

Internal Revenue Service

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Department of the Treasury

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Date:
November 26, 2001

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- ConOrg 1 =
- County X =
- State X =
- The Farm =
- Farm, Inc. =
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Dear

This responds to your letter dated May 8, 2001, requesting a ruling on the proper federal income tax treatment of a proposed grant of a conservation easement by Taxpayer to ConOrg 1 with respect to land owned by Taxpayer in County X, State X, as supplemented by letters and submissions dated June 14, July 24, July 31 and October 11, 2001.

REQUESTED RULINGS:

1. The grant of the proposed conservation easement by Taxpayer to ConOrg 1 will be a "qualified conservation contribution" under § 170(h) of the Internal Revenue Code.

2. The members of Taxpayer, and not Taxpayer itself, will be considered as having made the qualified conservation contribution, in proportion to their respective partnership interests.

APPLICABLE FACTS:

Taxpayer is a partnership, organized as a State X limited liability company in for the purpose of acquiring and owning certain property in County X (hereinafter, "The Farm"). Taxpayer has members, most of whom are individuals residing in the vicinity of The Farm.

On , Taxpayer acquired title to The Farm. This property was owned and operated previously by Farm, Inc. The principal activity conducted on the property was that of raising and training horses, including champion hunters, jumpers and race horses. Farm, Inc. was owned by members of Family. In , because of the death of certain members of Family and the cessation of horse training activities at The Farm, the shareholders of Farm, Inc. decided to sell The Farm. Founders of Taxpayer recognized that sale of The Farm to real estate developers would subject the land to extensive commercial and residential development, thus destroying its character as open space, woodlands and pasture forever.

Founder 1 and her husband were long-time employees of Farm, Inc. and therefore were familiar with the property and the members of Family. Founder 2 was a local resident heavily involved in conservation efforts through Conorg 2, a § 501(c)(3) corporation headquartered near The Farm. Both Founders believed that The Farm needed protection from intensive development to preserve the character of the entire community. The following are the specific reasons given by Taxpayer for protecting The Farm:

First: The Farm is one of the largest tracts of land under single ownership in County X and is completely undeveloped except for one residence and a commercial stable. The remainder of the property is wooded and pastured, except for ponds, a acre lake and a mile training track. Virtually no restrictions exist with respect to any development of the property under state or local law. The property is not subject to any zoning regulation.

Second: Foundation, a § 501(c)(3) organization formed to promote trails in State X, has expressed a desire to obtain a trail easement though The Farm to form part of Trail X, a trail extending from State X's coast to the mountains. A portion of Trail X already exists nearby, extending from a point about mile north of The Farm.

Third: Portions of The Farm contain unique biological and botanical features which have been studied by the biology department at College X over the past years. The existence of such features as well as the presence of endangered plant life was recently confirmed by a biological study conducted by Dr X.

Fourth: The northeastern corner of The Farm adjoins the site of Battle X, a battle of the , which has been identified by Project X of Foundation as a

priority site for protection and preservation. The easement will help protect the character of this historic site. Foundation has requested that Taxpayer place a monument just off Highway X on the subject property, near the battle site, with space sufficient to accommodate parking of a few cars at the site of the monument. In this way the battle site will become more easily identifiable and accessible to visitors. Taxpayer has assented to this request.

Fifth: Directly across Highway X, on The Farm's northern boundary, is Farm X, which includes a residence built in _____ and which also borders on the site of Battle X. The Farm X property was protected by a conservation easement granted to ConOrg 1 in _____. The conservation easement over The Farm will greatly enhance the protection of scenic vistas and the site of Battle X already afforded by the Farm X easement.

Because of these factors, Founders approached the principals of Farm, Inc. and negotiated a purchase contract. Taxpayer was formed to purchase The Farm. The purchase contract was executed on _____. Taxpayer then raised approximately \$ _____ by sale of its stock to acquire this property six months later.

The persons who purchased Taxpayer's stock will each receive a deeded "Distribution Tract," after Taxpayer grants the conservation easement on The Farm. The Distribution Tracts vary in size from _____ to _____ acres. The conservation easement will prohibit all development on the _____ Distribution Tracts except for construction of a single family residence and related structures on _____ of them. After conveyance of the Distribution Tracts, Taxpayer will retain ownership of the remaining _____ acres which, along with the four "Agricultural Tracts" on _____ acres, will remain barred from development in perpetuity. In addition, most of the land area in each Distribution Tract on which a single family residence is permitted will also remain in pasture and woodland in perpetuity. Thus, the conservation easement will maintain over 80 percent of the entire tract in its presently undeveloped state.

Following acquisition of The Farm, Taxpayer demolished the training track, old tenant houses, old wire fencing and farm equipment shed. It also conducted a general clean up. Presently, all pond dams are being inspected and repaired. The approximate location of riding trails and the Trail X easement are being located. A Preliminary Land Use Plan was developed which will be finalized prior to the grant of the conservation easement. Taxpayer will incorporate the Plan with the conservation easement restrictions.

Taxpayer proposes to grant, by deed, a conservation easement to ConOrg 1, a publicly supported organization described in §§ 509(a)(1) and 170(b)(1)(A)(vi) of the Code. ConOrg 1 is operated exclusively for charitable purposes and carries on an active program of conservation activities with specific emphasis on promotion of open space and countering urban sprawl in the region of State X where The Farm is situated. Under the conservation easement, ConOrg 1 will have the right to enforce the restrictions described in the conservation easement.

Simultaneously with Taxpayer's acquisition of The Farm, one of Taxpayer's

members acquired an adjoining parcel of _____ acres from Farm, Inc. A commercial riding and stable operation is conducted on that tract under a lease. The member entered into an agreement with Taxpayer to subject his property to the same conservation easement by contributing an identical easement on this property to Taxpayer which will thereafter be reconveyed by Taxpayer to ConOrg 1. However, that part of the tract which is leased to a commercial stable will become subject to the conservation easement restrictions only after the commercial lease terminates.

Pursuant to State X law, a conservation easement such as is proposed by Taxpayer is expressly permitted and is enforceable in perpetuity against the owners of the restricted property and their successors.

LAW AND ANALYSIS

Requested Ruling No. 1:

Section 170(a)(1) of the Code permits a deduction for a charitable contribution, as defined in § 170(c). Section 170(c) defines a charitable contribution as a contribution or gift to or for the use of certain qualifying organizations.

Under § 170(f)(3)(A) of the Code, a taxpayer who contributes, not in trust, less than the taxpayer's entire interest in property generally is not allowed a deduction. However, § 170(f)(3)(B)(iii) provides an exception to this rule in the case of a qualified conservation contribution. Section 170(h)(1) of the Code and § 1.170A-14(a) of the Income Tax Regulations define a qualified conservation contribution as a contribution of a qualified real property interest to a qualified organization exclusively for conservation purposes.

1. Qualified Real Property Interest

Section 170(h)(2)(C) of the Code defines the term "qualified real property interest" to include a restriction granted in perpetuity on the use of real property. Section 1.170A-14(b)(2) of the regulations states that a qualified real property interest includes a perpetual conservation restriction, which is a restriction granted in perpetuity on the use that may be made of real property including an easement or interest in real property that under state law has the attributes similar to an easement.

In the present case, Taxpayer will grant the conservation easement on The Farm pursuant to the State X _____ (the "Act") of _____, Citation X. The Farm is real property. The Act provides for granting of conservation easements of unlimited duration, which easements may provide for restrictions on the use of real property, which restrictions are enforceable in perpetuity against the owner of the property and successors. Therefore, the conservation easement will be a qualified real property interest within the meaning of § 1.170A-14(b)(2) of the regulations.

2. Qualified Organization -- Eligible Donee

Under § 170(h)(3)(A) of the Code, the term "qualified organization" includes an

organization which is described in § 170(b)(1)(A)(vi). The Service has determined that ConOrg 1 is an organization described in section 170(b)(1)(A)(vi) and, therefore, constitutes a qualified organization.

Section 1.170A-14(c)(1) of the regulations provides that for a qualified organization to be an eligible donee of a qualified conservation contribution, it must also have a commitment to protect the conservation purposes of the donation, and the resources to enforce the restrictions. It further provides that a conservation group organized or operated primarily or substantially for one of the conservation purposes specified in § 170(h)(4)(A) will be considered to have the commitment required by the preceding sentence. A qualified organization need not set aside funds to enforce the restrictions that are the subject of the contribution.

However, under § 1.170A-14(c)(2) of the regulations, the donor must prohibit transfers of the easement by the donee, unless, subsequent to the transfer, the donee requires that the conservation purpose continue to be carried out, and the subsequent transferee qualifies as an eligible donee under § 1.170A-14(c)(1). The deed of easement must require any transferee to assume the responsibilities of Donee under the easement. Additionally, the transferee must be a qualified organization under § 170(h) of the Code and be eligible under State's statute to hold the easement.

In the present case, all statutory and regulatory requirements as to eligibility of transferees of donees are satisfied by the provisions of paragraphs 17 and 18 of the instrument granting the conservation easement. Specifically, paragraph 17 provides that the rights and obligations under the conservation easement are assignable only to any organization that is qualified under § 170(h) of the Code and the applicable regulations promulgated thereunder, and authorized to acquire and hold conservation easements under State X law. Paragraph 17 further provides that as a further condition for assigning the easement, the grantee "shall require that the conservation purposes that the grant is intended to advance continue to be carried out." Under paragraph 18 the grantor of the conservation easement must incorporate the terms of the easement in any deed or other legal instrument by which there is any transfer or divestment of any interest or portion of the protected property. Accordingly, the proposed contribution of the conservation easement will be made to a qualified organization.

3. Conservation Purpose

Section 170(h)(1)(C) of the Code provides that a qualified conservation contribution must be exclusively for conservation purposes. Section 170(h)(4) provides that the term "conservation purpose" means (i) the preservation of land areas for outdoor recreation by, or the education of the general public; (ii) the protection of a relatively natural habitat of fish, wildlife, or plants, or similar ecosystem; (iii) the preservation of open space (including farmland and forest land) where such preservation is (I) for the scenic enjoyment of the general public; or (II) pursuant to a clearly delineated Federal, State, or local governmental conservation policy, and where it will yield a significant public benefit; or (iv) the preservation of an historically important land area or a certified historic structure.

The conservation easement in the present case qualifies as a donation for the protection of an environmental system under § 170(h)(4)(ii), the second of the four enumerated tests. Because of this, the remaining three tests will not be discussed.

A. Protection of an Environmental System

Section 1.170A-14(d)(3)(i) of the regulations generally provides that the donation of a qualified real property interest to protect a significant relatively natural habitat in which a fish, wildlife, or plant community, or similar ecosystem normally lives will meet the conservation purposes test of this section. The fact that the habitat or environment has been altered to some extent by human activity will not result in a deduction being denied under this section if the fish, wildlife, or plants continue to exist there in a relatively natural state. For example, the preservation of a lake formed by a man-made dam or a salt pond formed by a man-made dike would meet the conservation purposes test if the lake or pond is a nature feeding area for a wildlife community that included rare, endangered, or threatened native species.

Section 1.170A-14(d)(3)(ii) provides, in part, that significant habitats and ecosystems include, but are not limited to, habitats for rare, endangered, or threatened species of animal, fish, or plants.

Section 1.170A-14(d)(3)(iii) provides that limitations on public access to property that is the subject of a donation under this paragraph (d)(3) shall not render the donation nondeductible. For example, a restriction on all public access to the habitat of a threatened native animal species protected by a donation under this paragraph (d)(3) would not cause the donation to be nondeductible.

In the present case, the subject real property interest satisfies the conservation purpose requirement under the environmental protection criterion of paragraph (d)(3). The Farm is the habitat for eight separate species of plant life listed by state and/or federal authorities as endangered or threatened. The conservation easement will protect the unique natural features, including the endangered species of plant life found on the premises of The Farm. The fact that some of the protected property may have limited accessibility to the general public because it is maintained, in part, for residential use will not adversely affect the qualification of the property under this test. Moreover, the protection of Farm will permit College X to continue using its woodland area for educational purposes.

B. The Perpetuity Requirement

Section 170(h)(5)(A) provides that a contribution shall not be treated as exclusively for conservation purposes unless the conservation purpose is protected in perpetuity. Section 1.170A-14(g)(1) of the regulations provides that any interest retained by the donor must be subject to legally enforceable restrictions (for example, by recordation in the land records of the jurisdiction in which the property is located) that will prevent use of the donor's retained interest that is inconsistent with the conservation purposes of the donation. See S. Rep. No. 96-1007, at 13 (1980), 1980-2 C.B. 599, 605. Additionally, under § 1.170A-14(d)(4)(v), a deduction will not be allowed for the

preservation of open space under section 170(h)(4)(A)(iii), if the terms of the easement permit a degree of intrusion or future development that would interfere with the essential scenic quality of the land or with the governmental conservation policy that is being furthered by the donation.

Section 1.170A-14(e)(2) sets forth specific rules relating to inconsistent use. It provides that a deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests. For example, the preservation of farmland pursuant to a State program for flood prevention and control would not qualify under paragraph (d)(4) of this section if under the terms of the contribution a significant naturally occurring ecosystem could be injured or destroyed by the use of pesticides in the operation of the farm. However, this requirement is not intended to prohibit uses of the property, such as selective timber harvesting or selective farming if, under the circumstances, those uses do not impair significant conservation interests.

In the present case, the conservation easement will be filed in the land records of County X. Thus, the donor's retained interest will be subject to restrictions set forth in the easement which will become effective upon such filing.

In this connection there is an issue concerning whether the permitted use of some of the property burdened with the conservation easement is inconsistent. The easement permits construction on each of eight residential tracts, ranging in size from _____ to _____ acres, of one single family residence of up to _____ square feet in size; two ancillary buildings, one of which shall be no larger than _____ square feet and the other shall be no larger than _____ square feet; a barn no larger than _____ is reasonably necessary to accommodate the number of animals allowed on each tract and one riding ring no greater than one-half acre. On each tract the number of grazing animals permitted is determined by dividing the total number of acres of fenced pasture within each tract by three, with any fraction rounded to the nearest whole number. For example, if Tract A contains _____ acres of fenced pasture, the owner would be permitted to maintain and care for 4 grazing animals.

In the present case, the proposed inconsistent use of some of The Farm (consisting of approximately _____ acres) to be burdened by the conservation easement is not so significant as to impact the endangered or threatened species on the property. As noted above, no development will be permitted at all on the _____ acres retained by Taxpayer after transfer of the Distribution Tracts, or on the four "Agricultural Tracts" totaling _____ acres. In addition, most of the land area in each Distribution Tract, on which a single family residence is permitted (along with related structures), will also remain in pasture and woodland in perpetuity. Thus, the conservation easement will maintain over 80 percent of the entire tract in its presently undeveloped state, thereby preserving the habitat. Accordingly, the planned inconsistent use of some of the property is not significant enough to cancel the conservation purpose of the easement.

Section 1.170A-14(g)(5) of the regulations provides that in the case of a donation made after February 13, 1986, of any qualified real property interest when the donor

reserves rights the exercise of which may impair the conservation interests associated with the property, for a deduction to be allowable under this section the donor must make available to the donee, prior to the time the donation is made, documentation sufficient to establish the condition of the property at the time of the gift. Such documentation is designed to protect the conservation interests associated with the property, which although protected in perpetuity by the easement, could be adversely affected by the exercise of the reserved rights. Such documentation may include:

(A) The appropriate survey maps from the United States Geological Survey, showing the property line and other contiguous or nearby protected areas;

(B) A map of the area drawn to scale showing all existing man-made improvements or incursions (such as roads, buildings, fences, or gravel pits), vegetation and identification of flora and fauna (including, for example, rare species locations, animal breeding and roosting areas, and migration routes), land use history (including present uses and recent past disturbances), and distinct natural features (such as large trees and aquatic areas);

(C) An aerial photograph of the property at an appropriate scale taken as close as possible to the date the donation is made; and

(D) On-site photographs taken at appropriate locations on the property. If the terms of the donation contain restrictions with regard to a particular natural resource to be protected, such as water quality or air quality, the condition of the resource at or near the time of the gift must be established. The documentation, including the maps and photographs, must be accompanied by a statement signed by the donor and a representative of the donee clearly referencing the documentation and in substance saying "This natural resources inventory is an accurate representation of [the protected property] at the time of the transfer."

Paragraph (g)(5)(ii) provides that the donee must have a right of inspection and legal remedies. It states that in the case of any donation referred to in paragraph (g)(5)(i) of this section, the donor must agree to notify the donee, in writing, before exercising any reserved right, e.g. the right to extract certain minerals which may have an adverse impact on the conservation interests associated with the qualified real property interest. The terms of the donation must provide a right of the donee to enter the property at reasonable times for the purpose of inspecting the property to determine if there is compliance with the terms of the donation. Additionally, the terms of the donation must provide a right of the donee to enforce the conservation restrictions by appropriate legal proceedings, including but not limited to, the right to require the restoration of the property to its condition at the time of the donation.

In the present case, the conservation easement will meet these requirements. Taxpayer represents that it will provide ConOrg 1 with documentation of the condition of The Farm at the time of conveyance of the conservation easement. Items furnished and to be furnished to donee include (1) a narrative of the history and current condition of The Farm; (2) a location map and directions to site; (3) written reports with site photographs describing ecological features of the subject property, including its wildlife,

its geology and soils, its plant cover types, its aquatic resources; (4) a written report discussing endangered species, wetlands and natural areas of The Farm by Dr. X; (5) an inventory of the natural areas of the River X area; (6) an aerial photograph of site; (7) base map (to include property lines and easement locations; (8) a “topo” [topographical] map (to include any key features manmade or ecological); (9) keyed site photographs with description; (10) a description of buildings, structures and other man-made structures (excluding power lines) included in site photographs and maps; and (11) an acknowledgment of condition in the form of notarized letter. Taxpayer has reserved no rights requiring that it notify and get approval from ConOrg 1 prior to their exercise, other than what is specifically provided by the terms of the conservation easement itself (the construction of private residences and related structures at predesignated locations). Furthermore, under the terms of paragraphs 11 and 12 of the conservation easement ConOrg 1, as donee, will have the right of entry and inspection of the property to monitor compliance with the terms of the restrictions and the right to legally enforce them.

Section 1.170A-14(g)(6)(i) provides that if circumstances change making impossible or impractical the continued use of the property for conservation purposes, then the easement will be treated as protected in perpetuity if the restrictions are extinguished by judicial proceedings and all of the proceeds received by the donee are used by the donee in a manner consistent with the conservation purposes of the original contribution. Section 1.170A-14(g)(6)(ii) provides that the donor must agree that the donation of the perpetual conservation restriction gives rise to a property right with a fair market value that is at least equal to the proportionate value that the restriction at the time of the gift bears to the value of the property as a whole. It further provides that proportionate value of the donee’s property rights shall remain constant.

In the present case, the easement provides for extinguishment only pursuant to judicial proceedings, limits the use of proceeds received by the donee as a result of extinguishment to consistent conservation purposes, and gives the donee a property right that satisfies the percentage values requirement of the regulation, which are to remain constant with respect to such property rights. In this connection, paragraph 16(b) of the conservation easement provides the following:

For the purposes of this paragraph, the ratio of the value of the Easement to the value of the Protected Property unencumbered by the Easement

shall remain constant.

Accordingly, the proposed donation will be deemed as having been made exclusively for conservation purposes and is enforceable in perpetuity within the meaning of the relevant regulations.

Requested Ruling No. 2:

Section 701 of the Code provides that a partnership as such shall not be subject to the income tax imposed by chapter 1. Persons carrying on business as partners shall be liable for income tax only in their separate or individual capacities.

Section 703(a)(2)(C) provides that the taxable income of a partnership shall be computed in the same manner as in the case of an individual except that the deduction for charitable contributions provided in § 170 shall not be allowed to the partnership.

Section 1.703-1(a)(2)(iv) of the regulations provides that each partner of a partnership is considered as having paid within his taxable year his distributive share of any contribution or gift, payment of which was actually made by the partnership within its taxable year ending within or with the partner's taxable year. This item shall be accounted for separately by the partners as provided in § 702(a)(4).

Section 702(a)(4) provides that, in general, in determining his income tax, each partner shall take into account separately his distributive share of the partnership's charitable contributions (as defined in § 170(c)).

Section 1.702-1(a)(4) provides that, in general, each partner shall take into account, as part of the charitable contributions paid by him, his distributive share of each class of charitable contributions paid by the partnership within the partnership's taxable year.

Section 1.702-1(b) provides, in part, that the character in the hands of a partner of any item of income, gain, loss, deduction, or credit described in § 702(a)(1) through (8) shall be determined as if such item were realized directly from the source from which realized by the partnership or incurred in the same manner as incurred by the partnership.

RULINGS:

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

- (1) The grant of the proposed conservation easement by Taxpayer to ConOrg 1 will be a "qualified conservation contribution" under § 170(h) of the Code; and
- (2) Each member of Taxpayer, rather than Taxpayer, shall take into account, as part of the charitable contributions paid by each member, each member's distributive share of the grant by Taxpayer of the conservation easement to ConOrg 1.

DISCLAIMERS AND LIMITATIONS:

As a general rule, the amount allowed as a deduction for a conservation easement is the difference between the value of the burdened property before and after the donation. See Symington v. Commissioner, 87 T.C. 892 (1986). It is possible that the value of Taxpayer's retained property may increase as a result of the easement. The contribution is deductible only to the extent that its value exceeds the value of the benefits received. See S. Rep. No. 96-1007, at 14-15 (1980), 1980-2 C.B. 599, 606; See also Rev. Rul. 73-339, 1973-2 C. B. 68, as clarified by Rev. Rul. 76-376, 1976-2 C.B. 53.

Except as specifically ruled above, no opinion is expressed as to the federal tax treatment of the transaction under any other provisions of the Code and the Income Tax Regulations that may be applicable or under any other general principles of federal income taxation. Neither is any opinion is expressed as to the tax treatment of any conditions existing at the time of, or effects resulting from, the transaction that are not specifically covered by the above ruling.

This ruling is directed only to the taxpayer(s) who requested it. Section 6110(k)(3) of the Code provides that it may not be cited as precedent.

Sincerely yours,
Associate Chief Counsel
(Income Tax & Accounting)

by _____
Thomas D. Moffitt
Chief, Branch 2