

# Part III. Administrative, Procedural, and Miscellaneous

## Charitable Contributions and Conservation Easements

### Notice 2004-41

The Internal Revenue Service is aware that taxpayers who (1) transfer an easement on real property to a charitable organization, or (2) make payments to a charitable organization in connection with a purchase of real property from the charitable organization, may be improperly claiming charitable contribution deductions under § 170 of the Internal Revenue Code. The purpose of this notice is to advise participants in these transactions that, in appropriate cases, the Service intends to disallow such deductions and may impose penalties and excise taxes. Furthermore, the Service may, in appropriate cases, challenge the tax-exempt status of a charitable organization that participates in these transactions. In addition, this notice advises promoters and appraisers that the Service intends to review promotions of transactions involving these improper deductions, and that the promoters and appraisers may be subject to penalties.

#### *Contributions of Conservation Easements*

Section 170(a)(1) allows as a deduction, subject to certain limitations and restrictions, any charitable contribution (as defined in § 170(c)) that is made within the taxable year. Generally, to be deductible as a charitable contribution under § 170, a transfer to a charitable organization must be a gift of money or property without receipt or expectation of receipt of adequate consideration, made with charitable intent. *See U.S. v. American Bar Endowment*, 477 U.S. 105, 117-18 (1986); *Hernandez v. Commissioner*, 490 U.S. 680, 690 (1989); *see also* § 1.170A-1(h)(1) and (2) of the Income Tax Regulations.

Section 170(f)(3) provides generally that no charitable contribution deduction is allowed for a transfer to a charitable organization of less than the taxpayer's entire interest in property. Section 170(f)(3)(B)(iii) provides an exception to this rule in the case of a qualified conservation contribution.

A qualified conservation contribution is a contribution of a qualified real prop-

erty interest to a qualified organization exclusively for certain conservation purposes. Section 170(h)(1), (2), (3), and (4); § 1.170A-14(a). A qualified real property interest includes a restriction (granted in perpetuity) on the use that may be made of the real property. Section 170(h)(2)(C); *see also* § 1.170A-14(b)(2). For purposes of this notice, qualified real property interests described in § 170(h)(2)(C) are referred to as conservation easements.

One of the permitted conservation purposes listed in § 170(h)(4) is the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem. Section 170(h)(4)(A)(ii); *see also* § 1.170A-14(d)(1)(ii) and (3). Another of the permitted conservation purposes is the preservation of open space ("open space easement"), including farmland and forest land, for the scenic enjoyment of the general public or pursuant to a clearly delineated governmental conservation policy. However, if the public benefit of an open space easement is not significant, the charitable contribution deduction will be disallowed. *See* § 170(h)(4)(A)(iii); *see also* § 1.170A-14(d)(1)(iii) and (4)(iv), (v), and (vi). Section 170(h) and § 1.170A-14 contain many other requirements that must be satisfied for a contribution of a conservation easement to be allowed as a deduction.

A charitable contribution is allowed as a deduction only if substantiated in accordance with regulations prescribed by the Secretary. Section 170(a)(1) and (f)(8). Under § 170(f)(8), a taxpayer must substantiate its contributions of \$250 or more by obtaining from the charitable organization a statement that includes (1) a description of any return benefit provided by the charitable organization, and (2) a good faith estimate of the benefit's fair market value. *See* § 1.170A-13 for additional substantiation requirements. In appropriate cases, the Service will disallow deductions for conservation easement transfers if the taxpayer fails to comply with the substantiation requirements. The Service is considering changes to forms to facilitate compliance with and enforcement of the substantiation requirements.

If all requirements of § 170 are satisfied and a deduction is allowed, the amount of

the deduction may not exceed the fair market value of the contributed property (in this case, the contributed easement) on the date of the contribution (reduced by the fair market value of any consideration received by the taxpayer). *See* § 1.170A-1(c)(1), (h)(1) and (2). Fair market value is the price at which the contributed property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell, and each having reasonable knowledge of relevant facts. Section 1.170A-1(c)(2). *See* § 1.170A-14(h)(3) and (4) for a discussion of valuation.

If the donor (or a related person) reasonably can expect to receive financial or economic benefits greater than those that will inure to the general public as a result of the donation of a conservation easement, no deduction is allowable. Section 1.170A-14(h)(3)(i). If the donation of a conservation easement has no material effect on the value of real property, or enhances rather than reduces the value of real property, no deduction is allowable. Section 1.170A-14(h)(3)(ii).

#### *Purchases of Real Property from Charitable Organizations*

Some taxpayers are claiming inappropriate charitable contribution deductions under § 170 for cash payments or easement transfers to charitable organizations in connection with the taxpayers' purchases of real property.

In some of these questionable cases, the charitable organization purchases the property and places a conservation easement on the property. Then, the charitable organization sells the property subject to the easement to a buyer for a price that is substantially less than the price paid by the charitable organization for the property. As part of the sale, the buyer makes a second payment, designated as a "charitable contribution," to the charitable organization. The total of the payments from the buyer to the charitable organization fully reimburses the charitable organization for the cost of the property.

In appropriate cases, the Service will treat these transactions in accordance with their substance, rather than their form. Thus, the Service may treat the total of the

buyer's payments to the charitable organization as the purchase price paid by the buyer for the property.

#### *Penalties, Excise Taxes, and Tax-Exempt Status*

Taxpayers are advised that the Service intends to disallow all or part of any improper deductions and may impose penalties under § 6662.

The Service intends to assess excise taxes under § 4958 against any disqualified person who receives an excess benefit from a conservation easement transaction, and against any organization manager who knowingly participates in the transaction. In appropriate cases, the Service may challenge the tax-exempt status of the organization, based on the organization's operation for a substantial nonexempt purpose or impermissible private benefit.

In addition, the Service intends to review promotions of transactions involving improper deductions for conservation easements. Promoters, appraisers, and other persons involved in these transactions may be subject to penalties under §§ 6700, 6701, and 6694.

#### DRAFTING INFORMATION

The principal author of this notice is Patricia M. Zweibel of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Ms. Zweibel at (202) 622-5020 (not a toll-free call).

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## **Request For Comments Regarding Rev. Proc. 81-70, 1981-2 C.B. 729**

### **Notice 2004-44**

Section 368(a)(1)(B) of the Internal Revenue Code defines as a reorganization the acquisition by one corporation, in exchange solely for all or part of its voting stock (or in exchange solely for all or a part of the voting stock of a corporation which is in control of the acquiring corporation), of stock of another corporation if, immediately after the acquisition, the acquiring corporation has control of such other corporation (whether or not such acquiring corporation had control immediately before the acquisition) (a B reorganization).

Section 362(b) generally provides that the basis of property acquired by a corporation in connection with a reorganization shall be the same as it would be in the hands of the transferor. Therefore, the acquiring corporation's basis in the stock acquired in a B reorganization is determined by reference to the basis of the former shareholders in such stock.

In Rev. Proc. 81-70, 1981-2 C.B. 729, the Internal Revenue Service set forth guidelines for estimating the basis of stock acquired by an acquiring corporation in a B reorganization. That revenue procedure permits the acquiring corporation in a B reorganization to apply certain statistical sampling techniques to determine its basis in the acquired stock. The guidelines reflect the recognition that the information needed by the acquiring corporation to establish the basis of the acquired corporation's stock is in the possession of the former shareholders of the acquired corporation, who may not respond to basis inquiries. They also reflect the recognition that, in certain cases, it may be time consuming, burdensome and costly for the acquiring corporation to contact each former shareholder of the acquired corporation.

The Service is concerned that changes in the marketplace since Rev. Proc. 81-70 was issued may have rendered compliance with its requirements for statistical sampling unduly burdensome or impossible and that, therefore, taxpayers are not complying with those requirements. For example, the Service understands that the way stock is held today may prevent or hinder access to the information necessary to determine the shareholder's basis in such stock.

A number of commentators have suggested that the Service revise Rev. Proc. 81-70. The Service requests comments regarding problems taxpayers are encountering in their effort to comply with the requirements of Rev. Proc. 81-70 and whether it should be modified.

The Service particularly seeks comments from those who perform basis studies that are intended to comply with the requirements of Rev. Proc. 81-70, those engaged in providing services and information to the investment community (including those who maintain custodial information that may be used in such studies, such as broker/dealers, banks, and

similar organizations), and other interested parties.

In addition, from those that perform basis studies that are intended to comply with the requirements of Rev. Proc. 81-70, the following information is specifically requested: (i) descriptions of the sources of information, both historic and recent, available for use in performing basis studies; and (ii) descriptions of the methodologies utilized to determine the basis of stock held by persons that do not respond to requests for basis information.

From record keepers, the following information is specifically requested: (i) descriptions of the kinds of information that are maintained that may be used to perform basis studies and of the sources of this information; (ii) statements describing the length of time that this information is generally maintained and available for use; and (iii) descriptions of confidentiality concerns, if any, that may impair or delay a response to a basis inquiry.

Please submit all comments by September 30, 2004. Written comments should be sent to:

Internal Revenue Service  
Attn: CC:PA:LPD:PR  
(Notice 2004-44)  
Room 5203  
P. O. Box 7604  
Ben Franklin Station  
Washington, DC 20044

Or hand delivered between the hours of 8 a.m. and 4 p.m. to:

Courier's Desk  
Internal Revenue Service  
Attn: CC:PA:LPD:PR  
(Notice 2004-44)  
1111 Constitution Avenue, N.W.  
Washington, D.C. 20224

Alternatively, comments may be submitted electronically via e-mail to the following address: [Notice.Comments@irs.counsel.treas.gov](mailto:Notice.Comments@irs.counsel.treas.gov). Please include "Notice 2004-44" in the subject line. All comments will be available for public inspection and copying in their entirety.

#### FOR FURTHER INFORMATION

For information regarding estimates and sampling techniques, please con-