

JERRY J. McCOY

ATTORNEY AT LAW

1050 CONNECTICUT AVENUE, N.W., SUITE 1200
POST OFFICE BOX 66491
WASHINGTON, D.C. 20035-6491

(202) 466-6941
FAX (202) 466-6942

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Michael Dennis
General Counsel
Suite 100
4245 North Fairfax Drive
Arlington, VA 22203-1606

Dear Mike:

This is in response to your request for my comments on a particular form of transaction used by The Nature Conservancy ("TNC") in its land conservation activities.

You also asked for a curriculum vitae showing my qualifications to comment on such a matter, and that is attached. As noted there, I have practiced tax law (with a specialty in charitable tax planning) for more than thirty years, teach courses in the subject at two national law schools, and have written widely in the field (including a book on family foundations and two monthly newsletters, Charitable Gift Planning News, and Family Foundation Advisor).

The Subject Transaction

The transaction you described is a typical land trust technique for acquiring, protecting and reselling tracts of land with significant conservation values. The transaction generally proceeds as follows:

In Step One, the land trust purchases the land, generally paying an amount equal to the fair market value of the land. (If the original owner were inclined to donate the land to the land trust, or sell it for less than full value, he or she would probably be willing to proceed with the protection of the land without involving the land trust in the sale transaction at all.)

In Step Two, the land trust encumbers the land with a negative restriction or "conservation easement," thereby permanently limiting its use and assuring it will not be developed or otherwise converted to uses that would be injurious to the conservation values being protected. As when an individual creates a conservation easement, the effect of this step is to reduce the market value of the land since prospective purchasers who would otherwise acquire it for development are effectively barred from the market.

In Step Three, the land trust sells the land (which is now encumbered by the easement) to a purchaser who is willing to limit his or her use of the land to activities that are permitted under the easement. Because this friendly or sympathetic buyer is motivated at least partially by the conservation considerations of the property, he or she is generally willing to underwrite all or part of the land trust's loss on the purchase and sale in either of two ways.

Alternative A — In some instances, this donor/buyer makes a cash contribution to the land trust sufficient to make it whole (i.e., an amount equal to the difference between the price originally paid by the land trust for the property and the lesser amount paid for the property by the donor/buyer).

Alternative B — In other instances, the donor/buyer simply pays the land trust a price for the land equal to what the land would be worth in the absence of the easement (typically the same amount the land trust paid).

In either case, whether the donor/buyer proceeds under Alternative A or Alternative B above, the result is the same. The total outlay of the donor/buyer is equal to the full, unencumbered value of the property, and the excess over the actual value (reflecting the restrictions imposed by the conservation easement) is deductible for income tax purposes.

Example

Using a simple example, let's assume TNC acquires a tract of forest land for \$1,000,000. The land can be developed into a series of 5-acre homesites, and the \$1,000,000 price reflects this factor. TNC conveys to a local governmental agency a conservation easement precluding such development of the land and any other activity (e.g., logging, strip mining, operation of a business, etc.) that would be deleterious to the pristine forest nature of the property. This means that any future purchaser is limited in his or her ability to realize the full economic value of the land. Accordingly, the land cannot be sold in the open market for more than \$700,000. The values are confirmed by reliable professional appraisals.

TNC locates a buyer, D, who will buy the property subject to the easement for \$700,000, and this sale is consummated. At the closing or soon thereafter, D voluntarily contributes \$300,000 in cash to TNC, so that it breaks even on the transaction. This is the approach used in Alternative A above. Alternatively, D may buy the property from TNC for \$1,000,000, the same amount TNC paid for it. Since D is paying \$1,000,000 for an asset that is worth only \$700,000, D has conferred a \$300,000 benefit on TNC. This is Alternative B.

Because TNC is a qualified charity and the benefit in question (either the \$300,000 cash contribution in Alternative A or the \$300,000 cash benefit in Alternative B) was conferred with the intention of supporting the charitable mission of TNC, D will be entitled to a charitable contribution deduction in the amount of \$300,000 for income tax purposes under either approach.

Availability of Deductions

You indicated that some question has been raised as to the proper deductions allowable under one or both of these alternatives, and I believe I can say with certainty that the buyer (D in our example) is clearly entitled to the deductions described, subject to the normal conditions (e.g., a qualified donee, substantiation by means of a timely receipt, qualified appraisals, percentage limitations based upon the donor's adjusted gross income, etc.). Indeed, this seems only appropriate, since in each case D is out of pocket (and the land trust is enriched) by this amount.

In the case of the cash contribution in Alternative A, there would seem to be little room for argument assuming the values are correct. In the case of the purchase of property at a price in excess of value (Alternative B), the economic result is the same, and the tax result follows. The Regulations provide for this result in §1.170A-1(h), where a taxpayer who purchases goods or services from a charitable organization, but intentionally pays an amount in excess of the fair market value of the goods or services is entitled to a charitable contribution deduction. This is the case in the everyday situation where a donor buys a charitable gift annuity from a charity, where the amount payable for the annuity is set at a level which exceeds the value of the annuity purchased; the excess is deductible as a charitable contribution. The IRS has recognized this principle in the Regulations [§1.170A-1(d)(1)] and in Revenue Ruling 70-15, 1970-1 CB 20. Moreover, the Supreme Court has upheld this principle in United States v. American Bar Endowment, 477 US 105 (1986), where the Court stated as follows:

“The sine qua non of a charitable contribution is a transfer of money or property without adequate consideration. The taxpayer, therefore, must at a minimum demonstrate that he purposely contributed money or property in excess of the value of any benefit he received in return.”

Of course, the critical question is one of respective values — the amount paid by the donor/buyer versus the value of the property received. As with any charitable contribution situation involving property, these values must be determined by appraisals, and are subject to question by the Internal Revenue Service on audit of the taxpayer making the contribution. The donee organization is not involved in the valuation process, and the determination of value (including defense of any attack by IRS) is entirely the donor's obligation.

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I hope this discussion is helpful. Please let me know if there are any additional questions or if I should elaborate on any of the points discussed above,

Sincerely,

Jerry J. McCoy

JERRY J. McCOY

Office:

1050 Connecticut Avenue, N.W., Suite 1200
P.O. Box 66491
Washington, D.C. 20036
(202) 466-6941 [fax (202) 466-6942]
mccoyle@aol.com

Professional Associations

Private Practice, Washington, D.C. (Since 1994)

Diversified tax practice with heavy specialization in tax-exempt organizations, charitable tax planning and estate planning. Clients include colleges and universities, national and international charitable organizations, private foundations and related organizations, both publicly- and closely-held businesses, and private individuals.

Reid & Priest
Washington, D.C. (1992-94)

Silverstein and Mullens
Washington, D.C. (1968-1992)

Charitable Gift Planning News, a monthly newsletter published by Little, Brown & Co., Boston, Mass. until June, 1990, now published by the co-editors (Co-Founder and Co-Editor, 1983 to date)

Co-founder and co-author of monthly newsletter on tax and other considerations affecting charitable giving; circulation includes development officers for educational institutions and other charitable organizations, as well as attorneys, accountants, financial planners, life underwriters, and other donee advisors.

Family Foundation Advisor, a monthly newsletter published by Aspen Law & Business (A Wolters Kluwer Company), New York beginning February, 2002

Co-founder and co-editor of monthly newsletter for advisors and managers of family foundations, designed to complement the Family Foundation Handbook (listed below).

Professional Organizations

American Bar Association, Section of Real Property, Probate and Trust Law (Washington Coordinator for the Probate and Trust Division; Group Chairman for Committees on Charitable Planning and Exempt Organizations)

American Bar Association, Section of Taxation (Co-Chairman, Subcommittee on Community Foundations of Exempt Organizations Committee; former Chairman of Legislative Recommendations Committee)

Fellow of The American College of Trust and Estate Counsel (Chairman, Charitable Planning and Exempt Organizations Committee; 1990-91 Editor of Probate Notes)

Fellow of The American College of Tax Counsel

Member, American Law Institute

Adjunct Faculty, Georgetown University Law Center (coinstructor for charitable tax planning course in the Master of Laws in Taxation Program, 1996-date)

Adjunct Faculty, University of Miami Law School (coinstructor for charitable tax planning course in the Master of Laws in Estate Planning Program, 1983-date)

Founding Faculty, American Institute of Philanthropic Studies, California State University, Long Beach

Named in Who's Who in America and Who's Who in American Law (Marquis), and The Best Lawyers in America (1999-2000 ed., published by Woodward/White)

Other Memberships and Positions

Founding Member, Board of Directors, International Institute of Association and Foundation Lawyers

Founding Member, Board of Directors, International Planned Giving Foundation

Member, Board of Directors, National Committee on Planned Giving (1992-1994)

Assistant Treasurer, National Park Foundation (1972-1993)

Treasurer and Co-Counsel, Commission on Private Philanthropy and Public Needs [The Filer Commission] (1973-1976)

Member, Advisory Committee, Philip E. Heckerling Institute on Estate Planning, University of Miami, 1978 to date

Advisory Board, The Exempt Organization Tax Review (a Tax Analysts publication)

Board of Advisers, The Journal of Taxation of Exempt Organizations (a Warren, Gorham & Lamont publication)

Publications and Lectures

Co-Author (with Kathryn W. Miree), Family Foundation Handbook, Published January 2001 by Aspen Law & Business (A Wolters Kluwer Company), New York.

Author, United States chapter in International Charitable Giving: Laws and Taxation, (Carole Shelbourn George, ed.), Published 1994 by Graham & Trotman/Martinus Nijhoff (Kluwer Academic Publishers Group), London/Dordrecht.

Author of articles on tax, estate planning, and charitable subjects in various professional publications (in addition to the institutes listed above), including Trusts & Estates, The Journal of Taxation of Exempt Organizations, Tax Law Review, TAXES - The Tax Magazine, Taxation for Accountants, Taxation for Lawyers, The Practical Tax Lawyer, and numerous publications of Tax Management, Inc. (a division of the Bureau of National Affairs, Inc.)

Speaker at national, regional and local meetings on tax and estate planning subjects, including the following:

Philip E. Heckerling Institute on Estate Planning, (University of Miami)
New York University Institute on Taxation
Southern Federal Tax Institute
American Bar Association (Annual Meetings)
Tulane Tax Institute
Midwest Tax & Business Planning Institute
Duke Estate Planning Conference
UCLA/CEB Estate Planning Institute
Georgetown Law Center/D.C. Bar Institutes
Notre Dame Estate Planning Institute
National Conference on Planned Giving
American College of Trust and Estate Counsel (Annual Meetings)
International Association for Financial Planning
(National Conventions)
ALI/ABA National Institutes
Various State Bar Meetings, Local Planned Giving Councils, Estate Planning Councils and
Community Foundations Nationwide

Education

LL.M. (in Taxation), New York University School of Law, New York, N.Y. (1967)

LL.B., Duke University School of Law, Durham, N.C. (1966)

B.S. in Business Administration, West Virginia University, Morgantown, W.Va. (1963)