Office of Chief Counsel
Internal Revenue Service

memorandum

CC:LM:MCT:WAS:[redacted]:TL-N-6338-00
[redacted]

date: 15 DEC 2000

to: Group Manager [redacted]

from: [redacted]
Senior Attorney (LMSB)

subject: [redacted]
Deduction of Charitable Contribution in [redacted] for the Transfer of An Easement to the City of [redacted]

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

ISSUES

1. Whether the taxpayers made a charitable contribution in [redacted] when they transferred a right-of-way and improvements thereon to the City of [redacted].

2. Whether the Service should set up an adjustment to the amount of the claimed deduction as an alternative position to the full disallowance of the charitable deduction claimed by the taxpayers.

3. Whether the Service should assert some type of penalty against the taxpayers for claiming the charitable deduction.

CONCLUSIONS

1. It is our opinion that the determination that the taxpayers did not make a charitable deduction is a sound one. Further factual development, however, will be needed.

2. Our advice will depend, in part, upon the strength of the Service's position in Issue 1. For the moment, it is our opinion that the Government's interests would be best protected by making an adjustment to the value claimed by the taxpayers for the charitable contribution as an alternative position. We believe the adjustment may be significant.

3. There are presently insufficient facts contained in the file for us to evaluate whether assertion of a penalty against the taxpayers would be appropriate.

FACTS

On their [redacted] consolidated return, [redacted] [hereinafter referred to as [redacted] or the taxpayers] claimed a charitable deduction in the amount of $[redacted] because they dedicated a right-of-way over a portion of their land to the City of [redacted] [hereinafter referred to as the City]. They also claimed a charitable deduction in the amount of $[redacted] as the cost of improvements they made to the right-of-way immediately before the dedication. Based on your discovery of an agreement between [redacted] and the City, you are now contemplating disallowance of the claimed charitable contribution.

On [redacted], [redacted] and the City entered into a Memorandum of Agreement regarding the future use of property owned by [redacted] and public rights-of-way in the City that were adjacent to property owned by [redacted]. The Agreement dealt with several different projects. The project from which the claimed contribution arose was the "[redacted]." According to the agreement regarding that project, [redacted] would dedicate its property for a necessary right-of-way and construct, at its own expense, the portion of [redacted] extending south from [redacted] Street to [redacted] Street. The construction of the extension was to be done generally as shown on a preliminary plan dated [redacted]. [redacted] was required to complete the [redacted] no later than [redacted]. Upon completion of the extension and its acceptance by the City, [redacted] agreed to deed the "necessary right-of-way and improvements to the City without warranty as to the land and with no expense to the City." Other details of the parties' agreement are found in paragraph 1 of the Memorandum of Agreement.

Paragraph 2 of the parties' agreement was titled, "[redacted]." Apparently, as part of an earlier Master Plan, the City had decided to build the [redacted] that would have extended [redacted] from [redacted] to the south of [redacted]'s [redacted] and connected to [redacted] Street at its intersection with [redacted] Street. The [redacted] project would have necessitated condemnation of some of [redacted]'s property and damage to its remaining property. In the Agreement, the City acknowledged that its Master Plan had been amended to delete plans for the [redacted] and that it no longer had plans to propose or take action to plan for, acquire, take or develop any of [redacted]'s property in order to construct the [redacted] or any other roadway in the same general area.

Nonetheless, in paragraph 2 of the Agreement, the City agreed that, "[redacted]." The City also agreed that payment of any [redacted] reimbursement would be added to, and not deducted from, the amount of just compensation separately determined to be due and awarded to [redacted] on the basis of the value of its property taken and any damages to its remaining property. The added sum, however, was to be considered an element of the just compensation due [redacted] for any [redacted] condemnation. According to [redacted], the City has never yet developed new plans for the [redacted].

Under paragraph 3 of the Agreement, the parties acknowledged that certain changes to an intersection adjacent to [redacted]'s property were necessary. [redacted] agreed to undertake a traffic count study related to proposals for improving traffic flow at the intersection. Details regarding the study were set forth. The parties agreed to mutually agree to a final plan and design for improvements to the intersection, taking into consideration [redacted]'s proposal for development of its property adjacent to the intersection. They further agreed to use their best efforts to obtain the [redacted]s[1] consent to the

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[1] The [redacted] was set up by the [redacted] as a consortium of local governing bodies (e.g., the City of Richmond and surrounding counties) empowered to administer certain facilities, a toll way and

final plan and design for the improvements.

Upon initiation of construction of agreed improvements to the intersection, [redacted] agreed to advance a maximum of $[redacted] toward the actual cost of the city in constructing the improvements. The City was to repay the advance to [redacted] in [redacted] equal annual installments, without interest. Although we are not certain whether the studies were performed and what other activities may have been undertaken under paragraph 3, [redacted] has indicated that the City has not undertaken construction of improvements at the intersection.

Paragraph 4 of the Agreement dealt with the possible current or future need for a "[redacted]." To the best of our present knowledge, no action has ever been taken regarding a [redacted]. It is interesting to note, however, that the parties indicated in that paragraph that, if it was necessary for the City to obtain a right-of-way for and construction of the [redacted], they would follow the same general procedures they had used in their "Agreement of Purchase and Sale," dated [redacted]. We do not have a copy of that agreement. In paragraph 4, the parties stated that it concerned the dedication and construction of the [redacted] and [redacted] Streets right-of-way and road improvements which had been constructed in accordance with design plans and specifications prepared by [redacted] and approved by the City.

Paragraph 5 of the Agreement dealt with a complex arrangement regarding the placement of utilities including combined sewer overflows on the portion of [redacted]'s property that generally ran from the west to east between [redacted] Street and [redacted] Street and from the north to south between [redacted] Street and [redacted] Street. Some of the City's easements were to be relocated. [redacted], thereafter, would generally have the right to relocate City utilities subject to the City's approval at the sole cost of [redacted]. [redacted] would grant the City a "license or similar right" for the use and maintenance of all existing City utilities on [redacted]'s land. Once [redacted] delivered the license, the City would deliver to [redacted] a quitclaim deed conveying to [redacted] all of the City's rights, title and interest in any "prior easement, prescriptive right or any similar interest involving the affected utilities and any property subject thereto." Interestingly, the City acknowledged that, pursuant to [redacted]'s right to relocate utilities, it could chose to relocate them beneath or adjacent to the [redacted]." If [redacted] did chose to relocate utilities, the license regarding those

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transportation systems.

utilities would terminate and [redacted] would dedicate and donate to the City a non-exclusive permanent underground easement at the time of each relocation of utilities.

Paragraph 6 contained provisions for a major benefit to [redacted], some of which was made contingent upon the completion and opening of the "[redacted]" that forms the subject of [redacted]'s alleged donation.[2] The City agreed to relocate the combined sewer overflow, the related dry weather flow regulator and sanitary sewer connection line that ran beneath a portion of [redacted]'s property to a location below [redacted] street that is adjacent to [redacted]'s property. It also agreed to abandon its existing water lines in the same area. Once the City relocated the lines, it would fill, seal and abandon the area from which the lines were removed. [redacted] was given the right to approve many aspects of the City's planning and execution of the project. Although [redacted] agreed to reimburse the City for its costs up to the amount of [redacted] dollars, the taxpayers have indicated that they have made no reimbursement to the City.

The City agreed that, following the completion and opening of the "[redacted]," the City would close [redacted] Street and [redacted] Street by formal action of the City Counsel. The City further agreed that upon completion of its relocation project and the completion and opening of the "[redacted]," it would deliver to [redacted] a "[redacted]"

The final substantive paragraph of the Agreement dealt with the possibility that the City might request a determination regarding a specific turning lane. No action has been taken under that paragraph.

[redacted] obtained an appraisal of the property it was to transfer from [redacted] of [redacted] dated [redacted]. He undertook to determine the fair market value in fee simple title of the interest to be conveyed by [redacted] as of [redacted]. That date predates the taxpayers' construction of improvements on the right-of-way. [redacted]

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[2] Delivery of a deed to the right-of-way was not made a part of the required contingency.

described the property as the land within a right-of-way for the extension of [redacted] Street, containing approximately [redacted] square feet. In his report, he quoted the definition of fee simple from the 1984 edition of the "Dictionary of Real Estate Appraisal" published by the American Institute of Real Estate Appraisers, as, "Absolute ownership unencumbered by any other interest or estate; subject only to the limitations of eminent domain, escheat, police power and taxation." This definition is in conflict with the terms of the deed ultimately executed by [redacted].

The parcel [redacted] appraised was a strip of land approximately [redacted]' wide by [redacted]' long. It was on vacant land adjacent to [redacted]'s [redacted]. After defining the highest and best use of property as "its best use if it is vacant and available for development," he determined that the highest and best use for the strip of land was for use for office purposes. He did not discuss exactly how a strip of land only [redacted]' wide might be used for office purposes.

[redacted] used the market comparison approach for valuing the property. He used comparables that were of a more traditional shape and more easily usable for office or similar purposes than was the land owned by [redacted]. Nonetheless, [redacted] used the value determined by [redacted] as the value of their alleged charitable contribution.

[redacted] has provided a copy of the [redacted] it submitted on [redacted] in order to obtain funding for the [redacted] project and for performance of the traffic studies, "as required by agreement with the City of [redacted], dated [redacted]." On page two of the request for funding, the sponsors of the request stated:

> This project is required to comply with an agreement, dated [redacted], between [redacted] and the City of [redacted]. The attached agreement requires [redacted] to obtain a traffic study of the [redacted] and [redacted] Street intersection and to build an extension of [redacted] Street, from [redacted] to [redacted] Street, by [redacted].

On [redacted], [redacted] and the City executed a document entitled, Deed of Gift of Right-Of-Way And Road Improvements.[3]

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[3] The deed was signed on behalf of the City by City Manager [redacted]. On the same day, he signed a "Gift Acknowledgment," acknowledging receipt of the property from [redacted] and certifying that the City did not provide any goods or

Nowhere in the document did the parties use the words "fee simple" or "easement." [redacted] recited that it was donating a portion of its land to the City "for use as public right-of-way." The document also described the improvements [redacted] had made and was "donating" to the City. In the deed, [redacted] excluded from the "donation" two conduits it had constructed as part of the improvement project that consisted of multiple PVC pipes encased in concrete installed by [redacted] in two separate locations extending beneath and through the entire width of the Right-of-Way.

According to the deed, [redacted] conveyed the interest in property to the City for use as a public street. It further stipulated that the Right-of-Way and the Road Improvements:

> shall exist, be subject to and be used in accordance with the following terms:
>
> 1. <u>Nature of Use.</u> The Right-of-Way and the Road Improvements shall be used and maintained by Donee only as a public street.
>
> 2. <u>Nature of Conveyance.</u> The Right-of-Way and the Road Improvements are given and conveyed subject to all recorded easements, agreements, covenants, restrictions and conditions affecting the Property or any part thereof.

The deed also required the City to maintain the interest conveyed in a manner that caused the least damage and inconvenience to [redacted] and portions of the "Property" not included within the Right-of-Way or involving the Road Improvements.

Finally, the deed contained a savings clause providing that, to the extent any of the rights and privileges granted to [redacted] or the City under the Deed would be invalid because they were deemed to be in violation of the rule against perpetuities or any other rule of law regarding the vesting of interests in property or the suspension of the power to transfer property, then those rights and privileges would only be exercisable by [redacted] or the City during the period that would end [redacted] years after the death of the last survivor of certain persons that were named in the deed.

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services to [redacted] in consideration for the transfer. He is the same person who signed the Agreement dated [redacted] between [redacted] and the City on behalf of the City. The current City Manager is a [redacted] of [redacted].

The actual deed incorporated two exhibits. Exhibit A was a plat prepared by the City's Department of Public Works depicting the Right-of-Way and the road improvements. [redacted] provided you with a copy of that exhibit. You have not been given a copy of Exhibit B. The second exhibit contained a legal description of the property transferred.

The plat attached as Exhibit A labels the interest as the proposed dedication of property to the City for right-of-way purposes. There are three "Notes" on the face of the map. The first note indicates that the map shows the area of proposed dedications for "right-of-way purposes." The area is designated as, "Proposed Variable Width Right-Of-Way ([redacted])." The second note makes reference to a plat "[redacted]." The third note indicates that [redacted], between [redacted] Street and [redacted] Street was closed and maintained as a full width utility easement per a City ordinance adopted [redacted] and accepted on [redacted]. We have not been able to determine where [redacted] Street was, or is, located. The Revenue Agent who identified this issue attempted to locate the plats and ordinances referenced in the notes from public records but was unable to do so.

On [redacted], the City executed a [redacted] in favor of [redacted] transferring to them all of the City's right, title and interest in and to the closed portions of [redacted] and [redacted] Streets, the public right-of-way and improvements included therewith and any and all prior easements, prescriptive rights or similar rights related thereto along with all public utilities located in, on or under the closed streets. This was done pursuant to paragraph 6 of the City's Agreement with [redacted] dated [redacted].

Prior to its receipt of a copy of the Agreement, the Service intended only to determine whether the interest conveyed by [redacted] had been properly valued. Toward that end, and, in the interest of conserving resources, you obtained the services of an outside appraiser, who had formerly worked for the Federal Government, to "review" the appraisal report prepared by [redacted]. Our appraiser did not prepare an appraisal of her own. Although the review did identify flaws in [redacted]'s appraisal, you have indicated that you do not desire to rely on the review done by the outside expert.

On [redacted], I spoke with [redacted] of the City

Attorney's office ([redacted] in general terms. When I described the terms used in the [redacted] supplied by [redacted], [redacted] was quite puzzled. She indicated that the City usually has such deeds state whether the interest transferred is one of fee simple or, instead, an easement. She did volunteer that, in some cases, the City complied with the wishes of land owners to use different language for tax purposes. She thought that there should be a map prepared by the Department of Public Works and that it should use the words "easement" or "fee simple." When I told her that I had not seen such a map, she said that she would have to see the deed and a map in order to determine whether a fee simple interest in land had been transferred or merely an easement. She indicated that she would be quite happy to assist us in any way possible.

ANALYSIS

ISSUE 1

I.R.C. § 170(a) provides for a tax deduction for charitable contributions. I.R.C. § 170(c)(1) defines the term "charitable contribution" as, among other things, a contribution or gift to or for the use of a political subdivision of a State if, and only if, the contribution is made for exclusively public purposes. Some transfers that would otherwise qualify as charitable contributions, however, must be denied pursuant to the provisions of I.R.C. § 170(f)(3)(A). That section denies a charitable deduction when the taxpayer transfers an interest in property that is less than its entire interest in the property transferred unless the value of the interest transferred would be allowable under I.R.C. § 170(f)(2) if the interest had been transferred in trust or unless the interest falls within one of the three exceptions set forth in I.R.C. § 170(f)(3)(B). The three exceptions are:

(i) a contribution of a remainder interest in a personal residence or farm,

(ii) a contribution of an undivided portion of the taxpayer's entire interest in property, and

(iii) a qualified conservation contribution.

I.R.C. § 170(f)(3)(B). According to the statute, a gift of the right to use property must be treated as a gift of less than the taxpayer's entire interest in the property. I.R.C. § 170(f)(3)(A).

Under the facts presently contained in the file, it appears

that the City was a proper recipient of the interest [redacted] transferred for purposes of section 170. Although we believe the transfer was made for exclusively public purposes, additional factual development may prove otherwise. Thus, there are two issues raised by the facts that warrant further analysis. The first is whether the transfer truly was a charitable one. The second is whether a deduction must be denied under I.R.C. § 170(f)(3) either because the interest was a partial one, such as an easement, or because the transfer might have been defeated if the City had later built the [redacted].

A. Was the Transfer A Charitable Contribution?

In order to determine whether a taxpayer has made a charitable contribution, courts typically look to see whether the transfer constitutes a gift. See Osborne v. Commissioner, 87 T.C. 575, 581 (1986); Sutton v. Commissioner, 57 T.C. 239, 242 (1971); DeJong v. Commissioner, 36 T.C. 896, 899 (1961), aff'd. 309 F.2d 373 (9th Cir. 1962). Courts seek to make the factual determination of whether a taxpayer's primary or dominant motive, incentive or purpose was to make a gift. See Stubbs v. United States, 428 F.2d 885, 887 (9th Cir. 1970); Elrod v. Commissioner, 87 T.C. 1046, 1076 (1986); Sutton v. Commissioner, 57 T.C. 239, 243 (1971).

The courts search not merely for the subjective attitude of the donor. They, instead, seek to discover the "true nature of the transaction: whether the 'gift' was made 'in expectation of the receipt of certain specific direct economic benefits within the power of the recipient to bestow directly or indirectly, that which otherwise might not be forthcoming.'" Sutton v. Commissioner, 57 T.C. 239, 243 (1971), quoting Stubbs v. United States, 428 F.2d 885, 887 (9th Cir. 1970); see Elrod v. Commissioner, 87 T.C. 1046, 1076 (1986).[4]

In several cases, courts have found that a taxpayer

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[4] When we are dealing with a gift made by a corporation rather than an individual, we should remember that some incidental benefit to the corporation is allowable. Congress has sought to encourage gifts by corporations and, if there is not incidental business benefit to a corporation (e.g., good will), the act of donating may be considered outside of the corporations's authority. The corporation must be able to justify any charitable contributions to its shareholders. See the discussion of this point in Citizens & Southern Nat'l. Bank of South Carolina v. United States, 243 F. Supp. 900 (D.C. S.C. 1965).

transferred land to a political subdivision in return for favorable rezoning consideration. Thus, the transfer was not a gift. See Stubbs v. United States, 428 F.2d 885 (9th Cir. 1970); Grinsdale v. Commissioner, 59 T.C. 566 (1973); Ackerman Buick, Inc. v. Commissioner, T.C. Memo. 1973-1061. In other cases, courts have denied charitable deductions because they found that the donor's remaining land became more salable or would be capable of development consistent with the donor's wishes only after the transfer. See Elrod v. Commissioner, 87 T.C. 1046 (1986)(the Tax Court allowed the taxpayer a deduction for one transfer but denied deductions for others); Sutton v. Commissioner, 57 T.C. 239 (1971); Perlmutter v. Commissioner, 45 T.C. 311 (1965).

Courts have even gone so far as to deny deductions to donors who transferred land for a public street and a sewer and water system to a city or village on the ground that the political subdivision's agreement to improve and maintain the street, in one case, and the village's agreement to maintain the sewer and water system in the other, provided more than incidental benefits to the taxpayers involved. See United States v. Transamerica Corp., 392 F.2d 522 (9th Cir. 1968); Wolfe v. Commissioner, 54 T.C. 1707 (1970). Based on similar facts, however, courts found that a charitable donation was allowable. See Collman v. Commissioner, 511 F.2d 1263 (9th Cir. 1975); Citizens & Southern Nat'l. Bank v. United States, 243 F. Supp. 900 (D.C. SC 1965); Toole v. Tomlinson, 63-1, USTC para. 9267 (DC Fla. 1963).

The disparity in the courts' holdings highlights the risk in simply looking at a transfer and attempting to make a common sense analysis of the situation without a full inquiry into the negotiations between a donor and a donee and the potential benefit to the donor. In Citizens & Southern Nat'l. Bank of South Carolina v. United States, 243 F. Supp. 900 (D.C. S.C. 1965), it was clear that the court wanted to promote corporate donations that conferred a large benefit on the public. The Bank had donated two parcels of property to the City and the Highway Department so that a highway could be built through the Bank's property and a small amount of cash so that the city could purchase adjoining property to make the highway the proper width. Id. The Bank had purchased land in a blighted area of the city. It had been trying for some years to get a foothold on business in the city. The court found that the Bank wanted to create favorable relations with the community and felt that revitalization of the blighted area in which it owned property would be a significant public relations step. The Bank felt that the building of the highway would further revitalization of the area. Id. at 903.

The court found that, at the time of the transfers, the benefit to the taxpayer's property was the same "in degree and kind" as the benefit to other properties in the area. Id. at 904. The court went on to find that it was difficult for it to imagine a transfer to a "state or municipality of such a modest amount that has resulted in such an extraordinary public benefit." Id. at 905. Finally, the court distinguished cases in which transfers of rights-of-ways for public purposes had been found not to constitute gifts. It noted that, in those cases, the taxpayer had been required to make the transfers in order to be able to transact business in the manner it wished. In the case of the Bank, it did not have to make the transfer as a condition of doing something else. Id. at 906.

In order to reach its decision, the court made findings of fact regarding the taxpayer's history in the area, short and long term goals, the history of the city's transportation plans, negotiations between the city and the taxpayer regarding this and another transfer made by the taxpayer to the city and the ultimate benefit bestowed upon the city. See Citizens & Southern Nat'l. Bank of South Carolina v. United States, 243 F. Supp. 900 (D.C. S.C. 1965). In most, if not all, of the cases we have analyzed in responding to your request, the courts have made an equally wide-ranging inquiry into the facts and circumstances surrounding plans of the donor and the donee and the negotiations between the two regarding the transfer before the court as well as others that may have been made. See, e.g., Elrod v. Commissioner, 87 T.C. 1046 (1986); Sutton v. Commissioner, 57 T.C. 239 (1971).

In Grinsdale v. Commissioner, 59 T.C. 566 (1973), the Tax Court denied the taxpayers a charitable deduction after looking into a complicated series of negotiations between the taxpayer and the donee. The court found that it must start with a "realistic and practical view" that the transfer of the parcel for which the taxpayer sought the deduction was only a part of the total transaction the taxpayers negotiated with the city. The court found that it was compelled to look at the totality of the transactions between the two parties and could not treat one conveyance as a separate and distinct transaction. 59 T.C. 566, 574, 577 (1973).

From the face of the Memorandum Of Agreement executed by [redacted], and the City of [redacted] on [redacted] it appears that the transfer for which [redacted] seeks a charitable deduction in [redacted] was only part of a complex set of negotiations between the parties and that [redacted] received consideration for its transfer. Because we are not yet sure exactly what interest [redacted] transferred and the true value of that interest and do not know the value of the

assets and benefits [redacted] received in exchange, we can not tell whether it received full value for the transfer.

In paragraph [redacted] of the Agreement, the parties agreed that, if the city ever took any action to acquire, take or condemn any of [redacted]'s property for the [redacted], it would pay [redacted] of the sum of the value of the interest in property [redacted] transferred and [redacted] of [redacted]'s costs of improvement thereon in addition to the amount of just compensation for any such taking. This gives rise to the inference that [redacted] stood to gain some benefit from the transfer it made in [redacted] that would no longer exist if the [redacted] were built. We do not have sufficient information from which to guess what the benefit might be.

The Agreement also makes mention of a previous agreement the parties had entered into on [redacted] of which we know nothing. Also, from general, extensive media coverage of the [redacted] project, we know that [redacted], along with [redacted] other large companies donated property to the project in [redacted]. There are two interesting questions that arise from the media coverage. The first is whether there are a series of additional agreements between the City, other companies and [redacted] that should be scrutinized in connection with this issue. The second arises from statements in the newspaper indicating that the value of all property donated by [redacted] companies for the [redacted] project totaled $[redacted]. If accurate, that would make it extremely unlikely that the true value of the right-of-way and improvements transferred in [redacted] by [redacted] was $[redacted] as they claim.

In order to fully develop the issue of whether the transfer made by [redacted] was a charitable one, facts such as those looked at by the Tax Court and Federal district court and described in the second full paragraph of page 12, above, should be sought from the City or other sources.

B. Whether a deduction must be denied pursuant to I.R.C. § 170(f)(3).

I.R.C. § 170(f)(3) was added to the Code in 1969, prohibiting charitable deductions for the transfer of partial interests in property. See Tax Reform Act of 1969, Pub. Law 91-172, sec. 201(a), 83 Stat. 487, 549. In 1976 and 1977, Congress amended the section to make provisions for contributions for certain conservation purposes. See Tax Reform Act of 1976, Pub. L. 94-455, sec. 2124(e)(1), 90 Stat. 1520, 1919; Tax Reduction and Simplification Act of 1977, Pub. L. 95-30, sec 309, 91 Stat. 126, 154. In 1980, Congress repealed the previous provisions and

enacted an exception for "qualified conservation contributions." See Tax Reform Act of 1984, Pub. L. 98-369, sec. 1035, 98 Stat. 494, 1042; Stark v. Commissioner, 86 T.C. 243 (1986).

For gifts made on or before December 17, 1980, Treasury Regulation § 1.170A-7(b)(ii) provided relief for the donation of some easements by declaring that they were to be considered a taxpayer's entire interest in property. Treas. Reg. § 1.170A-7(b)(ii). Now, however, contribution of an easement is denied unless the easement is a taxpayer's entire interest in the property or it falls within the definition of a "qualified conservation contribution" and is, thus, an exception to the prohibition of I.R.C. § 170(f)(3). See Great Northern Nekoosa Corp. and Subsidiaries v. United States, 38 Fed. Cl. 645 (1997); The Stanley Works and Subsidiaries v. Commissioner, 87 T.C. 389 (1986). Because of the changes in the statute and the regulations promulgated thereunder, it is important to note the year in which cases scrutinizing gifts of easements have been decided.

A comparison of language used on the Quitclaim Deed through which the City of [redacted] transferred property to [redacted] on [redacted] with the language used in the Deed of Gift of Right-Of-Way And Road Improvements executed by [redacted] in favor of the City on [redacted] leads us to believe that [redacted] may have transferred an interest which was less than its entire interest in the property. In the Quitclaim Deed, the City stated that it granted, remised, released and forever quitclaimed to [redacted] all of its "right, title and interest in and to the closed streets, public right of way and improvements included therewith, any and all prior easements, prescriptive rights or similar interests related thereto or derived therefrom . . . ." Attached to the Quitclaim Deed was a map prepared by the City's Department of Public Works and an exhibit containing the legal description of the property transferred. Similar language is typically used to convey the owner's entire interest in real property.

In contrast, the language used by [redacted] was: "the Donor does hereby give, grant and convey unto the Donee, without warranty, the Right-of-Way and the Road Improvements, all as depicted on the plat attached hereto as Exhibit A and as more particularly described on Exhibit B attached hereto." The deed goes on to describe the limitations of the use to which the right-of-way and improvements shall be put and states that the "Right-of-way and the Road Improvements shall exist, be subject to and be used in accordance with" the limiting provisions. Although the taxpayers provided you with a copy of Exhibit A, they did not provide you with a copy of Exhibit B that might have clarified the extent of the interest they conveyed.

Black's Law Dictionary defines "right-of-way" as follows:

> 1. A person's legal right, established by usage or by contract, to pass through grounds or property owned by another. Cf. EASEMENT. 2. The right to build and operate a railway line or a highway on land belonging to another, or the land so used. 3. The right to take preference in traffic.

Black's Law Dictionary (Bryan A. Garner ed., West Group 7th ed. 1999). "Easement" is defined as:

> An interest in land owned by another person, consisting in the right to use or control the land or an area above or below it, for a specific limited purpose (such as to cross it for access to a public road). . . . Unlike a lease or license, an easement may last forever, but it does not give the holder the right to possess, take from, improve, or sell the land. The primary recognized easements are (1) a right-of-way . . . .

Black's Law Dictionary (Bryan A. Garner ed., West Group 7th ed. 1999).

Under these definitions, the interest transferred by [redacted] would have been less than the fee simple interest they had valued and on which they based their claimed deduction.[5] In practice, however, parties do not always use a term as it is defined in a law dictionary.

This makes it vitally important that we find out exactly what interest [redacted] conveyed. Perhaps the best source of this information is the City and Exhibit B to the Deed of Gift executed by [redacted] and the City on [redacted].

There is another way in which I.R.C. § 170(f)(3) might apply to the circumstances surrounding [redacted]'s transfer. Although it seems less likely to preclude a deduction, the facts can easily be verified by the City when you contact them regarding other facts we need to flesh out the issue. Pursuant to I.R.C. § 170(f)(3)(A), if the interest that is transferred to the donee

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[5] If [redacted] conveyed an easement but the easement was the only interest they owned at the time of the conveyance, it would not have been an interest in property that is less than the taxpayers' entire interest in the property. Thus, a charitable deduction would not be denied by I.R.C. § 170(f)(3).

may be defeated by the performance of some act or the happening of some event, it may not be the subject of an allowable donation. See, Briggs v. Commissioner, 72 T.C. 646 (1979), aff'd. without published opinion 665 F.2d 1051 (9th Cir. 1981). Pursuant to Treasury Regulation § 1.170A-1(e) and Treasury Regulation § 1.170A-7(a)(3), a deduction of such contribution shall not be disallowed if, on the date of the gift, it appeared that the possibility of the act or the event taking place was so remote as to be negligible. See Stark v. Commissioner, 86 T.C. 243, 254-55 (1986).

In paragraph 2 of the Agreement between [redacted] and the City, they recited that the City's Master Plan had been amended so that it no longer had plans to propose or take action to plan for, acquire, take or develop any of [redacted]'s property in order to construct the [redacted]. Nonetheless, they provided for monetary payments the City would have to make to [redacted] if it ever did take such action. They stated that the agreement regarding the monetary payments was consideration for [redacted]'s agreement to transfer the interests that form the basis for its claim to a charitable deduction.

If the City bears out the fact that, on the day of the transfer, the possibility of their taking action to propose or take action to plan for, acquire, take or develop any of [redacted]'s property in order to construct [redacted] was so remote as to be negligible, Treasury Regulations §§ 1.170A-1(e) and 1.170A-7(a)(3) would protect the charitable deduction from the proscription of I.R.C. § 170(f)(3)(A) on that ground. If, on the other hand, the City informs us that the possibility of their taking the enumerated actions was not negligible at the time of the transfer, it might be that at least ½ of the claimed deduction must be denied pursuant to I.R.C. § 170(f)(3)(A), due to the conditions subsequent set forth in the Agreement.

From all the facts presented, it appears that [redacted] lacked the requisite donative intent and may have been barred from taking its claimed charitable donation because it transferred less than its entire interest in property.

ISSUE 2

At the moment, the facts contained in the file in this case lead us to suspect, but not know, that [redacted] may have transferred an interest in property to the City that was less than their entire interest in the property and may not have had donative intent. If your additional factual development leads to the conclusion that [redacted] did, in fact, transfer only a partial interest in property to the City, the charitable deduction

claimed by [redacted] would be denied according to I.R.C. § 170(f)(3). In that case, an alternative position challenging the amount of the claimed deduction would not be necessary.

On the other hand, if the additional facts you gather lead to the conclusion that [redacted] did transfer their entire interest in property to the City, the alternative position would become very important given the unpredictability of court decisions regarding donative intent.[6] Thus, in a practical sense, the stronger the Service's position under I.R.C. § 170((f)(3), the less necessary a well-supported, alternative position is. Nonetheless, unless our position is very strong, we suggest that you do set up an alternative position contesting the amount of the claimed deduction. This does not mean that we believe you need to base the adjustment on the "review" prepared by the outside expert previously hired.

It is necessary to consider the appropriate kind of valuation that should be employed. If [redacted] were to satisfy you that, although they only transferred an easement, they should not be denied the deduction because they only owned an easement over the property prior to the transfer, the very specialized techniques for valuing easements must be used. Because deductions for donations of partial interests of property are generally denied unless they constitute qualified conservation contributions, we have looked to cases involving the valuation of qualified conservation contributions and extended principles set forth therein to the valuation of easements in general. See I.R.C. § 170(f)(3); Treas. Reg. § 1.170A-14(h)(3)(i); Browning v. Commissioner, 109 T.C. 303 (1997); Schwab v. Commissioner, T.C. Memo. 1994-232; Clemens, et al. v. Commissioner, T.C. Memo. 1992-436.

If comparable easement transfers are available for comparison, they should be used in determining the value of the property transferred. See Browning v. Commissioner, 109 T.C. 303, 312 (1997); Schwab v. Commissioner, T.C. Memo. 1994-232. Such comparables, however, are rarely available. When they are not, the preferred method is to value the easement by finding the difference between the fair market value of the taxpayer's property before the easement is granted and the fair market value of the property after the easement is granted. Under this method, any decline in value represents the value of the

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[6] Because we believe [redacted] greatly inflated the value of the property transferred, the determination of the alternative position might also bolster your argument that imposition of an addition to the tax or a penalty might be appropriate.

easement. See, Treas. Reg. § 1.170A-14(h)(3)(i); Browning v. Commissioner, 109 T.C. 303, 312, et seq. (1997); Schwab v. Commissioner, T.C. Memo. 1994-232; Clemens, et al. v. Commissioner, T.C. Memo. 1992-436.

The more important valuation will arise if the additional facts you find point to a supportable argument by [redacted] that it transferred its entire interest in the strip of land we are considering to the City. In that case, an alternative position, supported by an expert's opinion will be vital. The three major flaws in [redacted]'s appraisal of the property it transferred are its timing, its description of the property transferred and its determination of the highest and best use of that property.

[redacted] transferred the improved strip of land on [redacted]. It did not transfer an unrestricted strip of land on the valuation date of [redacted] and then complete improvements that it transferred. It is a long and well-established rule that the fair market value of an alleged gift must be determined as of the date of its donation. See, Treas. Reb. § 1.170A-1(c)(1); Browning v. Commissioner, 109 T.C. 303, 311 (1997).

[redacted], [redacted]'s appraiser, valued the property as a fee simple interest in an unimproved strip of land, "subject only to the limitations of eminent domain, escheat, police power and taxation." Instead, the property transferred was a roadway and, by the terms of the transfer, it could only be used and maintained by the City as a public street.

In its memorandum opinion in Clemens, et al. v. Commissioner, the United States Tax Court stated that, "[r]ealistic, objective potential uses control valuation" of property. T.C. Memo. 1992-436, citing, The Stanley Works and Subsidiaries v. Commissioner, 87 T.C. 389, 400 (1986). The property transferred by [redacted] could only be used as a public roadway. [redacted] based his valuation on his definition of highest and best use as "its best use if it is vacant and available for development." That definition can not be applied to the property transferred by [redacted] on [redacted]. [redacted]'s determination that the highest and best use of the land was for office purposes can not be a "realistic, objective potential" use of the land conveyed on the date of the transfer. [redacted] significantly altered the land and restricted its potential use between the time of [redacted]'s appraisal and the time of its transfer.

We feel certain that the value of the property transferred by [redacted] is significantly less than that claimed. The litigating hazards regarding the value of the transfer would be markedly

reduced if our position were based upon a carefully-defined expert appraisal.

There is one final valuation issue that might arise depending upon nature of facts you may receive in the future. If those facts lead you to believe that the consideration received by [redacted] might not have equaled the value of the property they transferred, valuations of the consideration they received would be appropriate.

Once you have received facts that more clearly reveal the exact interest in property that was transferred by [redacted], please contact me if you would like assistance in developing a request for an appraisal.

ISSUE 3

Due to the fact that City Manager [redacted] signed both the [redacted] Agreement between [redacted] and the City and the "Gift Acknowledgment" on [redacted] you believe that [redacted] and [redacted] may have colluded to make a non-gift transfer appear to be a gift for tax purposes. Therefore, you are considering determining that [redacted] is liable for an addition to the tax or penalty. Because we do not presently have sufficient facts in the file regarding behavior on the part of [redacted] that would form the basis of a determination that the taxpayers are liable for one or more additions to the tax or penalties, we can not analyze this issue. As you find more facts, particularly from the City's perspective, we will be glad to work with you to evaluate the possibility of raising additions to the tax or penalties.

Because there is no additional advice you have requested at this time, we are closing our file regarding this matter. If we may be of additional assistance, please contact me at (804) 916-3947.

[redacted]
Senior Attorney (LMSB)

cc: Case Coordinator [redacted]