payment of taxes, can result in fines of between 50 to 200 per cent of the tax sought to be evaded plus imprisonment for up to two (and, on indictment, five) years.[22] Where the nature of transactions (such as including over-inflated appraisals of donated property) ought to have alerted the taxpayer, this can be held to be evidence of gross negligence and absence of good faith, and thus merit the imposition of penalties of additional taxes.[23] In extraordinary situations of noncompliance with the act, charities could be deregistered and thus lose their tax-free and receipt-issuing privileges.[1] A 100 per cent tax penalty can be levied where a charity that is winding up does not dispose of its assets to a prescribed donee (generally, governments or other charities).

4.3 Property Tax Considerations

Property taxation is largely a provincial responsibility and is largely governed by the *Assessment Act*. With changes to property taxation in Ontario coming into effect in 1998, there are now new rules, procedures and a new agency (the Ontario Property Assessment Corporation). Fortunately, these changes provide several ways that annual property taxes can be reduced below ordinary rates. This is valuable knowledge for all landowners, both those with whom a land trust may be negotiating and also for the land trust itself. The property tax implications of certain types of owners and uses will affect the planning and structuring of securement transactions and thus are described in the following sections.

The traditional property tax system based on an assessor's determination of highest and best use (i.e., its potential likely use) creates the economic incentive and sometimes the

[22] *Income Tax Act*, subsections 239(1) and (2).
[23] *Arvisais v. M.N.R.* (1992), 93 D.T.C. 506 (T.C.C.). In this case, Mr. Arvisais and his family repeatedly purchased art works at 25 percent of their appraised and reported price, and then proceeded to donate them to art museums to obtain a charitable deduction. That he was a bank portfolio manager and thus informed and familiar with transactions, had sought advice only from his family rather than from independent sources, and had falsified the date of the reported purchase contributed to the court's finding of a lack of good faith and credibility.

necessity to develop properties. Particularly as near-urban areas begin to experience increasing development, property values will rise as assessors recognize potential higher prices and the likelihood of zoning changes to accommodate such uses. A landowner's personal income and revenue from the land may not have changed, but extrinsic forces and reassessments of such properties at new market values will put financial pressure on these taxpayers and can affect their ability to hold property in conservation uses. For example, landowners may be forced to pursue revenue-generating activities (e.g., forestry or housing development), with their often negative consequences for biodiversity, in order to meet high property tax levels. Also, where lands do not qualify for a specified category of conservation or other open-space use, private lands will often be assessed taxes at much higher residential or development rates.

To counter this pressure, the Ontario government provides exemptions and reductions in taxes to particular kinds of landowners and for certain types of lands (e.g., farms, forests. or those with conservation value). Formerly, people owning certain conservation, managed forest and farmlands received partial or full rebates on their property taxes. Now, if the land qualifies, the landowner can fill out an application to be placed in these lower tax categories and thus will not need to wait to get a rebate back. These benefits reflect the fact that these open-space lands contribute valuable public amenities on private lands, require little if any public services, reduce costly sprawl, and would be converted from such uses if they were taxed at development rates.

4.3.1 Property Tax Assessment System

Generally, the province assesses real property for property tax purposes on the basis of its market value, or a percentage thereof. This approach to valuation of land recognizes its potential use and value rather than just its worth in its present use. This is so particularly in an area experiencing expanding development.
Once the province has assessed the land's value and determined into which assessment category it belongs (e.g., farmland, residential, or commercial), then a mill rate (a small fraction of a per cent) is calculated by all authorities that can levy property tax (generally, lower and upper-tier municipalities and school boards). The mill rate is set at a level that allows the taxing authority to meet its approved budget when applied to all types of assessment categories and the value of land within each category. A landowner will receive a tax assessment notice regarding the land's value and assessment class from the Ontario Property Assessment Corporation, and later a tax bill from the municipality which applies the applicable mill rates to the assessed value to determine the total annual property tax payable.

The assessed fair market value of property will reflect its "highest and best use," namely the most profitable, likely and legal use, assuming that a prospective purchaser is prepared to pay for the property's potential value. Use of this basis for comparing and assessing properties has the advantage of creating a uniform standard and thus equity among taxpayers, although in practice this is not always followed and some legislation provides for preferential treatment in certain circumstances. The determination of fair market value follows the three methodologies outlined in the earlier appraisal section, although the use of a computer-based regression analysis of properties in an area, based on a number of factors, is now the standard practice. The Supreme Court of Canada has also endorsed standard practice by accepting a recent open sale of the property or recent open sales of identical properties in the same neighbourhood and market.

If a landowner disagrees with the assessment of a property, they can first informally discuss the matter with the regional assessment office; second, ask for an official reconsideration by that office; and third, if this is not satisfactory, appeal the assessment. During the transition period under the new property tax system, there is a substantial backlog in dealing with these appeals. If there is a default in paying property taxes, the municipality may sell the land to recapture these taxes, subject to elaborate procedures. Under the *Municipal Tax Sales Act*, the municipality has the choice of whether to have a tax sale or not.

4.3.2 Conservation Land Tax Incentive Program

Lands designated as “conservation lands” under the Conservation Land Tax Incentive Program (CLTIP) are now totally exempt from property tax and are also assessed at a value that roughly represents their “current use” (usually as farmland) rather than their fair market value. These lands are the most environmentally important in the province: Escarpment Natural Areas zoned as such in the Niagara Escarpment Plan, provincially significant wetlands (classes 1-3), provincially significant Areas of Natural and Scientific Interest (ANSI), the habitat of endangered species, and lands owned by nonprofit conservation groups which contribute to provincial conservation and natural heritage program objectives. The latter Other Conservation Lands category is particularly relevant for land trusts and is the only one not determined simply by the designation of provincially significant habitat by the provincial government. Note that a conservation easement on a property generally does not, in itself, create entitlement to this program.

The Ministry of Natural Resources identifies which lands qualify for each of the categories under CLTIP. Properties with eligible conservation land greater than 0.2 hectare (i.e., a half acre) in size are eligible for the program. This area does not include 0.4 hectare (one acre) assigned to any structure on site. For all but Other Conservation Lands, qualifying landowners will be notified by the Ministry of Municipal Affairs and will be provided with the appropriate forms to submit for the program. Each year, landowners must indicate some general information on the forms and agree to maintain the land under the terms of the program and allow MNR inspectors to enter onto the land to determine the land is being so maintained. The forms must be submitted by August 31 of each year.

Conservation organizations with new properties must obtain the appropriate forms and approvals in order to add them under the Other Conservation Lands program; the Ministry of Municipal Affairs will only provide notification and forms for properties already in the program. MNR staff began a review of the Other Conservation Lands category in the spring of 1998 and proposed cancelling the category as one option. To date, while not formally taking a decision, the ministry has nonetheless changed this program by not accepting new properties. While it looks optimistic that the category will be reinstated in some form, this has not yet occurred due to limited staffing and other priorities. Consequently, only properties which qualified for the program in 1997 will continue to qualify, unless properties can qualify under one of the alternative conservation land categories or other programs. Land trusts may be able to apply for their other lands once the MNR makes a decision, but when and how this will be done and under what process for dealing with taxes already paid is not yet apparent.

4.3.3 Managed Forest Tax Incentive Program

Managed forests under the Managed Forest Tax Incentive Program are assessed at 25 per cent of residential rates and at a value reflecting local farm values. To qualify, the forested area of a property must cover at least four hectares (about ten acres) and be managed for one or more of conservation, recreation, forest product, or other accepted purposes. Generally, one acre will be subtracted from the eligible area for any building on the property, as will substantial clearings which are not part of the plan. Land must be owned by a Canadian citizen, a permanent resident, or a Canadian corporation, partnership or trust, or a conservation authority. Golf courses, campgrounds, ski hills and other such businesses may have their forests qualify if the plan contributes to the overall forest health, the commercial operation does not fragment the forest, and it does not intend to expand into the forest in the future. Land is not eligible if it is subject to a registered plan of subdivision, is licensed or zoned for aggregate extraction, or is owned by a municipal, provincial, or federal government that pays grants in lieu of taxes. Land with too small a density or size of tree may also not qualify, and thus determining the stocking of trees on a property is an important step in preparing the management plan.

Getting a management plan prepared and reviewed is a core part of the program. A detailed guide[24] provides substantial information on how landowners can prepare a plan, or else landowners can hire persons to prepare the plans on their behalf. The plan is then sent to a Managed Forest Plan Approver in the area (the MNR can provide a list of plan approvers), who reviews and approves the documentation for a fee and then forwards the package by August 31 to either the Ontario Woodlot Association or the Ontario Forestry Association. These organizations then forward the information to the provincial ministries. Landowners prepare a management plan every five years but must send in an Annual Renewal Card each year indicating any changes to the eligible area and other requested information. An audit must be done by a different Managed Forest Plan Approver at the end of that five year period, when the land is sold, or when the landowner leaves the program.

[24] Ministry of Natural Resources, *A Guide to ... The Managed Forest Tax Incentive Program (MFTIP)* (Peterborough, Ontario: Ministry of Natural Resources, 1998). Updated versions of this Guide are expected in subsequent years.

4.3.4 Farm Tax Incentive Program

Under the Farm Tax Incentive Program, qualifying farmlands will also be assessed at 25 per cent of residential rates and at farm values. The program does not require any management plan, and thus is preferred by some landowners over the MFTIP or even CLTIP programs.

To qualify, land must be classified as “farmland” by the regional assessment office and the owner or renter of the land must make at least $7,000 from the farm and have a farm business registration number. Persons may also qualify if they earn less than $7,000, under certain conditions. These conditions are, first, if they did earn this amount during the past ten years but have since retired or have fallen ill, or second, they can demonstrate a plan to eventually earn this amount under the “Start-A-Farm” program.

4.3.5 Other Tax Reduction Opportunities

Other lands may also qualify locally for lower or current use assessment, or for tax deferrals or rebates to charities. For example, some local municipalities have decided that a rebate of property taxes in some instances is appropriate. This allows more subtlety than the provincial programs by providing special recognition and relief for certain types of lands or ownership.

A few other categories of land receive enhanced property tax benefits under the *Assessment Act*. These include tax exemptions for lands used for particular educational, hospital, religious, cemetery, Boy Scouts and Girl Guides, agricultural society, battle site commemoration, and relief of the poor purposes. Some government agencies, such as the Ontario Heritage Foundation and Royal Botanical Gardens, are exempted from property taxation in their founding legislation. Understanding which organizations have these special situations may help tailor a transaction to determine who should retain or own a conservation property. Up to eight hectares (twenty acres) of land used for forestry purposes on a farm can also be exempt from property tax.

4.3.6 Property Taxation for Conservation Easements

When a conservation covenant or easement is placed on a lot, property values on-site and nearby may go up or down, depending upon the buyer and upon the particular local situation. Generally, it will restrict the types of uses allowed for a certain property, and this will usually alter the "highest and best use" that is legally possible on that property, often resulting in a lower property value. The extent of the reduction in value would correspond to the degree of restriction on uses of the property, the easement's terms, and the property's particular characteristics. Any reduction in the property's value may provide grounds for a landowner's request for reassessment or an appeal according to the property's new market value. However, the result of this approach is unclear, given the uncertain language used in the legislation, as described below.

The terms used in the *Assessment Act* for similar interests contemplate only common law easements and equitable covenants, i.e., those requiring appurtenant (nearby) lands:

> Where an easement is appurtenant to any land, it shall be assessed in connection with and as part of the land at the added value it gives to the land as the dominant tenement, and the assessment of the land that, as the servient tenement, is subject to the easement shall be reduced accordingly.[25]

Regarding a related aspect, if a landowner defaults in paying property taxes, a municipality usually may sell the land to recapture these taxes, subject to elaborate procedures. The *Municipal Tax Sales Act* provides that land sold for arrears in taxes will not affect easements or covenants attached to the land.[26] However, this is again phrased within the language of common law easements and equitable covenants and their associated requirements to have nearby land.

The authorizing legislation for most conservation easements in Ontario deems these interests to be restrictive covenants.[27] Therefore statutory interpretation may bring such conservation easements within the scope of the assessment and tax sales provisions. While this may benefit easement use and landowners generally, it does not assist assessors with the mechanics, since there is no property to which to assign and assess the value of the easement.

There is little case law on the interpretation of these easement assessment provisions, and most cases do not directly consider the issues of concern here. While the cases are limited and at times quite old, such treatment by these tribunals demonstrates a reluctance to apply the law in a manner that reduces assessment for lands subject to easements. In practice, some properties with development restrictions have, upon appeal, received a generic 50 per cent reduction in assessment. Further, a landowner can provide particulars and obtain a letter from a municipality indicating there are limitations on development for the parcel, which can then be provided to the regional assessment office for consideration.

With untested statutory interpretation required, little guidance otherwise from the case law, and only administrative practice to rely upon, the property taxation of conservation easements remains somewhat uncertain. Consequently, most conservation easement documents will require the landowner to continue to pay all property or other taxes for the land. However, where there are opportunities to reduce the property taxes on the property once a conservation easement is in place, the land trust may wish to help the landowner obtain these benefits.

[25] *Assessment Act*, R.S.O. 1990, c.A.31, s.9(1). A restrictive covenant running with the land is also deemed to be an easement within the meaning of this section; see subsection 9(2).

[26] For example, the *Municipal Tax Sales Act*, R.S.O. 1990, c.M.60, s.9(5).

[27] *Conservation Land Act*, R.S.O. 1990, c.C.28, s.3(10).

Properties with a conservation covenant or easement may qualify for preferential assessment or tax reduction under the incentive programs noted earlier, especially if they meet the program's criteria independently of the easement. The Ontario government's position on whether conservation covenants or easements would qualify for CLTIP has yet to be established, although they did qualify under the predecessor program. Nonetheless, the tax reduction programs are generally based on outright ownership, not on partial interests, and may not encompass such arrangements in the future.

The impact of conservation covenants and easements on property taxation is uncertain for both individual and neighbouring properties and depends upon numerous factors. Restricting the uses on the property may cause one buyer to pay a lower price, while another buyer may feel that the protection of the attributes on the property itself or nearby is in fact an asset and may be willing to pay market rates or a slight premium for the property. If a series of easements protect the scenic, environmental, or recreational aspects of a community, then this may increase the value of all the lots in that area. The zoning of the land will also affect property values; if a conservation easement merely duplicates existing zoning provisions or still allows some development, the impact on property and assessment values will likely be negligible. Further, open-space uses have been shown to require less public servicing. Protecting such uses through a conservation easement thus may help reduce a municipality's overall tax expenditures. These issues are further discussed in the next section.

4.3.7 Economic Benefits From Tax Reductions

Lands that qualify in these conservation, managed forest, and farm land categories contribute to the health and rural character of communities. However, the impact of conservation on property taxation and municipal finance is understandably a concern of increasingly stretched municipal governments and taxpayers for two reasons: in the short term, land protection may result in land value being removed from the tax rolls and the taxes then are shifted to other taxpayers; and in the long term, protected land cannot be developed into something which would pay more taxes than open space; for example, a commercial business, which would help reduce other taxpayers' bills.[28] Land trusts and landowners participating in these tax reduction programs may become involved in discussions about these concerns and thus some background and perspectives are provided here.

The value of the land will relate to patterns of buyer preference, the value of protecting existing amenities, and the availability of similar amenities nearby. In reality, protecting a few parcels of land will likely redirect rather than preclude development, thereby influencing its pattern and location rather than its amount or type.[29]

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[28] Deb Brighton and Judy Cooper, *The Effect of Land Conservation on Property Tax Bills in Six Vermont Towns* (Montpellier VT: Vermont Land Trust, 1994), at p.1.

[29] Brighton and Cooper, note 29 above, at p.21.

Conserving land produces various environmental, aesthetic, and recreational benefits which are regularly used to market properties and are well known to raise property values and assessment.[30] As ex-urbanites take an interest in certain areas, many will value the long-term security of preserved amenities, privacy, views, access to trails and hunting, and reduced possibilities of development and disturbance next door. Maintaining open space allows farmers to continue farming; doing so may decrease nearby subdivision and development that affects viable farm size, a rural economy, and complaints about traditional farm practices by newcomers. Farmers and other resource producers also may be able to use conservation securement to gain industry certification and resulting premium market access and prices.

Besides possible contribution to higher assessment values and thus revenues for municipalities, conservation can also help reduce municipal costs. Securement of lands can restrict and avoid development pressures and demands, thus reducing tendencies toward urban sprawl and associated infrastructure and servicing costs. In many cases this must accompany increased densities within existing urban areas, made more palatable and attractive by planning for accessible green space nearby.

In Ontario, the 1996 *Report of the Greater Toronto Area Task Force* made the case that $1 billion each year could be saved in this region if development was made more compact.[31] Several U.S. studies have demonstrated that controlling diffuse development with its expensive infrastructure and servicing costs is actually more cost effective for a municipality and its taxpayers than is unbridled development.[32] The use of conservation techniques is now being funding by numerous state and local governments in the U.S. in order to protect important community assets and avoid the consequences of urban sprawl. As one example, in 1998 New Jersey authorized the spending of $98 million each year for thirty years for this purpose.

In general, tax bills are higher—not lower—in towns with more people and in towns with more commercial/industrial development. It may be just as accurate to look at land conservation as protecting the town from development, which is expensive to service, as it is to look at conservation as precluding development, which would bring in tax revenues.[33]

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[30] For example, U.S. National Park Service, *Economic Impacts of Protecting Rivers, Trails, and Greenway Corridors: a Resource Book*, 4th Ed., (Washington, DC: National Park Service, Rivers, Trails and Conservation Assistance, 1995); Land Trust Alliance, *Economic Benefits of Land Protection* (Washington, DC: Land Trust Alliance, 1994); Steve Lerner and William Poole, *The Economic Benefits of Parks and Open Space* (San Francisco, CA, Trust for Public Lands, 1999).

[31] Greater Toronto Area Task Force, *Greater Toronto* (1996, Publications Ontario, Toronto), at p.112; also see Pamela Blais, “The Economics of Urban Form”, prepared as a background paper to the *Greater Toronto* report and appended to it on disk.

[32] See, for example, the various Costs of Community Studies conducted by the American Farmland Trust of Washington, DC.

[33] Brighton and Cooper, at p.21.

In summary, protected or nearby lands may increase in value, they will remain as open space to provide amenities for the community, and they will help avoid costly public servicing. Property tax implications for municipal treasuries are likely to be small. As a result,

> The conclusion of the report is not that towns should discourage growth and development. Rather, townspeople should make decisions about where development and conservation take place based on their goals and vision for the future of their communities—not on perceptions of property tax impacts.[34]

4.4 Other Tax Considerations

4.4.1 Goods and Services Tax

On January 1, 1991, the Goods and Services Tax (GST) replaced the Federal Sales Tax. The GST applies, at a rate of 7 per cent, to the supply of the vast majority of goods and services consumed in Canada. It is thus relevant to properties owned by land trusts and those they might acquire.

Certain goods and services are designated as zero-rated or exempt, including:
- long-term residential rents and sales of used housing;
- most supplies by charities;
- certain supplies by nonprofit organizations, etc.

Conservation authorities, as key partners for land trusts, need to provide a declaration that they perform municipal functions in order to be exempt from the tax.

Charities may claim a rebate of 50 per cent of GST payable. Where payable, the GST is therefore calculated at 3.5 per cent (i.e., 50 per cent of 7 per cent). Certain goods and services that charities provide are also exempt from GST, including:

- licences or short-term leases of real property (e.g., hall, basement, or office rentals) and property or services provided in conjunction with these licences or leases (e.g., audio-visual equipment);
- parking spaces;
- property or services that a caterer provides under contract for an event or occasion;
- admissions to fundraising events such as dinners, balls, and concerts when part of the payment represents an amount for which the charity can issue an official donation receipt for income tax purposes;

[34] Brighton and Cooper, at pp.9 and 21 (emphasis in the original).

- and rights entitling children under 15 to supervision or instruction in recreational or athletic activities.

With respect to the purchase of land by a land trust, the following types of property are exempt:

(a) A long-term residential rent;
(b) The sale of used residential housing that has not been substantially renovated;
(c) The sale of personal-use land by an individual or trust;
(d) The sale of farmland to a related individual who will be utilizing the lands and premises for personal use;
(e) The sale of real property by a charity, nonprofit organization, or other public service organization.

Exemption (c) is most often the situation with respect to a land trust's purchases. One needs to have information on the type of owner and land use, read the definitions and review the exemptions, determine who has responsibility for collecting and reporting tax as well as the documentation needed to support the transaction.

Note that donations of land or conservation easements are not subject to GST since there is no payment or consideration. Purchases of commercial, corporate, or holding company lands are subject to GST, calculated at 3.5 per cent of the purchase price.

Prior to completion of any purchase, the land trust should require that a GST Certificate be prepared and signed by the vendor. The general form of the Certificate is found in Appendix 4F.

4.4.2 Land Transfer Tax

Where land is sold or otherwise transferred, it is subject to a tax under the *Land Transfer Tax Act* based upon the declared value of the transaction. Where there is a donation of property, there is no payment to the seller and thus no land transfer tax is due. Governments are not required to pay this tax.

Land transfer tax will be payable on purchases of land by the land trust. The amount of tax payable is calculated as follows:

First $55,000 of purchase price	0.5%
Next $195,000 of purchase price	1.0%
Next $150,000 of purchase price	1.5%
In excess of $400,000[35]	2.0%

[35] This applies to residential land with one, but not more than two, single family residences.

If a restriction like a conservation easement is placed on a property, this may reduce the value of the retained title. This decreased value can also reduce land transfer tax once the property is sold. A conservation easement may also increase the value of neighbouring properties, affecting future land transfer taxes.

4.4.3 Probate Fees/Tax

Probate fees are the fees charged by a court for granting "probate" of a will or to approve the administration of a person's estate where there is no will. Based upon the total value of the estate, the current probate fee is $5 per $1,000 of property up to the first $50,000, and then $15 per $1,000 above the $50,000 threshold. This "fee" has been converted from a fee into a tax in order to comply with a recent court decision.

The impact of probate fees is a factor in any land transaction taking place by means of a will or administering a person's estate. Land trusts need to be aware of these implications and in some cases can help landowners fulfill their plans to reduce these fees. One reduction opportunity arises with a conservation easement granted through a will. It may lower the value of the property, thus reducing the value of the estate subject to probate fees upon the owner's death. Another alternative is joint ownership, since when one joint tenant dies, the property automatically becomes owned by the other joint tenant(s) and thus is not part of the first person's estate. Other probate fee planning opportunities may take advantage of the fact that debts on real estate (but not other debts) are deducted from the value of the estate for probate fee purposes, and some assets such as life insurance and RRSPs can designate beneficiaries other than the person's estate. While these may be means to avoid probate fees, they may have other income, property, land transfer, or other financial or personal implications. Accordingly, careful consideration, planning, and advice for the entire estate is strongly recommended.

4.5 U.S. Residents and Land

4.5.1 Tax Considerations

When a U.S. citizen (or Canadian nonresident) wishes to donate Canadian real property to a land trust, they usually do so with the intent of being able to claim a charitable deduction on their U.S. income tax return. Article XXI, paragraph 5 of the Canada-U.S. Tax Convention provides that "contributions by a citizen or resident of the United States to an organization which is resident in Canada, which is generally exempt from Canadian tax and which could qualify in the United States to receive deductible contributions if it were resident in the United States, shall be treated as charitable contributions." The contributions, however, would be applied against the individual's Canadian source income. In other words, if the U.S. resident does not have an income in Canada, there is no benefit derived from the charitable gift.

For those U.S. residents who do not have a Canadian source income, the alternative is for them to donate the Canadian real property to a U.S. charitable organization with the intent that title then will be transferred to a Canadian land trust. This is a significant motivator for nonresidents to donate their Canadian real property. By donating the property to a U.S. organization, it is ensured that their gift can be applied as a deduction against their U.S. income tax. However, there are complex taxation matters associated with this type of transaction, which will be discussed further in this section. Thus the donor is encouraged to seek independent advice prior to considering the donation, so that they are aware of the implications.

The process for accepting a donation of Canadian real property from a Canadian nonresident does not differ that much, in the initial stages, from a Canadian resident donation, except that the donation must be made to a U.S. charitable organization. In general, the process for a fee simple donation by a nonresident is made through the cooperation of The Nature Conservancy (TNC) in the U.S. This assumes that TNC is prepared to assist in this capacity, which is usually the case if the land has some demonstrated environmental importance and this can be documented to TNC. The process involves the following:

- the nonresident provides a letter of intent to donate to TNC;
- the land trust confirms that the property meets its criteria, and then provides a natural features summary report to TNC;
- a preliminary title search is conducted, with the land trust providing a copy of the search report to TNC;
- an environmental assessment is conducted, with the land trust providing a copy of the assessment report to TNC;
- if required, a survey is completed by the donor;
- a market value appraisal is then conducted by the donor (within sixty days of transfer);
- a Transfer/Deed of Land is prepared for the donor to transfer the property to TNC; and
- TNC later transfers the property to the land trust, sometimes restricting the land's future use to conservation purposes in order to meet its U.S. federal tax and charity responsibilities.

No later than ten days after the date of the disposition, the donor must provide Revenue Canada with form number T2062, *Request by a Non-Resident of Canada for a Certificate of Compliance Related to the Disposition of Taxable Canadian Property* (see Appendix 4G).

To avoid or limit capital gains for a donation of property, the *Income Tax Act* under Section 118.1(6) allows for the donor to designate a value of the property at disposition other than the actual fair market value. A nonresident may also designate the value of the gifted property, provided that the gift was made to a "prescribed donee" (currently the only prescribed donee is The Nature Conservancy). TNC provides an undertaking to the Minister of National Revenue to the effect that the property will be held for use in the public interest (see Appendix H). The nonresident must file a Canadian income tax return for the year in which the disposition was made. If the donor is able to designate the lower value of the gifted property, they are able to avoid the capital gain, yet the full market value of the gift may still be claimed for U.S. tax deduction purposes.

4.5.2 Limitations on Carrying Out Certain Transactions

Besides income tax, there are other considerations in cross-border transactions, both for the donor and the land trust. These include:

- Are there state, provincial or internal organizational rules against holding land outside of the national or sub-national jurisdiction? For example, the Maine Coast Heritage Trust's by-laws restrict it to acquiring lands within the State of Maine. As well, certain agencies and their authorizing legislation may only enable acquisition of land within the jurisdiction or a defined area or mandate.

- Is the donor a corporation with a corporate relationship in the other country, which would allow particular opportunities to structure tax and ownership arrangements? The complexities of international corporate structures cannot be addressed here, except to note that different structures and relationships will result in varying tax consequences and flexibility.

- Who will have local supervision and management responsibilities during the period when The Nature Conservancy has ownership (sometimes two or more years)?

These and other factors will be important to consider when planning a transaction involving nonresidents.

4.6 Additional Reading and References

"Advanced Appraisal Issues" (Topic 6j), in: *National Rally '96 Workbook*, James L. Catterton, Land Trust Alliance, Washington DC, 1996.

“Canada and the U.S.: Cross-Border Donations and Taxes” (Topic IO), in: *National Land Trust Rally ‘96 Workbook*, Ian Attridge, Land Trust Alliance, Washington DC, 1996.

Conservation Easement Valuation and Taxation in Canada, Ian Attridge, North American Wetlands Conservation Council - Canada, Ottawa, 1997.

Deductible Gifts and Official Donation Receipts, Revenue Canada, Interpretation Bulletin IT-110R2, 1989.

Ecological Gifts: Implementing Provisions of the Income Tax Act of Canada, Canadian Wildlife Service, Ottawa, 1998.

Economic Benefits of Land Protection, Land Trust Alliance, Washington DC, 1994.

The Economic Benefits of Parks and Open Space, Steve Lerner and William Poole, Trust for Public Lands, San Francisco CA, 1999.

Economic Impacts of Protecting Rivers, Trails, and Greenway Corridors: a Resource Book, 4th Ed., U.S. National Park Service - Rivers, Trails and Conservation Assistance, Washington DC, 1995.

Gifts in Kind to Charity and Others, Revenue Canada, Interpretation Bulletin IT-297R2, 1990.

A Guide to ... The Managed Forest Tax Incentive Program (MFTIP), Ontario Ministry of Natural Resources, Peterborough, Ontario, 1998.

You Can't Give It Away: Tax Aspects of Ecologically Sensitive Lands, Mark Denhez, North American Wetlands Conservation Council - Canada, Ottawa, 1992.

4.7 List of Appendices

4A Purchase or Fee Simple Donation - Request for Appraisal Services

4B Conservation Easement - Request for Appraisal Services

4C Ecological Gifts (Ontario) Criteria

4D Ecological Gifts Form and Information Guidance

4E Ecological Gifts (Ontario) Process

4F GST Certificate

4G Revenue Canada Form T2062, *Non-Resident Compliance With Canadian Property Disposition*

4H Form of Undertaking for Prescribed Donee