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PLR-130310-18

Date:  
June 04, 2019

Foundation =  
State =  
Conservation Property =  
Endangered Bird Species =  
X =

Dear :

This letter responds to a request for a ruling from your authorized representatives dated October 1, 2018, that a portion of real property owned by Foundation is used or held for use directly in carrying out Foundation’s exempt purpose and, therefore, (i) Foundation can exclude the fair market value of the exempt use portion of the property, as defined below, for purposes of determining its minimum investment return under section 4942(e); and (ii) the expenses incurred in operating and maintaining the exempt use portion of the property constitute qualifying distributions within the meaning of section 4942(g)(1).

**FACTS**

Foundation is a State law charitable trust, which is recognized as a tax-exempt organization described in section 501(c)(3) and classified as a private foundation under section 509(a).

Foundation’s charitable purposes include conservation and the protection of natural resources. Foundation acquired Conservation Property approximately five years prior to submitting this request for rulings. Conservation Property consists of approximately X acres located in State and is home to many native varieties of trees threatened by non-native invasive species, and several types of at-risk plants, including two wildflower species, one of which is listed as threatened and the other as endangered under the Endangered Species Act, which is administered by the U.S. Fish and Wildlife Service and the Commerce Department’s National Marine Fisheries Service. Conservation Property also is an important habitat for various animals that roam the property, including two clusters of an Endangered Bird Species.

Foundation granted a conservation easement on Conservation Property to a tax-exempt organization recognized as described in section 501(c)(3) and classified as a public charity under section 509(a)(1). The purposes of the conservation easement include to “conserve and enhance the character of the Protected Property as predominantly hardwood bottomland and upland pine forests, wildlife and game habitat, biological diversity, scenic quality, unique historical and cultural features, native flora and fauna, rare species and communities protection, water quality and watershed protection” of the river running through Conservation Property and its “perennial tributaries, wetlands, and riparian zones, and the ecological processes which support them....” The conservation easement also prohibits any uses or activities that may threaten the viability of any species listed as threatened or endangered by State or the federal government.

Foundation’s trustees adopted a “Timber Management Plan” and a “Strategic Vision,” which provide a framework for managing Conservation Property, including monitoring stands of trees for insect and disease occurrences in conjunction with ongoing herbicide applications to eradicate non-native invasive species of plants and promoting the regeneration of native hardwood plant species. Low-intensity prescribed burn applications will be conducted to increase plant and animal diversity, promote plant growth, increase light availability, and help control invasive plants. Conservation Property also includes two habitat management areas which provide a high-quality habitat for Endangered Bird Species and will be operated in a manner that complies with a habitat conservation program established by a partnership between a State agency and a program operated by a university to conserve and protect the resources and lands of State. Foundation conducts timbering activity solely in furtherance of conservation initiatives, and income received from removed trees is used to pay for prescribed burns, maintenance of access roads, and the purchase of herbicides and other expenses related to conservation and natural resource protection objectives.

Foundation employs an executive director to develop and implement research, conservation, and outreach programs. The purpose of the research program is to build academic networks and promote scientific research on Conservation Property. Foundation provides access to Conservation Property at no cost to groups from local universities, government agencies, and other organizations for research and educational purposes. Foundation anticipates making grants (and exercising expenditure responsibility, if required) to academic institutions to support one or more researchers whose work will focus on specific questions related to Conservation Property ecosystems, and creating an internship program with one or more local universities to provide experience and training opportunities for college students majoring in natural resources and/or environmental sciences to receive valuable training specific to conservation and land management. Ultimately, Foundation anticipates creating an organization to oversee Conservation Property operations and also a research institute. Foundation’s outreach program intends to find creative ways to translate knowledge from complex properties like Conservation Property to small, family-owned properties by sponsoring regional stewardship events, with Conservation Property serving as a setting for regional policy workshops. The events will focus on

specific issues related to conservation, water policy, prescribed fire, air quality, and other needs.

Foundation is the lessor of two hunting leases on Conservation Property, both of which are subject to the conservation easement. Foundation represents that hunting is an extremely important aspect of land conservation and maintaining a healthy ecosystem. Both leases follow a game management plan prepared annually by the property manager, strict adherence to which ensures that only certain mature animals are targeted so that the health and quality of wildlife on Conservation Property improve over time. Foundation ensures that safe hunting practices and operational procedures are followed by meeting with hunters daily during hunting season and providing content to hunters regarding harvest goals, safety reminders, and concerns regarding actions by hunters. One of the lessees has a full-time employee trained in conservation and wildlife management who acts as a liaison to Foundation to ensure that the game management plan is followed.

Foundation states that but for the leases, it would be required to expend tremendous resources to hire a large enough staff to perform the hunting activities necessary to maintain a healthy ecosystem on Conservation Property. Other benefits of permitting controlled hunting include having extra sets of eyes and ears on the property to observe and record the number and types of species encountered, as well as detect the need for fence, road, and culvert repair, and to identify fallen trees and incidents of trespassing.

Accordingly, Foundation represents that, except for the fair market values of the two hunting leases and of the lodge and other improvements located on land subject to one of the leases, Conservation Property is used exclusively for exempt purposes ("Exempt Use Portion").

## **RULINGS REQUESTED**

Foundation requests the following rulings:

1. Foundation may exclude the fair market value of the Exempt Use Portion of Conservation Property for purposes of determining Foundation's minimum investment return pursuant to section 4942(e).
2. Foundation may treat the payment of expenses incurred in operating and maintaining the Exempt Use Portion of Conservation Property as qualifying distributions within the meaning of section 4942(g)(1).

## **LAW**

Section 4942(a) generally imposes on the undistributed income of a private foundation for any taxable year, which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year (if such first day falls within

the taxable period), a tax equal to 30 percent of the amount of such income remaining undistributed at the beginning of such second (or succeeding) taxable year.

Section 4942(c) provides that “undistributed income” is the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made out of such distributable amount.

Section 4942(d) defines “distributable amount” as an amount equal to the sum of the minimum investment return plus the amounts described in section 4942(f)(2)(C), reduced by the sum of the taxes imposed on the private foundation for the taxable year under subtitle A and section 4940.

Section 4942(e)(1) defines the term “minimum investment return” as five percent of the excess of the aggregate of fair market value of all assets of the private foundation other than those which are used (or held for use) directly in carrying out the foundation's exempt purposes, over the acquisition indebtedness (determined under section 514(c)(1) without regard to the taxable year in which the indebtedness was incurred).

Section 4942(g)(1) defines “qualifying distribution” as any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B), other than contributions to certain other organizations, or any amount paid to acquire an asset used (or held for use) directly in carrying out one or more purposes described in section 170(c)(2)(B).

Treas. Reg. § 53.4942(a)-2(c)(2)(v) provides that the assets taken into account in determining minimum investment return shall not include any assets used (or held for use) directly in carrying out the foundation's exempt purpose.

Treas. Reg. § 53.4942(a)-2(c)(3)(i) provides, in part, that an asset is used (or held for use) directly in carrying out a foundation's exempt purpose only if the asset is actually used by the foundation in carrying out the charitable, educational, or other similar purpose which gives rise to the exempt status of the foundation. Consequently, assets which are held for the production of income or for investment (for example, stocks, bonds, interest-bearing notes, endowment funds, or, generally, leased real estate) are not being used (or held for use) directly in carrying out the foundation's exempt purpose, even though the income from such assets is used to carry out the foundation's exempt purpose. Whether an asset is held for the production of income or for investment rather than used (or held for use) directly by the foundation to carry out its exempt purpose is a question of fact. However, where exempt use of property represents less than 95 percent of the property's total use, a reasonable allocation between such exempt and nonexempt use must be made.

Treas. Reg. § 53.4942(a)-2(c)(3)(ii) gives examples of assets which are “used (or held for use) directly in carrying out the foundation's exempt purpose,” including real estate

or the portion of a building used by a foundation directly in its charitable, educational, or other similar exempt activities.

Treas. Reg. § 53.4942(a)-3(a)(8), Example (1) provides for illustration of what constitutes a “qualifying distribution” that payments of compensation to employees of a private foundation for performing work on activities in furtherance of an exempt purpose and of items of overhead attributable to the activities of such employees in furtherance of an exempt purpose are qualifying distributions as payments of reasonable administrative expenses paid by the foundation to accomplish section 170(c)(1) or (2)(B) purposes under section 4942(g)(1).

Rev. Rul. 67-292, 1967-2 C.B. 184, provides that an organization formed to purchase and maintain a large tract of land as a forest to be reserved as a sanctuary for wild birds and animals and to be open to the public for educational purposes is exempt from federal income tax and described in section 501(c)(3).

Rev. Rul. 70-186, 1970-1 C.B. 129, provides that an organization formed to preserve a large lake as a public recreational facility and to improve the condition of the water in the lake to enhance its recreational features is exempt from federal income tax and described in section 501(c)(3). Any private benefits derived by the lake front property owners do not lessen the public benefits flowing from the organization’s operations.

Rev. Rul. 75-207, 1975-1 C.B. 361, describes a private foundation formed to further conservation, education, and the arts. The foundation owns and maintains an island dedicated to preserving the natural ecosystems and historical and archaeological remains on the island, which has no residential use. Access is limited to invited public and private researchers. The ruling holds that the island is being used directly to carry out the foundation’s exempt purpose in the manner indicated in the regulations under section 4942. Accordingly, the foundation may exclude the value of the island in computing its minimum investment return under section 4942(e).

Rev. Rul. 76-204, 1976-1 C.B. 152, describes an organization formed by scientists, conservationists, and other community representatives for the purpose of preserving the environment. It accomplishes this purpose by acquiring and maintaining (or transferring to a governmental agency) ecologically significant undeveloped land such as swamps, marshes, forests, wilderness tracts, and other natural areas. Generally, public access to such land is limited so that the delicate balance of the ecosystem remains undisturbed. In these situations, the organization will allow educational and scientific research or study, as long as such use will not disrupt the particular ecosystem. The ruling concludes that the organization is enhancing the accomplishment of an express national policy of conserving the nation’s unique natural resources and, in this sense, is advancing education and science and benefiting the public in a manner that the law regards as charitable. Furthermore, the restrictions on current access to the lands maintained by the organization are essential to the preservation of their natural state, and are therefore essential to the fulfillment of the organization’s charitable purpose.

Public benefit from environmental conservation derives not merely from the current educational, scientific, and recreational uses that are made of natural resources, but also from their preservation.

Rev. Rul. 82-137, 1982-2 C.B. 303, holds that the percentage of exempt use of a building owned by a private foundation, a portion of which is leased to commercial tenants, should be determined by dividing the fair rental value of that portion of the building used for exempt purposes by the fair rental value of the entire building.

## **ANALYSIS**

### Ruling 1

Foundation has been implementing its Strategic Vision to conserve and protect the natural resources, including threatened and endangered plant and animal species, of Conservation Property, which is subject to a conservation easement granted to and enforceable by a public charity. Conservation of natural resources and preservation of the environment, including forests, ecologically significant undeveloped land, and wildlife sanctuaries, is a recognized exempt purpose under section 501(c)(3). See Rev. Rul. 67-292, Rev. Rul. 70-186, and Rev. Rul. 76-204. Similar to the organization in Rev. Rul. 75-207, Foundation has consistently provided access to Conservation Property to groups from local universities and other organizations for research and educational purposes. Foundation also has an outreach program directed to educating other landowners in the region and sponsoring events and workshops related to conservation and other issues. Hunting is permitted on the property pursuant to a game management plan and only to the extent necessary to maintain a healthy ecosystem on Conservation Property, while the only timbering activity Foundation conducts is focused solely on conservation initiatives.

A private foundation's "distributable amount" under section 4942(d) is defined in reference to its minimum investment return, the calculation of which, under section 4942(e)(1), begins with a determination of the fair market value of all assets other than those which are used (or held for use) directly in carrying out the foundation's exempt purposes. Thus, a private foundation may exclude from its calculation of minimum investment return the value of assets which are used (or held for use) directly in carrying out the foundation's exempt purpose. See Treas. Reg. § 53.4942(a)-2(c)(2)(v). Under Treas. Reg. § 53.4942(a)-2(c)(3)(i), an asset is used (or held for use) directly in carrying out a foundation's exempt purpose only if the asset is actually used by the foundation in carrying out the charitable, educational, or other similar purpose which gives rise to the exempt status of the foundation. If exempt use of property represents less than 95 percent of the property's total use, a reasonable allocation between such exempt and nonexempt use must be made. A reasonable allocation between exempt and nonexempt use may be determined, in some cases, by dividing the fair rental value of a portion of a building used for exempt purposes by the fair rental value of the entire building. See Rev. Rul. 82-137.

Foundation is using Conservation Property directly in carrying out its exempt purposes by using the land for conservation, research, and educational purposes, although such use represents less than 95 percent of the property's total use. As represented by Foundation, the Exempt Use Portion of Conservation Property is its fair market value, reduced by the fair market values of the leases and of the lodge and other improvements located on land subject to one of the leases. Accordingly, the fair market value of the Exempt Use Portion of Conservation Property may be excluded from the calculation of Foundation's minimum investment return.

### Ruling 2

Foundation is using Conservation Property for exempt purposes described in section 170(c)(2)(B), as explained above. Under section 4942(g)(1), a "qualifying distribution" includes any amount (including that portion of reasonable and necessary administrative expenses) paid to accomplish one or more purposes described in section 170(c)(2)(B). See Treas. Reg. § 53.4942(a)-3(a)(8), Example (1). Foundation's reasonable and necessary expenses it incurs in operating and maintaining the Exempt Use Portion of Conservation Property may be treated as qualifying distributions.

### **RULINGS**

Based solely on the facts and representations submitted by Foundation, we rule as follows:

1. Foundation can exclude the fair market value of the Exempt Use Portion of Conservation Property for purposes of determining its minimum investment return pursuant to section 4942(e).
2. Foundation can treat the payment of reasonable and necessary expenses incurred in operating and maintaining the Exempt Use Portion of Conservation Property as qualifying distributions within the meaning of section 4942(g)(1).

The rulings contained in this letter are based upon information and representations submitted by or on behalf of Foundation and accompanied by a penalty of perjury statement executed by an appropriate party, as specified in Rev. Proc. 2019-1, 2019-1 I.R.B. 1, § 7.01(16)(b). This office has not verified any of the material submitted in support of the request for ruling, and such material is subject to verification on examination. The Associate Office will revoke or modify a letter ruling and apply the revocation retroactively if: (1) there has been a misstatement or omission of controlling facts; (2) the facts at the time of the transaction are materially different from the controlling facts on which the ruling is based; or (3) the transaction involves a continuing action or series of actions and the controlling facts change during the course of the transaction. See Rev. Proc. 2019-1, § 11.05.

Except as specifically set forth above, no opinion is expressed or implied concerning the federal tax consequences of the proposed transaction under any other provision of the Code or regulations, including the determination of the fair market value of the Exempt Use Portion and whether the grant of the conservation easement was a qualified conservation contribution within the meaning of section 170(h).

This letter is directed only to Foundation. Section 6110(k)(3) provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to Foundation's authorized representatives.

If you have any questions about this ruling, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

Mike Repass  
Senior Technician Reviewer  
Exempt Organizations Branch 3  
(Employee Benefits, Exempt Organizations, and  
Employment Taxes)

cc: