

**ANALYSIS OF AMENDED BILL**

Author: Berryhill and Evans Analyst: Victoria Favorito Bill Number: AB 454  
 Related Bills: See Legislative History Telephone: 845-3825 Amended Date: March 29, 2007  
 Attorney: Pat Kusiak Sponsor: \_\_\_\_\_

**SUBJECT:** Charitable Contribution Deduction/Qualified Conservation Contributions/Conformity

**SUMMARY**

This bill would allow a deduction for a charitable contribution of a qualified conservation easement for individuals and corporations.

**SUMMARY OF AMENDMENTS**

The March 29, 2007 amendments deleted the provisions relating to the Taxpayers' Rights Advocate and inserted provisions relating to the federal qualified conservation easement contribution deduction.

This is the department's first analysis of the bill.

**PURPOSE OF THE BILL**

According to the author's office, the purpose of the bill is to conform California law to the recently enacted federal law, allowing a deduction for charitable contribution of a qualified conservation easement.

**EFFECTIVE/OPERATIVE DATE**

As a tax levy, this bill would go into effect immediately and apply to contributions, as specified, made on or after January 1, 2007.

**POSITION**

Pending.

**Summary of Suggested Amendments**

Technical amendments are necessary and are provided. Department personnel are available to work with the author to resolve any other issues that arise as the bill moves through the legislative process.

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## **ANALYSIS**

### FEDERAL/STATE LAW

#### Current Federal Law

In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. The amount of deduction generally equals the fair market value of the contributed property on the date of the contribution. Charitable deductions are provided for income, estate, and gift tax purposes.<sup>1</sup>

In general, in any taxable year, charitable contributions by a corporation are not deductible to the extent the aggregate contributions exceed 10% of the corporation's taxable income, computed without regard to net operating or capital loss carrybacks. For individuals, the amount deductible is a percentage of the taxpayer's contribution base, which is the taxpayer's adjusted gross income computed without regard to any net operating loss carryback. The applicable percentage of the contribution base varies depending on the type of donee organization and property contributed. Cash contributions of an individual taxpayer to public charities, private operating foundations, and certain types of private nonoperating foundations may not exceed 50% of the taxpayer's contribution base. Cash contributions to private foundations and certain other organizations generally may be deducted up to 30% of the taxpayer's contribution base.

In general, a charitable deduction is not allowed for income, estate, or gift tax purposes if the donor transfers an interest in property to a charity while also either retaining an interest in that property or transferring an interest in that property to a noncharity for less than full and adequate consideration. Exceptions to this general rule are provided for, among other interests, remainder interests in charitable remainder annuity trusts, charitable remainder unitrusts, and pooled income funds, present interests in the form of a guaranteed annuity or a fixed percentage of the annual value of the property, and qualified conservation contributions.

#### Capital gain property

Capital gain property means any capital asset or property used in the taxpayer's trade or business the sale of which at its fair market value, at the time of contribution, would have resulted in gain that would have been long-term capital gain. Contributions of capital gain property to a qualified charity are deductible at fair market value within certain limitations. Prior federal law allowed contributions of capital gain property to charitable organizations described in Internal Revenue Code (IRC) section 170(b)(1)(A) (e.g., public charities, private foundations other than private non-operating foundations, and certain governmental units) generally are deductible up to 30% of the taxpayer's contribution base. An individual may elect, however, to bring all these contributions of capital gain property for a taxable year within the 50% limitation category by reducing the amount of the contribution deduction by the amount of the appreciation in the capital gain property. Contributions of capital gain property to charitable organizations described in IRC section 170(b)(1)(B) (e.g., private non-operating foundations) are deductible up to 20% of the taxpayer's contribution base.

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<sup>1</sup> IRC § 170, 2055, and 2522, respectively.

For purposes of determining whether a taxpayer's aggregate charitable contributions in a taxable year exceed the applicable percentage limitation, contributions of capital gain property are taken into account after other charitable contributions. Under prior federal law, contributions of capital gain property that exceed the percentage limitation may be carried forward for five years.

### Qualified conservation contributions

Qualified conservation contributions are not subject to the "partial interest" rule, which generally bars deductions for charitable contributions of partial interests in property. A qualified conservation contribution is a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes. A qualified real property interest is defined as: (1) the entire interest of the donor other than a qualified mineral interest, (2) a remainder interest, or (3) a restriction (granted in perpetuity) on the use that may be made of the real property. Qualified organizations include certain governmental units, public charities that meet certain public support tests, and certain supporting organizations. Conservation purposes include: (1) the preservation of land areas for outdoor recreation by, or for the education of, the general public; (2) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (3) the preservation of open space (including farmland and forest land) where such preservation will yield a significant public benefit and is either for the scenic enjoyment of the general public or pursuant to a clearly delineated federal, state, or local governmental conservation policy; and (4) the preservation of an historically important land area or a certified historic structure.

Qualified conservation contributions of capital gain property are subject to the same limitations and carryover rules of other charitable contributions of capital gain property.

Prior to the Pension Protection Act (PPA) of 2006 PL (109-280), the 30% contribution base limitation on contributions of capital gain property by individuals did not apply to qualified conservation contributions. Instead, the federal changes made by the PPA allow individuals to deduct the fair market value of any qualified conservation contribution to an organization described in IRC section 170(b)(1)(A) to the extent of the excess of 50% of the contribution base over the amount of all other allowable charitable contributions. These contributions are not taken into account in determining the amount of other allowable charitable contributions.

Individuals are allowed to carry over any qualified conservation contributions that exceed the 50% limitation for up to 15 years.

For example, assume an individual with a contribution base of \$100 makes a qualified conservation contribution of property with a fair market value of \$80 and makes other charitable contributions subject to the 50% limitation of \$60. The individual is allowed a deduction of \$50 in the current taxable year for the non-conservation contributions (50% of the \$100 contribution base) and is allowed to carry over the excess \$10 for up to 5 years. No current deduction is allowed for the qualified conservation contribution, but the entire \$80 qualified conservation contribution may be carried forward for up to 15 years.

## Farmers and ranchers

### *Individuals*

In the case of an individual who is a qualified farmer or rancher for the taxable year in which the contribution is made, a qualified conservation contribution is allowable up to 100% of the excess of the taxpayer's contribution base over the amount of all other allowable charitable contributions. In the above example, if the individual is a qualified farmer or rancher, in addition to the \$50 deduction for non-conservation contributions, an additional \$50 for the qualified conservation contribution is allowed, reaching the 100% limitation.

### *Corporation*

In the case of a corporation (other than a publicly traded corporation) that is a qualified farmer or rancher for the taxable year in which the contribution is made, any qualified conservation contribution is allowable up to 100% of the excess of the corporation's taxable income (as computed under IRC section 170(b)(2)) over the amount of all other allowable charitable contributions. Any excess may be carried forward for up to 15 years as a contribution subject to the 100% limitation.

### *Requirement that Land be Available for Agriculture or Livestock Production*

As an additional condition of eligibility for the 100% limitation, with respect to any contribution of property in agriculture or livestock production, or that is available for such production, by a qualified farmer or rancher, the qualified real property interest must include a restriction that the property remain generally available for such production. There is no requirement as to any specific use in agriculture or farming, or necessarily that the property be used for such purposes, merely that the property remain available for such purposes. Such additional condition does not apply to contributions made after December 31, 2005, and on or before August 17, 2006.

### *Definition*

A qualified farmer or rancher means a taxpayer whose gross income from the trade of business of farming (within the meaning of IRC section 2032A(e)(5)) is greater than 50% of the taxpayer's gross income for the taxable year.

## Current California Law

The Personal Income Tax Law (PITL) relating to charitable contribution deduction is generally the same as the federal deduction as of the "specified date" of January 1, 2005, with the exception of the excise tax on premiums concerning split dollar insurance arrangements.

Under the Corporation Tax Law (CTL), California has a stand alone law that mirrors federal law. California treatment of a contribution (not made by a transfer in trust) of an interest in property that consists of less than the taxpayer's interest in such property, is deductible only to the extent that the value of the interest contributed would be allowable as a deduction under the general rule for charitable contribution deduction.

In general, the charitable deduction limit is 10% of the corporation's net income. The deduction is computed without regard to the deduction for built-in gains and passive investment income. The definition of a qualified conservation contribution is the same under California and federal law.

### THIS BILL

This bill would reference an IRC section that does not exist as of the "specified date." Consequently, the bill would have no effect.

### IMPLEMENTATION CONSIDERATIONS

As written, this bill would not accomplish the author's intention, which is to conform California law to specific sections of the IRC as amended by the Pension Protection Act (PPA) of 2006.

### TECHNICAL CONSIDERATIONS

For clarity and to accomplish the author's purpose, the author may consider adding the PPA section number (1206) referencing Encouragement Contributions of Capital Gain Real Property Made for Conservation Purpose. Amendments 1 and 2 are provided.

Under the CTL, the section reference needs to be amended to incorporate the correct section relating to qualified conservation contributions. Amendment 3 is attached to resolve this concern.

### **OTHER STATES' INFORMATION**

The states surveyed include *Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York*. These states were selected due to their similarities to California's economy, business entity types, and tax laws.

*Florida* only has a corporation income tax; therefore, this personal income tax deduction is not applicable. *Illinois, Massachusetts, Michigan, Minnesota, and New York* adopted the federal provisions relating to charitable contributions for individuals. However, these states have not conformed to the provisions relating to the deduction of qualified conservation contributions.

### **FISCAL IMPACT**

This bill would not significantly impact the department's costs.

## ECONOMIC IMPACT

### Revenue Estimate

Based on data and discussion below, this provision would have no revenue impact.

Estimated Revenue Impact of AB 454 Effective for Tax Years BOA 1/1/2007 Assumed Enactment Date After 6/30/2007		
(\$ In Millions)		
2007/08	2008/09	2009/10
\$0	\$0	\$0

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

### Revenue Discussion

The California Revenue and Taxation Code provides that references to sections of the IRC are references to those sections as enacted January 1, 2005. The stated purpose of this bill implies a desire to reference the specified sections of the IRC as amended by the PPA) of 2006. If enacted as currently drafted, this bill has no revenue impact.

Note: PPA 2006 changes to the treatment of qualified conservation contributions do not apply to contributions made in taxable years beginning after December 31, 2007. If this bill were amended to reference the specified sections of the IRC as amended by PPA 2006, the revenue losses would be approximately \$1 million for fiscal year 2007/08; \$500,000 for fiscal year 2008/09; and \$250,000 for fiscal year 2009/10.

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FRANCHISE TAX BOARD'S  
PROPOSED AMENDMENTS TO AB 454  
As Amended March 29, 2007

AMENDMENT 1

On page 2, lines 5 and 6, strike out "Section 170(b)(1)(E) of the Internal Revenue Code." and insert:

Section 170(b)(1)(E) of the Internal Revenue Code, as amended by Section 1206 of the Pension Protection Act of 2006 (Public Law 109-280) relating to the encouragement of contribution of capital gain real property made for conservation purpose.

AMENDMENT 2

On page 2, line 12, strike out "Section 170(b)(2) of the Internal Revenue Code." and insert:

Section 170(b)(2) of the Internal Revenue Code, as amended by Section 1206 of the Pension Protection Act of 2006 (Public Law 109-280) relating to the encouragement of contribution of capital gain real property made for conservation purpose.

AMENDMENT 3

On page 2, lines 10 and 11, strike out "Section 24537.7" and insert:

Section 24357.7