

# Memorandum

To: Working Waterfront Tax Policy Grant Advisory Committee

Cc:

From: Steven R. Gerlach, Esq.

Date: September 20, 2010

Re: Working Waterfront Tax Strategies

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## I. OBJECTIVE

The objective of this memo is to provide context and rationale for the use of selected tax strategies for the preservation and promotion of working waterfront, and to articulate the legal and policy steps necessary to implementing these strategies. Where appropriate, the memo examines how combinations of these strategies may interact, negatively or positively. The strategies were originally identified in the predecessor memo to this one entitled, “Tax-Based Opportunities and Challenges for Working Waterfront Protection,” by Michael Dixon (the “Dixon Memo”). That memo identified, among other things, the following strategies: (1) land banking and related strategies, (2) property tax relief, (3) an amendment to the Internal Revenue Code providing a tax deduction for contributions of land, real property rights or other property to working waterfront conservancies and (4) state tax credits.

## II. LAND BANKING AND RELATED STRATEGIES

In the conservation context, land banking is the purchase and holding of land to be conserved by a nonprofit land trust, state or municipality. A related strategy is the purchase of development rights in which the buyer purchases an easement or covenant that restricts future development on the land in question. A further related strategy is the transfer of development rights in which a municipality, through regulation, swaps development rights on one property in exchange for the development rights on the land to be conserved. Although such strategies are

not tax related themselves, several tax mechanisms have been employed to fund land banking and related efforts to protect working waterfront.

### A. Real Estate Transfer Tax

As discussed in the Dixon memo, a designated real estate transfer tax has been used successfully to fund land banking programs in Nantucket and Martha's Vineyard. As also discussed, however, many subsequent such efforts have failed politically. The reasons for the isolated successes in Nantucket and Martha's Vineyard are perhaps due to the specific qualities of those island communities. For example, the populations of both islands tend to be well educated and have incomes higher than the national median.<sup>1</sup> Moreover, the working waterfront is likely to be important to a majority of voters who want to preserve the way of life their island communities and the working waterfront provide—the preservation of family lands for future generations, scenic views, tourist economy<sup>2</sup> and small town coastal living all depend upon limited development. In addition, both are relatively isolated island communities whose political choices do not depend on voters who do not live there.<sup>3</sup>

By contrast, a designated, statewide real estate transfer tax in Maine would depend upon the votes of a less prosperous and more diverse population. With a median income of about \$46,000,<sup>4</sup> the majority of voters in Maine earns well below the national median. A perceived increase in the financial burden of those voters may be a harder sell than it was in Nantucket or Martha's Vineyard. Moreover, although Maine has many coastal communities, its economy and geography are much more diverse than those of the Massachusetts island communities. In addition to fishing and waterfront based industries, Maine's top industries also include forest products, agriculture, technology, manufacturing and non-marine shipping.<sup>5</sup> Its geography includes not only waterfront, but mountains, forest, rural and urban areas.

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<sup>1</sup> The median income in Nantucket County, Massachusetts in 2008 was \$69,993; 38.4% of the population completed a bachelor's degree and 91.6% finished high school (U.S. Census Bureau, QuickFacts, Nantucket County, Massachusetts, <http://quickfacts.census.gov/qfd/states/25/25019.html>). Similarly, the median income in Dukes County, Massachusetts in 2008 was \$56,515; 38.4% of the population completed a bachelor's degree and 90.4% finished high school (U.S. Census Bureau, QuickFacts, Dukes County, Massachusetts, <http://quickfacts.census.gov/qfd/states/25/25007.html>). The median income in the U.S. for the same period is \$52,029; nationwide, 24.4% completed a bachelor's degree and 80.4% finished high school (U.S. Census Bureau, QuickFacts, Maine, <http://quickfacts.census.gov/qfd/states/23000.html>).

<sup>2</sup> See, e.g., Nantucket Community Comprehensive Plan, Ch. 3, [http://www.nantucket-ma.gov/Pages/NantucketMA\\_Planning/forms/CCP8Making%20A%20Living.pdf](http://www.nantucket-ma.gov/Pages/NantucketMA_Planning/forms/CCP8Making%20A%20Living.pdf). See also, Martha's Vineyard Chamber of Commerce, [http://www.mvy.com/Vineyard\\_Community/Employment.aspx](http://www.mvy.com/Vineyard_Community/Employment.aspx).

<sup>3</sup> The 2009 estimated population of Nantucket County is 11,322; for Dukes County it is 15,974.

<sup>4</sup> 22.9% of Maine's population has completed bachelor's degrees and 85.4% finished high school (U.S. Census Bureau, QuickFacts, Maine, <http://quickfacts.census.gov/qfd/states/23000.html>).

<sup>5</sup> See generally <http://www.maine.gov/portal/business/>.

Moreover, the Maine legislature has repeatedly failed to pass an increase in the real estate transfer tax.<sup>6</sup> This is in large part due to the strength of the real estate lobby in Maine, which makes challenging any such increases its first priority.<sup>7</sup> Of note are recent attempts to pass a local-option real estate transfer tax through the Maine legislature.<sup>8</sup> Under various bills, municipalities would have been allowed to levy a local real estate transfer tax in order to fund municipal purchase of lands for public use. In addition to opposition from the real estate lobby, county administrators challenged the bills as increasing the administrative burden at the county level. This opposition was supplemented by general resistance at the state level to relinquishing part of its taxing authority to the municipalities.

One possible solution is to reallocate the existing transfer tax dollars toward working waterfront purchases, rather than increasing the tax itself. Such a reallocation would, by necessity, take the tax dollars from some other recipient or recipients. As such, this too would likely entail a political battle to implement. One potential source of assistance in this battle, however, may come from the real estate lobby, which, when not confronted with a potential increase in the transfer tax, may be willing to support working waterfront issues.<sup>9</sup>

### *B. Bond Financing*

Another potential source of funding for land banking and related strategies is bond financing. Bond financing has proven more politically feasible than increasing the real estate transfer tax. For example, under Maine's Working Waterfront Access Pilot Program ("WWAPP"), the State's Department of Marine Resources purchases "working waterfront covenants" that prohibit all non-fishing-related activities (i.e., condos, marinas) in the protected area. The State also retains a right of first refusal to assure that the land will be sold at its working waterfront value in the future. WWAPP purchases have historically been successfully bond financed by embedding the bond request within larger requests for the Land for Maine's Future. It is unclear whether, standing alone, bonds financing WWAPP purchases would enjoy similar success.

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<sup>6</sup> See, e.g., 123<sup>rd</sup> Legislature, LD 1145; 122<sup>nd</sup> Legislature, LD 1086 and LD 1634.

<sup>7</sup> See Maine Association of REALTORS Public Policy Statement, Section 3.4, <http://www.mainerealtors.com/AboutMAR/2009-2010PublicPolicyStatement.pdf>.

<sup>8</sup> See, e.g., 121<sup>st</sup> Maine Legislature, 1<sup>st</sup> Regular Session, LD 115; 123<sup>rd</sup> Maine Legislature, 1<sup>st</sup> Regular Session, LD 761. Thanks to Senator Chris Rector for his recounting of this legislative history. See also 124<sup>th</sup> Maine Legislature, 1<sup>st</sup> Regular Session, LD 762, which would create a local-option real estate transfer tax to fund affordable housing in working waterfront areas. See also "Proposed Transfer Tax Would Support Affordable Housing," *The Working Waterfront*, October 13, 2010, <http://www.workingwaterfront.com/articles/Proposed-transfer-tax-would-support-affordable-housing/11627/>.

<sup>9</sup> Thanks to Katherine Knox, Esq. for sharing her working knowledge of Maine politics.

A similar example of successful debt financing is found in the Town of Tremont, Maine. Tremont is a small coastal village on Mount Desert Island. In 1992, the Town purchased .94 acres of working waterfront from a private seller at foreclosure. The voters of Tremont authorized the Town to finance the purchase with a loan from a local bank.<sup>10</sup>

### C. Other Financing

Other tax-related financing that may be worth exploring is beyond the scope of this memo. Such exploration might include dedicated excise taxes and financing purchases through the State's general fund, the source of which is generally broad-based income and sales taxes.

## III. PROPERTY TAX RELIEF

As discussed in the Dixon Memo, Maine voters overwhelmingly endorsed current use taxation of working waterfront property in 2005. The provision allows owners of working waterfront property to apply to have that property valued for property tax purposes according to the property's current use, rather than full fair market value. Since becoming effective, participation rates in the current use taxation program have varied greatly from county to county, and the average amount of relief provided is only about \$200 per year. The Dixon Memo asks whether this small amount of relief provides an effective incentive to preserve working waterfront.

Further relief may be provided by full or partial abatement of property taxes for working waterfront property. Practical, legal and constitutional issues may need to be resolved in implementing such an abatement program. As a practical matter, property tax abatement presents the same problem that any tax relief program does: lost revenue. The options for municipalities to deal with such lost revenue are two: (1) reduce municipal spending in other areas to make up for the loss or (2) increase municipal revenues from other sources. Option (1) may result in a reduction of municipal jobs, services or both. Option (2) will likely require shifting the lost revenue onto other taxpayers.<sup>11</sup> Perhaps the cost shifting could be accomplished through a designated real estate transfer tax, or excise tax, imposed at the municipal level, or through bond financing. Alternatively, the cost shifting could be accomplished by simply raising the property tax rates for

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<sup>10</sup> Information provided by Millard Billings, Town Manager of Tremont, ME. This also may be an example of the relative political ease in dealing with a small, circumscribed population, as compared with a statewide effort. The population of Tremont is about 1,500. Like Nantucket and Martha's Vineyard, the town is located on an island and much of its local economy depends on marine resources and tourism. See also Town of Tremont, [http://tremont.maine.gov/Pages/TremontME\\_WebDocs/about](http://tremont.maine.gov/Pages/TremontME_WebDocs/about) and the Tremont Comprehensive Plan, [http://tremont.maine.gov/Pages/TremontME\\_CPC/index](http://tremont.maine.gov/Pages/TremontME_CPC/index).

<sup>11</sup> The magnitude of lost revenue may vary greatly between municipalities, depending on the number and size of waterfront properties involved, as well as the property tax rate in the relevant municipality.

the municipality. Any such cost shifting would likely meet with political resistance, but, depending on the demographics of the municipality, such resistance may be more easily overcome than at the State level.

As a legal matter, property tax abatements for working waterfront property are not currently authorized under Maine statute.<sup>12</sup> To gain such authority, an amendment to the statute would need to be passed by the state legislature.<sup>13</sup> Moreover, Maine's Constitution requires that real estate taxes "be apportioned and assessed equally according to the just value thereof."<sup>14</sup> This requirement may make a property tax abatement program vulnerable to constitutional attack.

As also discussed in the Dixon Memo, Maine recently issued final rules governing its Voluntary Municipal Farm Support Program ("VMFSP"). Under this program, municipalities are permitted to refund all or part of the property tax costs associated with qualifying farmland in exchange for an agricultural conservation easement.<sup>15</sup>

A similar program could be developed in which the State passes a statute enabling municipalities to refund property taxes on working waterfront property. As evidenced by the passage of and subsequent rulemaking for the VMFSP, such a program seems politically feasible. Moreover, enabling such a program at the local level creates flexibility for municipalities to tailor the program to their particular needs.

The same practical, legal and constitutional concerns, however, appear to be present for the VMFSP as for a more general property tax abatement program.<sup>16</sup> Also, the program is so new that it is unclear whether it will be effective in helping preserve Maine farmland. Given these concerns, it may be wise to wait and see if the VMFSP is challenged, and if it is used effectively, before commencing a similar program for working waterfront property. During this waiting period, however, working waterfront advocates could be identifying and laying the groundwork with municipalities likely to benefit from such a program.

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<sup>12</sup> 36 M.R.S. § 841.

<sup>13</sup> For a more detailed discussion of the political process involved in passing a statute through the legislature, see discussion below regarding state tax credits at Section V.

<sup>14</sup> ME. CONST. art. IX § 8.

<sup>15</sup> 7 M.R.S. §§ 60, 60-A (2009). *See also* Me. Dept. of Agric. 01-001 CMR Ch. 37.

<sup>16</sup> *See* Interdepartmental Memorandum from Jerome D. Gerard, Acting Executive Director of Maine Revenue Services to Representatives Piotti, Marean and Pieh, as well as Senator Sherman (April 27, 2007) regarding LD 1414 An Act to Support Farms and Limit Sprawl. The memo raises concerns about the constitutionality of the VMFSP.

#### IV. FEDERAL INCOME TAX DEDUCTION FOR CHARITABLE DONATION

One tax strategy that would potentially aid in the protection of working waterfronts is the development of a federal income tax deduction for charitable donations of working waterfront property. Modeled after the “qualified conservation contributions” provided in section 170(h) of the Internal Revenue Code, working waterfront contributions might consist of the entire property interest of a donor, a remainder interest in the property, or a perpetual working waterfront easement on the property. To qualify for the deduction, contributions would be required to be made to qualifying charities and for the exclusive purpose of preserving the working waterfront.<sup>17</sup> As a point for further research, it should be determined whether nonprofit working waterfront organizations constitute qualifying charities for the purposes of this deduction. Working waterfront advocates should research IRS rulings on this issue and, if necessary and feasible, seek an on-point ruling from the IRS.

Politically, the best strategy for passing through Congress this deduction for donations of working waterfront property will likely be to collaborate with other national conservation groups such as the Land Trust Alliance and Trust for Public Land. Such an alliance could provide a sympathetic Congressperson with model language for the amendment, work with that person to identify an appropriate bill to insert the amendment into, and then keep pressure on that Congressperson to work towards the bill’s passage.<sup>18</sup>

#### V. STATE TAX CREDIT

At the state level, income tax credits could be granted to taxpayers who make capital investments in working waterfront businesses. An example of how such a program could work is provided in the Maine Seed Capital Tax Credit Program. In that program, taxpayers investing in small Maine businesses, and meeting the program’s other requirements, are granted tax credits for up to 60% of the investment. A similar program could be developed in which a certain percentage of a working waterfront investment comes back to the investor as a state income tax credit.<sup>19</sup>

Strategically, advocates of such a program should work initially with the legislature’s tax committee to iron out difficulties in language, bill sponsorship or fiscal impact. In addition to refining the bill, this initial work could win powerful allies within the committee.<sup>20</sup>

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<sup>17</sup> See Appendix A for model language of a working waterfront easement provision.

<sup>18</sup> Thanks again to Katherine Knox, Esq.

<sup>19</sup> See Appendix B for model language.

<sup>20</sup> Thanks again to Katherine Knox, Esq.

## VI. SYNERGIES AND CONCLUSION

For the most part, the strategies discussed in this memo are not mutually exclusive. Indeed, the strategies may be combined or layered to greater effect. For example, at the state level, combining an income tax credit with property tax relief would provide a double incentive: one to the landowner and one to the investor. The incentive to the landowner would help ensure that the land remains used for working waterfront purposes only. The incentive to the investor will help ensure that working waterfront businesses remain up-to-date, adequately capitalized and economically viable.

Combining a federal income tax deduction with a state tax credit would provide a similar double incentive.

In addition, a federal tax deduction would add another tool to the land banker's tool box. That is, land banks would not have to rely on purchases only; the land bank's holdings could also be increased by charitable contributions. This also opens up the possibility of part gift-part sale transactions in which a donor/seller sells part of a working waterfront property (or rights to it) to the land bank, but donates the rest (or rights to it) to receive a federal tax deduction. This flexibility to structure transactions to suit potential donor/sellers' needs will likely increase the number of such transactions.

In conclusion, the variety of tax strategies for preserving and promoting working waterfront, and the synergistic effects of combining them, argues for a multi-faceted approach to policy change. We recommend that advocates for working waterfront protection work on several fronts to promote statutory and regulatory changes at the federal, state and local level.

## APPENDIX A

### Federal Tax Code Amendment—Model Language

Prepared by Steven R. Gerlach, Esq. Bernstein Shur, Counselors at Law  
for Maine Sea Grant  
Sept 20, 2010

ADD—Code Section 170(f)(3)(B)(iv), providing:

“a qualified working waterfront contribution.”

ADD—Code Section 170(q), providing:

- (1) **In general.** For purposes of subsection (f)(3)(B)(iv), the term ‘qualified working waterfront contribution’ means a contribution—
  - (A) of a qualified real property interest,
  - (B) to a qualified organization,
  - (C) exclusively for working waterfront purposes.
- (2) **Qualified real property interest.** For purposes of this subsection, the term ‘qualified real property interest’ means any of the following interests in real property:
  - (A) the entire interest of the donor other than a qualified mineral interest,
  - (B) a remainder interest, and
  - (C) a restriction (granted in perpetuity) on the use which may be made of the real property.
- (3) **Qualified organization.** For purposes of paragraph (1), the term ‘qualified organization’ means an organization which—
  - (A) is described in clause (v) or (vi) of subsection (b)(1)(A), or
  - (B) is described in section 501(c)(3) and—
    - (i) meets the requirements of section 509(a)(2), or is controlled by an organization described in subparagraph (A) or in clause (i) of this subparagraph.
- (4) **Working waterfront purpose defined.**
  - (A) In general. For purposes of this subsection, the term ‘working waterfront purpose’ means—the preservation of waterfront land areas for commercial fishing activities and uses incidental thereto, including but not limited to the:
    - (i) erection, maintenance, operation and repair of docks and floats for vessels used to harvest aquatic (both marine and freshwater) organisms,



- (ii) berthing, landing, loading, unloading, cleaning, maintaining, repairing, supplying, provisioning, and outfitting vessels used to harvest aquatic organisms,
- (iii) fueling of vessels used to harvest aquatic organisms,
- (iv) purchase, fabrication, storage, repair and maintenance of equipment for vessels used to harvest aquatic organisms,
- (v) purchase of aquatic organisms for retailing or wholesaling,
- (vi) preparation or processing of aquatic organisms for retailing,
- (vii) retailing of fresh or processed aquatic organisms for off-site consumption,
- (viii) wholesaling of fresh aquatic organisms,
- (ix) retail shops, offices, on-site open air snack-bar or take-out service, and administrative services, provided that such facilities shall derive from and relate to the uses described in subparagraphs (i) through (viii),
- (x) parking to support uses described in subparagraphs (i) through (viii), and
- (xi) uses supportive of or related to uses described in subparagraphs (i) through (viii), except that no such use shall reduce the availability of or access to float or dock space for berthing or other water-dependent uses of the property.

(B) ‘Working waterfront purpose’ shall not include indoor restaurants, apartments, residences, condominiums, hotels, lodging, gas stations, yacht clubs and ‘Marinas.’

(C) For the purposes of this subsection, ‘Marina’ means a facility that repairs vessels for hire or profit, or rents long-term (more than 3 months, including extensions) berthing space for non-working waterfront vessels.

- (5) **Exclusively for working waterfront purposes.** For purposes of this subsection—
- (A) Working waterfront purpose must be protected. A contribution shall not be treated as exclusively for working waterfront purposes unless the working waterfront purpose is protected in perpetuity.
- (6) **Qualified mineral interest.** For purposes of this subsection, the term ‘qualified mineral interest’ means—
- (A) subsurface oil, gas or other minerals, and
  - (B) the right to access such minerals.”