Tax Incentives for Making Donations to Park and Recreation Agencies

John L. Crompton

Abstract: Financial incentives are provided by federal and state governments to encourage the donation of park and open space land. These incentives stem primarily from three elements of the federal tax structure: the income tax, the capital gains tax, and the inheritance tax. The paper explains the implications of these three taxes. The income tax and capital gains tax are most likely to be prominent considerations in the donation decisions of both individuals and business enterprises, while the inheritance tax is often a central influence in decisions to donate conservation easements.

Keywords: donations, federal income tax, capital gains tax, inheritance tax, parks, open space, conservation easements.

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The purpose of this paper is to discuss and illustrate the tax benefits that accrue from making various types of donations. The tax laws are invariably a consideration in potential donation decisions, and in some instances they are the central determining factor in the final donation decision. However, it is also recognized that the donation of park and open space land to a public agency so others may enjoy access to it, has some obvious appeals beyond tax considerations to those who are in a position to be philanthropic. These include:

- People associate parks and open space with permanence. They are forever, unlike buildings which have a more finite life. A gift of a park or open space is a lasting legacy, which will benefit a donor’s descendants along with other future visitors.
- Some of the donor’s finest life experiences may have taken place in parks. These moments become cherished memories which many people would like to sustain.
- Most park agencies have a positive public image. People feel they are accountable and will deal honorably with their donations.
Hence, there has been a long tradition of donation support for public recreation and park services in the United States. In 1929 the National Recreation Association published a report resulting from a survey of 1000 towns and cities which stated that nearly one-third of the total municipal park acreage in 1925-26 had been donated (Cited in Huus, 1935, p. 43). Similarly, the author of one of the earliest texts in the parks and recreation field observed:

Private initiative and generosity have always played an important part in furthering the progress of municipal recreation. In the earlier period, private philanthropy in this field found it necessary not only to provide areas but also the means for their operation. Now that cities are assuming the responsibility for recreation needs and can generally be counted on for maintenance funds, the field remains open for the financially more significant, and personally more appealing gifts of lands, buildings, swimming pools and other specialized projects. The size and number of these gifts within recent years show how attractive this means of expression is to wealthy and civic-minded persons (Huus, 1935, p.63).

As the field evolved to become a service which residents expected government to provide, the perceived civic imperative for donors to contribute declined. Bonds, redeemed by taxes, emerged as the standard mechanism for securing park and open space land. However, donations have remained an important supplementary source for acquisition of these resources. In communities in which there is resistance to passing bond issues, donations become especially important.

In recent decades, the notion of noblesse oblige which motivated much early donation behavior has increasingly been supplemented by financial incentives provided by federal and state governments. These incentives stem primarily from three elements of the federal tax structure: The income tax, the capital gains tax, and the inheritance tax.

If park and recreation managers are to be effective in soliciting donations of land or easements, then there has to be some understanding of these tax laws. Even those donors whose primary motives are altruistic, are likely to seek maximum tax benefits from their donations. Hence, taxes are a factor that park and recreation agency managers cannot responsibly ignore. The central principle of the discussion of tax structure and tax benefits in this paper is the notion of net cost. This recognizes that the amount of money in which a seller is interested is not the selling price, but rather the amount realized from the sale after expenses and taxes.

It is beyond the scope of this paper to go into the tax structure in great detail because while recreation and park managers should be well informed on the issue, they do not need to be experts. Their task is to identify potential donors and then to alert them to some of the tax principles that may make it advantageous for them to donate. If interest is aroused, then the donor should be counseled to retain a tax expert to recommend how the donation should be structured to the donor’s best advantage. Thus,
what is presented here is a simplified discussion of the tax laws, which are complex and constantly changing.

The key motive underlying donations is philanthropy, which literally means "affection for mankind." Thus, the only value which is supposed to accrue to the donor is the satisfaction of knowing that good is being done with the donated resources. Philanthropic donations are considered to be altruistic rather than commercial, since they are concerned with humanistic or community concerns rather than with a commercial return on the investment. Hence, the tax rules deny tax deductions to a donor if there is a quid pro quo, i.e. the donation must not result in personal benefit measurable in money to the donor. Psychic benefits are permitted, even where they are substantial. For example, if a park is named after the donor, the personal satisfaction received from the donation may be very high, but the benefit is not measurable in "money or money's worth" by the Internal Revenue Service (I.R.S.), so a tax deduction would be permitted. In contrast, if a donation of park land was made by a developer to a jurisdiction in order to secure a change in zoning, approval of a subdivision, or some other act that financially benefited the developer in a tangible way, or where the donation enhanced the value of the developer's remaining property, then tax deductions would not be permitted because there was a quid pro quo.

While this conceptual distinction is clear, it is sometimes difficult to ascertain in a specific context. The effective, operational determination of whether land or a conservation easement contributed by an individual or company to a park and recreation agency is classified as a donation is made by the I.R.S. If the I.R.S. rules that a giver receives a tangible, measurable, economic benefit from the contribution, then it is classified as an investment undertaken for commercial advantage and is not eligible for a tax write-off. In contrast, if the benefits are perceived to be intangible and emotional, and not measurable, then the contribution is considered to be a philanthropic donation and eligible for the associated tax deduction.

The paper first discusses tax incentives available to individuals who donate land for a park or open space. The focus then shifts to business enterprises where, although there are some similarities with the incentives influencing individuals, there are also important differences. In both these cases, the charitable contribution rules that permit deductions to the donor from income tax and the capital gains tax are likely to be the most prominent influences. The last section of the paper discusses donations of conservation easements, and the central tax influence in these cases is likely to be the inheritance tax.

Incentives to Individual Donors of Land

The income tax laws offer an incentive for individuals to make a donation to a public recreation and park agency or qualified 501(c)(iii) non-profit organization, because such donations are fully deductible up to 30% of an individual's adjusted gross income per year. Adjusted gross
income is a federal income tax term which is defined as a taxpayer’s annual
gross income from all sources, minus certain allowable deductions. One of
the allowable deductions is for gifts made to government or qualified non-
profit organizations. The deduction permitted for a gift is equal to the full
fair market value of the donation. If the value of the donation exceeds 30%
of adjusted gross income, the excess may be carried over and deducted over
the next five years until it is used up.

| Table 1 |
| Federal Income Tax Rates |
| Tax Rate | Single Person Income ($'s) | Married Individuals Filing Joint Return Income ($'s) |
| Increment | Cumulative | Increment | Cumulative |
| 15% | <22,100 | <36,900 |
| 28% | 31,400 | 53,500 | 52,250 | 89,150 |
| 31% | 65,500 | 115,000 | 50,850 | 140,000 |
| 36% | 135,000 | 250,000 | 110,000 | 250,000 |
| 39.6% | >250,000 | >250,000 |

| Table 2 |
| Federal Income Tax Implications of a $20,000 Donation For a Single Individual with a $70,000 Adjusted Gross Income |
| Tax Paid if a Donation of $20,000 is Made | Tax Paid if no Donation is Made |
| Tax Rate | Tax Bracket | Taxes Paid | Tax Bracket | Taxes Paid |
| 15% | <$22,100 | $3,315 | <$22,100 | $3,315 |
| 28% | $22,100-$50,000 | $7,812 | $22,100-$53,500 | $8,792 |
| 31% | | | $53,500-$70,000 | $5,115 |
| TOTAL TAXES PAID | $11,127 | $17,222 |

The value of a donation deduction to an individual will depend upon
the magnitude of his or her annual adjusted gross income. The federal
income tax rates that currently prevail are shown in Table 1. The Table
indicates that a single person whose adjusted gross income was $70,000
would be taxed at a rate of 15% on the first $22,100, 28% on the amount
between $22,100 and $53,500, and 31% on the income between $53,500
and $70,000. If a donation valued at $20,000 was made by this individual,
then he or she would pay less tax because the adjusted gross income would
be reduced by the donation deduction from $70,000 to $50,000. Table 2
illustrates the tax benefits from this donation. Without the donation, the
individual’s federal income tax bill is $17,222. However, when the $20,000
donation is deducted from the $70,000 adjusted gross income, the tax bill
is $11,127. Thus, the “tax write-off” of $20,000 results in a tax saving of $6,095 ($17,222-11,127). The net cost to the taxpayer of the $20,000 donation, therefore, would be $13,905 ($20,000 minus $6,095). Table 1 shows that tax rates increase with adjusted income growth, so that at the highest rate (39.6%), a $20,000 donation made by those with an adjusted gross income over $250,000 would receive a tax deduction of $7,880 so the net cost to the individual of making the donation would be $12,120.

A second relevant tax to individual donors is the long-term capital gains tax. This tax is applied to any capital asset which has been held for a period of more than one year. Long-term capital gain is defined as the difference between the cost associated with acquiring the asset and the income accruing from its sale. The maximum rate of capital gains tax for an individual is 28% (as compared to the maximum income tax rate of 39.6% on “ordinary” income). If an asset has been held for a period of one year or less (i.e. short-term), then the income is considered to be part of an individual’s annual ordinary gross income and is taxed at the regular income tax rate.

Ownership of a parcel of land can be conceptualized as a “bundle of rights.” These include such elements as the right to sell or bequeath the land, the right to keep others off it, the right to use it for farming, ranching, recreation, or timber production, the right to extract minerals from it, and the right to erect buildings and other structures upon it. Taken together, all rights constitute the property in “fee simple”. If a landowner wishes to dispose of a property in fee simple in the near future, there are three alternative strategies he or she could pursue. The financial implications of each of these strategies are summarized in the hypothetical case shown in Figure 1 (Hutton, 1996).

First, the land could be sold at fair market value. The market price is anticipated to be $750,000, but to sell the property the landowner would hire a real estate broker who would claim 10% commission on the sale. Long-term capital gains tax is levied on the difference between the cost paid for the asset and the net sales price realized, which in this illustration is $525,000. After Federal and State long-term capital gain taxes have been applied, the landowner retains $350,000 from the profit on the land sale. In addition, he or she retains the cost basis amount which was deducted to calculate the capital gain. Thus, the landowner’s after-tax overall proceeds from the sale are $500,000.

A bargain sale is a sale of property in which the amount of the sale’s proceeds is less than the property’s fair market value. When a bargain sale is made to a government agency or a qualified non-profit organization, the excess of the fair market value of the property over the sale price represents a donation to the organization (Abbin et al, 1995). Each part of a bargain sale is reported separately according to its tax consequences. Thus, the donor reports both a sale and a contribution.
Figure 1
Implications of an Individual Selling Land at Fair Market Value, Negotiating a Bargain Sale, or Making and Outright Donation

The following illustrations are based on four assumptions:

1) The landowner is in the highest income tax bracket;
2) The landowner is committed to disposing of 300 acres of potentially attractive park land which has appreciated in value from $500 per acre to $2,500 per acre since it was purchased 20 years ago;
3) The federal long-term capital gain tax is 28% and that there is also a state long-term capital gain tax of (say) 5.33%;
4) A dollar in year 1 is worth more than a dollar in year 2 and 3, but to simplify the exposition these calculations do not consider the net present value of money.

SALE AT FAIR MARKET VALUE

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling Price (300 acres x $2,500)</td>
<td>$750,000</td>
</tr>
<tr>
<td>Less Broker’s Commission at 10%</td>
<td>75,000</td>
</tr>
<tr>
<td>Net Selling Price</td>
<td>675,000</td>
</tr>
<tr>
<td>Less Cost Basis (300 acres x $500 original purchase price)</td>
<td>150,000</td>
</tr>
<tr>
<td>Long Term Capital Gain</td>
<td>525,000</td>
</tr>
<tr>
<td>Federal and state long-term capital gain taxes at 33 1/3%</td>
<td>175,000</td>
</tr>
<tr>
<td>Amount left over after levying the tax</td>
<td>350,000</td>
</tr>
<tr>
<td>Plus Cost Basis</td>
<td>150,000</td>
</tr>
<tr>
<td><strong>Overall Proceeds</strong></td>
<td><strong>500,000</strong></td>
</tr>
</tbody>
</table>

BARGAIN SALE (SELL AT 60% OF FAIR MARKET VALUE, DONATE 40%)

The 60% Sale

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling Price (180 acres x $2,5000)</td>
<td>$450,000</td>
</tr>
<tr>
<td>Less Cost Basis (180 acres x $500)</td>
<td>90,000</td>
</tr>
<tr>
<td>Long-term capital gain</td>
<td>360,000</td>
</tr>
<tr>
<td>Federal and state long-term capital gain taxes at 33 1/3%</td>
<td>120,000</td>
</tr>
<tr>
<td>Amount left over after levying the tax</td>
<td>240,000</td>
</tr>
<tr>
<td>Plus Cost Basis</td>
<td>90,000</td>
</tr>
<tr>
<td>Proceeds from 60% sale</td>
<td>330,000</td>
</tr>
</tbody>
</table>

The 40% Donation (120 acres valued at $300,000)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted gross income of the landowner</td>
<td>860,000</td>
</tr>
<tr>
<td>Maximum donation deduction permitted in Year 1 ($860,000 x 30%)</td>
<td>258,000</td>
</tr>
<tr>
<td>Value of Year 1 income tax deduction (Federal income tax at 39.6% and state income tax at (say) 5.4% = 45% of $258,000 applied on Year 1)</td>
<td>116,100</td>
</tr>
<tr>
<td>Value of Year 2 income tax deduction (45% of $42,000) ignoring time value of money</td>
<td>18,900</td>
</tr>
<tr>
<td><strong>Overall Proceeds</strong></td>
<td><strong>465,000</strong></td>
</tr>
</tbody>
</table>

OUTRIGHT DONATION

45% of $750,000

Given an adjusted gross income of 860,000 and the 30% limitation, this amount would be deducted over a three year period.

The bargain sale illustration in Figure 1 assumes a selling price which is 60% of fair market value. Often land is donated or offered as a bargain sale because its owners are good stewards of the land and want to see it retained for conservation purposes. In other instances, the bargain sale approach is used because it offers tax advantages. For tax purposes, the property is assumed to be divided into two sections. In this illustration, the first section of 180 acres (60% of 300 acres) is treated as if it were being sold at fair market value, while the second section of 120 acres is treated as a donation. The sale price of the 180 acres is $450,000. Since it is really the whole 300 acres that is being sold for this price, and the sale is being negotiated with a park and recreation agency, no real estate broker is needed and no commission is paid. The law requires that the cost basis of bargain sale property must be allocated between the sale and donation elements of the transaction (Abbin et al, 1995). Thus, only the cost basis of 180 acres can be used in calculating the long-term capital gain in the illustration in Figure 1. After the long-term capital gains tax has been paid and the cost basis added back into the proceeds, $330,000 accrues from the 60% sale of property.

The donation segment of the bargain sale was valued at $300,000 (40% of $750,000). However only 30% of the adjusted gross income can be deducted in a year ($258,000), so some of the deduction has to be carried forward to year 2. With an adjusted gross income of $860,000, the landowner is in the highest federal income tax bracket of 39.6%. Most states also levy a state income tax and the rates for this vary widely across states. To simplify the arithmetic used in the illustration, a state income tax of 5.4% has been assumed. By being permitted to deduct the $258,000, the landowner pays the 45% total income tax only on $602,000 of income instead of the $860,000, resulting in a savings of $116,100 in year 1. A similar deduction process in year 2 using the remainder of the $300,000 donation, results in savings for that year of $18,900. Thus, after-tax overall proceeds accruing to the landowner from both the sale and donation components of the bargain sale are $465,000.

The third strategy which a landowner could use is to make an outright donation. Given the landowner’s adjusted gross income, the most that can be donated in any one year is $258,000, so the deduction for a $750,000 donation would have to be spread over three years. At the end of that period, the landowner would be able to retain $337,500 which would have been paid in income tax if a donation had not been made.

The difference between a sale at fair market value and the overall proceeds that would accrue to the landowner from the other two strategies should be viewed as the real “cost” of making the donation (Hutton, 1996). The illustrations in Figure 1 indicate that if the landowner proceeds with an outright gift, then the income foregone compared to the bargain sale and fair market value sale options is $35,000 and $162,500, respectively. However, if the landowner elects to receive these additional financial amounts, then it will cost the park and recreation agency $450,000 or
$750,000, respectively, to acquire this park land. These large amounts to be paid by the agency are likely to be acquired only after great effort from public bond referenda, foundation grants, fund-raising or wherever, and it is unfortunate that such scarce resources have to be used to provide such relatively small incremental returns to the landowner. Given this situation, and the landowner's relatively high adjusted gross income, he or she may be persuaded to offer the outright donation, even though it entails some loss of income. In addition, a strong emotional appeal may be made to the landowner on the basis that if he or she pays capital gain and income tax they go to Washington D.C., but if a donation is made then the public in the local area will be the beneficiaries.

Tax structures are created by federal and state legislatures and, thus, are subject to frequent adjustments. These adjustments may substantially impact the incentive to donate. For example, the highest federal income tax rate shown in Table 1 is 39.6%, but in 1980 the highest federal rate was 70%. If the 70% federal rate and 5% state rate are used in the Bargain Sale and Outright Donation illustrations given in Figure 1, then the overall proceeds from these options would have been $525,000 and $562,500, respectively. At that rate, it would clearly be more financially advantageous to the landowner to make an outright donation, than to try to sell it in whole or in part. When tax rates fall the financial incentive to donate is reduced, whereas when they are raised the incentive to donate is increased. This maxim applies equally to the long-term capital gain tax as it does to the income tax.

If a decision has been made to make a donation of property which has highly appreciated and is subject to long-term capital gain tax, then the donor should donate the property rather than donate the proceeds from its sale. If it is sold, then the owner is required to pay the long-term capital gain tax. Thus, the remaining proceeds when donated will be reduced by this amount, which means the magnitude of the income tax donation is reduced by that amount. In contrast, if the property itself is donated the owner does not have to pay long-term capital gain tax, so the net value of the donation is higher as is the consequent tax deduction for which the donor is eligible.

Two limitations associated with the income tax deduction should be noted (Browne, 1984). First, such deductions are only useful if an individual has income to shelter with them, otherwise they have no value. Thus, for example, the donation of attractive ranch land appropriate for park use is often not feasible, because many ranchers have little or no taxable income to shelter with the donation deduction. Second, it has been suggested that an inequity of the deductions is that the U.S. Treasury (federal taxpayers), in essence, pays more (through the deductions offered) for a piece of land which is owned by an affluent landowner, than it would if the same piece of land was in the hands of a lower bracket landowner (Browne, 1984). There is no rational reason why there should be different payments by taxpayers for the same piece of land.
The tax laws help park and recreation managers to define those in their community who are most likely to be potential donors. Their characteristics are likely to include:

- They are good stewards of their property, are concerned for its welfare, and seek perpetuation of its existing state. Usually they have lived on it for many years.
- Philanthropic capability, that is, they have enough money to take advantage of the tax advantages afforded to donors of gifts to a public agency.
- No significant heir or heirs are interested in taking over the property.
- A substantial time period has elapsed since the property was purchased, so its value has appreciated substantially from what the landowner paid for it. Under these conditions a landowner is likely to receive substantial tax benefits for donating the property.

**Incentives To Business Donors Of Land**

Like individuals, corporations are required to pay federal income taxes on their net income. This tax is also levied by some states. However, the tax implications vary according to whether the corporate entity is an S corporation or a C corporation. S corporations are limited to having no more than 75 shareholders and these S corporations do not directly pay income taxes. Rather the income gains or losses and taxes are computed at the corporate level, but passed through to the shareholders and reported by them as individuals according to their proportional share ownership. Thus, any deduction from a charitable donation would be passed through to the shareholders.

This section of the paper focuses on the tax implications for C corporations because they do pay income taxes directly. Whereas for individuals the maximum tax rate on capital gains is lower than the top rate of income tax on ordinary income (28% compared to 39.6%), the long-term capital gains of corporations are taxable at the same rate as their ordinary income. The rates range from 15% on taxable income under $50,000, through 34% on amounts over $75,000 and 39% on amounts from $100,000 to $350,000, to 35% on income over $10 million. Again, these are substantially lower rates than those prevailing in 1980, so the tax incentives for major corporations to donate appreciated land for park use have been reduced during the past two decades. A corporation can deduct the value of donations up to 10% of its taxable income (before the dividends received deduction and the charitable contribution deduction). Amounts exceeding this can be carried forward for five years.

The example in Figure 2 illustrates the different outcomes to a C corporation of selling an appreciated property at fair market value, negotiating a bargain sale, or making an outright donation (Hutton, 1996). A comparison of the overall proceeds from each of the three scenarios in Figure 2 suggests that it is most advantageous for the company to proceed
Implications of a Corporation Selling Land at Fair Market Value, Negotiating a Bargain Sale, or Making an Outright Donation

The following illustrations are based on four assumptions:

1) The corporation is a C corporation (not an S corporation).
2) The corporation is in the 35% federal income tax bracket and is also in a state which levies a corporate income tax of 5%.
3) The corporation is committed to disposing of 100 acres of potentially attractive park land which has appreciated in value from $2,000 per acre to $12,000 per acre since it was purchased 30 years ago.

### SALE AT FAIR MARKET VALUE

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling price</td>
<td>$1,200,000</td>
</tr>
<tr>
<td>Less broker commission at 10%</td>
<td>$120,000</td>
</tr>
<tr>
<td></td>
<td>$1,080,000</td>
</tr>
<tr>
<td>Less cost basis</td>
<td>$200,000</td>
</tr>
<tr>
<td></td>
<td>$880,000</td>
</tr>
<tr>
<td>Long-term capital gain at 35% federal rate</td>
<td>$308,000</td>
</tr>
<tr>
<td>5% state rate</td>
<td>$44,000</td>
</tr>
<tr>
<td>Left over after paying long-term capital gain tax</td>
<td>$528,000</td>
</tr>
<tr>
<td>Plus cost basis</td>
<td>$200,000</td>
</tr>
<tr>
<td><strong>Overall Proceeds</strong></td>
<td><strong>$728,000</strong></td>
</tr>
</tbody>
</table>

### BARGAIN SALE (SELL AT 50% OF FAIR MARKET VALUE, DONATE 50%)

**The 50% Sale**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling price (50 acres @ $12,000)</td>
<td>$600,000</td>
</tr>
<tr>
<td>Less cost basis (50 acres @ $2,000)</td>
<td>$100,000</td>
</tr>
<tr>
<td>Long-term capital gain</td>
<td>$500,000</td>
</tr>
<tr>
<td>Federal and state capital gain taxes @40%</td>
<td>$200,000</td>
</tr>
<tr>
<td>Amount left over after LTCG Tax</td>
<td>$300,000</td>
</tr>
<tr>
<td>Plus cost basis</td>
<td>$100,000</td>
</tr>
<tr>
<td>Proceeds from the 50% sale</td>
<td>$400,000</td>
</tr>
</tbody>
</table>

**The 50% Donation**

600,000 x 40% income tax deduction

**Overall Proceeds**

240,000

**OUTRIGHT DONATION**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>40% of $1,200,000: <strong>Overall Proceeds</strong></td>
<td><strong>$480,000</strong></td>
</tr>
</tbody>
</table>

with a fair market sale. However, there are three factors which may persuade
the company to pursue one of the other two options.

First, the differences in overall proceeds between the fair market price,
and the bargain sale and outright donation are $88,000 and $248,000,
respectively. On a property valued at $1.2 million a major company may
regard the potential positive public relations to be worth the income
foregone. For example, St. Joe Mineral Corporation, which is a large
mining company listed on the New York Stock Exchange, donated a 9,000
acre strip-mined area to Missouri State Parks valued at $1.8 million.
Although the calculations showed that donation of the land, compared to
a sale at fair market value, cost St. Joe a little over $170,000, the company
considered this a reasonable price to pay for the considerable amount of
favorable publicity which the donation yielded (Howard & Crompton,
1980).

Second, opting for the bargain sale alternative costs the company only
$88,000, but it saves the public agency $600,000. Similarly, the $248,000
donation cost to the company is relatively small compared to the $1.2
million price the agency would have to pay for a fair market purchase
(Hutton, 1996). The cost to the company is so much lower than the burden
that would be incurred by the community’s taxpayers to acquire this
property, that the company may be persuaded this is a situation in which it
should demonstrate its commitment to being a good corporate citizen in
the community.

Third, as part of the company’s income, the $728,000 overall proceeds
from the fair market value sale, presumably will be distributed in the form
of dividends to the company’s shareholders. If these shareholders are
themselves in the highest individual income tax bracket (39.6 % Federal
income tax and (say) 5.4% state income tax), then a further $327,000 will
be paid in income taxes, leaving only $401,000 in the shareholder’s pockets
from this $1.2 million property sale. (Of course, this amount will be higher
if the shareholders are in a lower marginal income tax bracket, and if the
state does not levy an income tax). The corporation may regard this so-
called “double tax effect” as confiscatory and opt instead for the donation,
since the net return is now less than would accrue from an outright
donation (Hutton, 1996).

**Tax Deductions for Surplus Property and Inventory**

Much of the incentive for donating real estate is provided by the
charitable contribution rules that allow for deduction of capital gains tax on
appreciated property. However, there are at least three situations in which
companies may wish to donate park land, recreation facilities, or equipment
where capital gains tax on appreciated property is not the primary motive.

First, legislation may have been passed which rendered the property
useless for the purpose for which it was originally purchased. For example,
with the passing of the Flood Plains Act, limiting federal insurance
protection in those areas, or on lands subjected to protective wetlands
legislation, some developers could no longer pursue their intent to build.
In some cases, developers recognized that a donation would relieve them of having to pay property taxes and provide tax relief on their other income. Hence, they approached public recreation and park agencies offering the land as a donation.

Second, the donation may occur after completion of a development. Often a developer uses recreation amenities such as a golf course, marina, or ski-slope, as a central loss-leader attraction. This serves to increase surrounding land values and provide a distinctive marketing theme around which to promote the development. After completion, the recreation component may be donated to a public agency, since this relieves the developer of property taxes and maintenance responsibilities. However, agencies are increasingly resistant to these types of donations, arguing that the property should stay on the tax roll and maintenance be the responsibility of the homeowner’s association.

Third, if corporations donate equipment from current unsold inventory then they are permitted to deduct more than its cost. They can take a “stepped-up” deduction, which equals the cost of making the product plus half the difference between its retail price and its cost. For example, if they donate an item that cost $50 to manufacture and sells for $100, they can deduct $75 (Steckel & Simons, 1992). In addition, there are inventory control benefits. Donating products to a park and recreation agency can save a company warehousing costs as well as inventory carrying costs, and can help a company dispose of out-of-date products without destroying them (Steckel & Simons, 1992).

Incentives to Donate Conservation Easements

Conservation easements are negative easements under which a landowner agrees to conserve the resource by giving up development rights on it, and/or the right to remove vegetation or add building extensions. The revision of the federal tax laws in 1980, provided more incentives for landowners to consider using easements. The use of conservation easements is increasing exponentially as the advantages become familiar to a larger number of attorneys, land use planners and landowners. It has been noted that, “The conservation easement is no longer an interesting notion or an innovative idea. It is a proven, pragmatic, voluntary land-saving technique that is powerfully resonant with our dual traditions of individual responsibility and community action” (Stokes & Watson, 1989 p.60). In the last decade, over 1.5 million acres of land has been placed in easements by public agencies, and a similar amount by Land Trusts. The Maryland Environmental Trust alone, has negotiated over 300 easements in the past decade.

The financial gains landowners realize from the way that the tax laws treat easement transactions, often accrue without them really giving up anything. The landowner may continue to use the land in the way it has always been used. An easement will reduce market value to the extent that it limits a property’s development and use potential. Its financial value is
equal to the difference between the fair market value of the property it encumbers before the granting of the restriction, and the fair market value of the encumbered property after the easement is granted.

Financial benefits from a conservation easement agreement may accrue to the landowner from three sources. First, if a perpetual easement is donated to a public agency or tax-exempt organization "exclusively for conservation purposes," then a charitable donation equal to the value of the easement may be claimed. This could be used as a deduction against state and federal income taxes. Easement donations are treated in a similar way to the donation of property in fee simple which was discussed earlier in the paper. "Conservation purposes" must meet one of the following four tests defined by the IRS (Diehl & Barrett, 1988):

1. Preservation of land areas for outdoor recreation by, or for the education of, the general public. This category inevitably requires public access, which many landowners have no interest in permitting.
2. Protection of relatively natural habitats of fish, wildlife, or plants, or similar ecosystems.
3. Preservation of open space—including farm land and forest land for scenic enjoyment or pursuant to an adopted governmental conservation policy; in either case, such open space preservation must yield a significant public benefit.
4. Preservation of historically important land areas or buildings.

Most landowners do not offer public access, and are not concerned with habitat protection or with historical preservation, so it is the open space standard (the third test listed above) that is the most frequently used criterion. In urban contexts "scenic enjoyment" may be difficult to establish, so the primary test is frequently: "Is the easement donation furthering clearly delineated government policy?" If a government agency accepts an easement, then it is ipso facto likely to be considered by the IRS to be a donation consistent with government policy.

The income tax deduction financial benefit is increasingly being used by "Conservation Easement Buyers." These individuals purchase a property as a second home because of its hunting, fishing or other recreational amenities, and immediately donate a conservation easement on it giving up development rights. The effect is to substantially reduce the purchase price. For example, a wealthy individual from a major city may pay $5 million to purchase a ranch which she intends to use for hunting, fishing and other recreational purposes. She is in the highest federal income tax bracket (39.6%) and state income tax bracket (5.4%). If the easement is valued at $2 million, then she will receive a 45% write-off on her income tax in that year, i.e. $900,000 for donating it. In essence, this has lowered the purchase price to $4.1 million. Since the major attraction in purchasing the property was its recreational attributes, the easement is unlikely to substantially adversely affect its long term future sale price.
A second financial benefit stems from an easement agreement reducing a property's value, because it no longer has development potential. Land cannot be taxed for a use that the property owner cannot legally perform. Thus, the property's assessed valuation for tax purposes will be commensurably lower. This will result in a landowner paying less property taxes than would have been paid before the easement agreement.

A reduction in estate (inheritance) taxes is a third source of potential financial benefit to a landowner. Estate taxes are imposed on the value of the deceased’s property based on its “highest and best use” at the time of the owner’s death. Thus, for example, the estate taxes on a 600-acre property consisting of visually attractive mountain pasture, may reflect the value of 60 ten-acre ranchettes that could be constructed on it rather than its existing use value as a recreational retreat. Like the income tax, the estate tax is progressive and cumulative. Federal law grants an exemption of $600,000 for inheritance taxes to each taxpayer. This credit applies to all transfers including those made as gifts during life, not only to transfers occurring after death. Above that amount, however, the tax rate rapidly rises from a minimum level of 37% to a high marginal rate of 55% which is applied when estates reach a value of $3 million and above.

In addition, 17 states impose a separate inheritance tax and in some instances (for example, New York State) the tax is based on the entire amount of the property. The heirs of a $600,000 estate in these 17 states, in addition to their federal obligation, would owe state governments amounts ranging from $5,900 in Nebraska to $55,000 in Massachusetts. However, in all jurisdictions, an inheritance of a $2 million estate would pay at least $588,000 in taxes; a $2.5 million estate creates federal inheritance taxes of no less than $833,000; and on a $5 million estate, no less than $2.198 million is due in taxes. These large tax amounts must be paid within nine months of the death of the estate owner (Small, 1992). Faced with a tax demand of this magnitude to be raised in such a short period of time, heirs may have no choice but to sell the property to pay inheritance taxes. If a perpetual easement preventing development of the property was in place, then its value would be much lower. This may enable heirs to continue their preferred lifestyle of ranching and preserve the aesthetic beauty of the site for the general public. A hypothetical illustration of the effect of donating a conservation easement is given in Figure 3.

A superior alternative solution for the Smiths to that described in Figure 3, would be for them to donate a conservation easement on 80% of their property (320 acres) which would reduce its value to $2 million, but retain development rights on four 20 acre lots. These could then be sold as ranchettes for (say) $300,000 each. These lots would be carefully sited so they did not mar the viewscape from the state park. Thus, when the Smiths die, their total estate would be valued at $3 million. Federal inheritance taxes on it would be slightly more than $1.1 million, which could be paid by the sale of the four ranchettes for $1.2 million (Small, 1992).
Beautiful Ranch is a 400-acre property located adjacent to a state park. It is scenic and is an important part of the viewscape for visitors to the state park. The current owners are Joe and Ethel Smith, who are both over 70 years old. When they die, they want their son and his family to be able to continue to live on Beautiful Ranch. The market value of the ranch if it is sold for development has been assessed at $4 million; and the Smiths have another $1 million invested in the stock market. Thus, when they die, their estate will be valued at $5 million.

Their son would be required to pay federal inheritance tax on this $5 million which, assuming the ranch is in a state which has no additional state inheritance tax, would amount to almost $2.2 million. Even after selling the $1 million worth of stock investments, he would still have to raise $1.2 million within 9 months, making it probable that he would have to sell the ranch to raise the money needed to pay the inheritance tax bill.

If the Smiths donated a perpetual conservation easement to the state which forever prohibited future development, then the market value of the land would fall substantially to $1.5 million. Thus, when the Smiths die, their total estate would be valued at $2.5 million rather than $5 million, and the inheritance tax would be $833,000 rather than $2.2 million. Since this could be paid out of the stock investments, it would mean their son and his family could continue to live on Beautiful Ranch.

It is unlikely that younger people would resort to an easement if their motive was to reduce inheritance taxes, because the Congress may change the inheritance tax rate at some future date. Thus, for example, if the tax-free limit was raised to $1 million and the maximum inheritance tax rate was reduced to 20%, then the incentive to donate a conservation easement may disappear. However, the average age of a majority of rural landowners is 60 and in the next two decades tens of millions of acres will change hands, and potentially change use:

When you consider the advancing age of the principal private landowners in this country along with the often staggering amount of estate tax that might be owed on their property, it becomes absolutely clear that millions of acres of open space, wildlife habitat, farmland, forestland, watershed, and ranchland are at risk over the next few decades (Small, 1996, p.14).

Concluding Comments

Private support for public park and recreation services is not new. However, in the past, contributions often were forthcoming on the initiative of the donors. What is now evolving is a deliberate effort by agencies to counter budget cuts and enhance park and recreation services through developing organized solicitations. The onus is on the park and
recreation manager to assume the entrepreneurial posture which has traditionally been associated with leadership in the commercial sector. Contributions used to come into the field randomly, like leaves falling off a tree. Today, the park and recreation manager has to shake the tree and try to direct the contributions to fall into this field rather than another.

This discussion has focussed on tax incentives for donations, but it is recognized that some donations are made by people in the recreation and parks field who receive relatively little tax benefit. Indeed, several of the illustrations in this paper indicate that even where individual donors do receive a substantial tax deduction, they rarely get back in value what they donate. Some people are motivated by guilt; others simply desire to “do good”; while for some it is a way to “leave a mark.” Some people have special emotional reasons for wishing to contribute to public park and recreation services, for example, a memorial to a deceased parent.

Similarly, the motives underlying corporate donations involve much more than tax incentives. Corporate donations reflect “enlightened self-interest” in which corporations seek to enhance their positions in the marketplace and their profitability through donations they make. The officers of a corporation have no mandate to give away their stockholders’ money. Rather, their charge is to invest company resources in a way which optimizes the return to stockholders on their investment.

Thus, recreation and park managers are confronted with two challenges when engaging in an informed donation solicitation effort. One is to find the *quid pro quo*, that is, to answer the question, “What’s in it for the individual or business?”, but the second which is of equal importance is to have a conceptual grasp of available tax incentives. Without such a grasp, the manager is not likely to be in a position to identify, understand and interpret donation opportunities or the responses to a solicitation approach.

References


