The Basics of Charitable Giving

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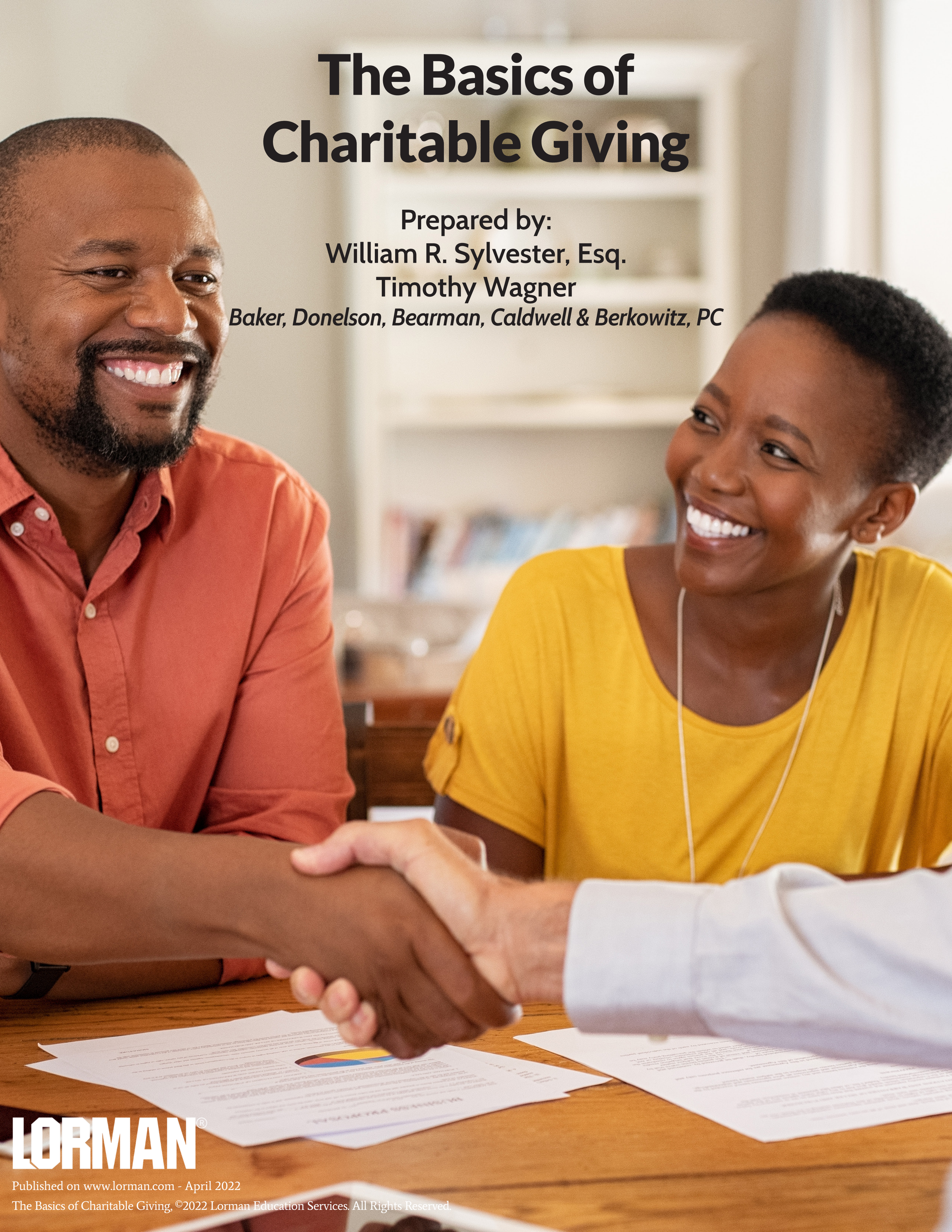

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<u>THE BASICS OF CHARITABLE GIVING.</u>

1. Income tax deductions for charitable contributions have been a part of the federal tax code since 1917. The current statute is Section 170 of Code. The tax treatment of charitable contributions under the Code varies, depending on the form of the charitable contribution, the type of property given, and the nature of the recipient donee.

2. Code Section 170(f)(3) generally **denies** deductions for most gifts of **less than** the taxpayer's entire interest in the donated property (the so-called "**Partial Interest Rule**"). The specific exceptions for which a deduction is allowed consistent with the Partial Interest Rule are: (a) a remainder interest in a personal residence or farm; (b) an undivided portion of a taxpayer's entire interest in property; and (c) a Conservation Easement.

3. Charitable deductions are limited by individual or corporate adjusted gross income, determined without regard to loss carrybacks (the "**Contribution Base**"). Current law generally provides the following limitations: (a) 50 percent of the Contribution Base for individuals; (b) 30 percent of the Contribution Base with respect to contributions to private foundations or of capital assets which would produce long-term capital gain if sold by the taxpayer; (c) 20 percent with respect to contributions to private foundations of capital assets which would produce long-term capital gain if sold by the taxpayer; and (d) 10 percent for regular Subchapter C corporations.

4. Under current rules, when a partnership or Sub-S corporation makes a charitable contribution, the deduction **passes** through to the partners or shareholders. (Partnerships, limited liability companies, and small business corporations having a valid election under Code Section 1362(a) are sometimes referred to as "**Pass-Through Entities**").

5. Certain taxpayers who enjoy substantial benefits from deductions, exemptions, and exclusions under the regular income tax law are subject to the alternative minimum tax (the "**AMT**"). The AMT largely disallows most deductions from being allowed in calculating AMT liability. However, charitable contribution deductions, including those associated with conservation easement deductions, are allowed in calculating tax liability for the AMT.

6. Like all gifts of appreciated property, a charitable conservation contribution deduction will be **reduced** under Code Section 170(e) if: (a) the donor has a holding period of less than a year and a day with respect to the property; **or** (b) the property is so called "dealer" property held for sale to customers in the regular course of business.

7. When a Donor, partner, or member has charitable contributions in excess of his allowable portion of the Contribution Base for the year of donation, she can generally carry-forward and use the deduction in the succeeding five (5) years. Code Section 170(d). Currently, the carryover period for Conservation Easements is fifteen

(15) years. This special treatment is a part of what we will refer to as the "**Enhanced Incentives**" afforded to conservation easements, in comparison to gifts of land in fee simple, granted by Individuals and Pass-Through Entities. ***See*** **EXHIBIT I** attached for a quick look at some of the similarities and distinctions between Conservation Easements and outright charitable in-kind gifts of appreciated real estate.

8. All substantial charitable contributions of property are subject to detailed recordkeeping, appraisal, and substantiation provisions. See for instance Code Sections 170(f)(8) and 170(f)(11) and Treasury Regulation Section 1.170A-1. IRS Form 8283, Noncash Charitable Contributions, is to be signed by the Donor, the Qualified Donee, and an appraiser meeting specific standard (a "**Qualified Appraiser**"). The Form 8283 must be attached to the Donor's return for the year of donation. Code Section 170(f)(11)(A)(ii)(II) provides a limited **reasonable cause** exception to some of these recordkeeping, appraisal, and substantiation requirement. In our **CASE STUDIES** feature we will touch on ***Blau (sub nom RERI Holdings I)*** 924 F.3d 1261and ***Oakhill Woods***, T.C. 2020-24 for decisions in which the IRS successfully challenged the accuracy or completeness of the pertinent IRS Form 8283 and, in so doing, set aside the entire charitable contribution at issue.

9. Code Section 170(f)(11)(E) and Treasury Regulations Sections 1.170A-13(c)(3) through 1.170A-13(c)(6) have detailed conditions concerning **any** Qualified Appraiser and his or her appraisal report (a "**Qualified Appraisal**"). Among other things, Treasury Regulation Section 1.170A-3(c)(3)(i) requires that the Qualified Appraisal: (a) relate to an appraisal made no earlier than sixty (60) days prior to the date of contribution of the appraised property; (b) be prepared, signed, and dated by a Qualified Appraiser; (c) include the information required by the Code and Treasury Regulations; and (d) not involve a prohibited appraisal fee. In addition to other requirements, a Qualified Appraiser must: (a) have earned an appraisal designation from a recognized professional appraiser organization or otherwise meet certain minimum education and experience requirements; (b) regularly perform appraisals for compensation; (c) satisfy other requirements set out in Treasury Regulations; and (d) not be performed by person who has been barred from practice before the IRS under 31 U.S.C. Section 330(d).

10. Failure to obtain a Qualified Appraisal or to comply with any of the other recordkeeping and substantiation requirements in the Code and Treasury Regulations can result in the complete denial of a charitable contribution deduction. Presumably, the additional provisions of Treasury Regulation 1.170A-14 do **not** apply to **outright** charitable gifts of appreciated real estate or the **bargain-**

sale variant thereof, where the Donor sales the gifted real estate to the Donee for **less than** its fair market value.

11. There is no requirement in the Code or under the Treasury Regulations that the Restricted Property be in the territorial United States. So long as the Donor can preserve the Restricted Property **permanently** under the laws of the host country, an international Conservation Easement could be created. For instance, the laws of Canada are amenable to Conservation Easements. The laws of Mexico, however, present challenges, since land within 100 kilometers of any national border, or within 50 kilometers of any ocean, may not be owned outright by any US or other foreign Donor.

THE CHARITABLE CONSERVATION DEDUCTION GENERALLY.

1. As detailed, Charitable Conservation Easement deductions were first particularly authorized by the Code in the year of the bicentennial, 1976, to encourage the conservation and preservation of special and unique natural resources not directly funded through cash outlays by the national, state, or local governments. The incentive provided by Section 170(h) has been enormously effective. In fact, as of 2020, at least 61M-acres in the United States were in conservation under the stewardship of land trusts. ***See*** **EXHIBIT II** attached.

2. While the requirements for a Conservation Easement are myriad and sometimes complex, the basic elements of the

gift are: (a) the donation of a qualified real property interest; (b) to a Qualified Organization; and (c) to be exclusively used for conservation purposes. One should always remember that every Conservation Easement must meet **all** rules of Code Section 170 applicable to charitable donations in general. For example, there must **not** be a ***quid pro quo*** given **to** the Donor by the Qualified Organization, by any public authority, or by others, that is inconsistent the **donative intent** of the Donor.

QUALIFIED REAL PROPERTY INTEREST.

1. In order to sustain a Conservation Easement deduction, the contribution of a **qualified real property interest** is required. Code Section 170(h)(1)(A). Qualified real property interests are: (a) the entire interest of the donor **other than** a **qualified mineral interest**; (b) a remainder interest, and (c) a restriction granted **in perpetuity** on the use which may be made of real property (i.e., an easement, restrictive covenant, or equitable servitude). Code Section 170(h)(2); Treasury Regulation Section 1.170A-14(b)(2). A qualified mineral interest is the Donor's interest in **subsurface** oil, gas, or other minerals **and** the right to access such minerals. Treasury Regulation Section 1.170A-14(b)(1)(i).

2. An outright gift of the **fee interest** in land will does **not** constitute a **qualified real property interest** and is **not** eligible for the Enhanced Incentive. See IRS Notice 2007-50, under which states that a taxpayer's "entire interest in

real property' does **not** qualify for the Enhanced Tax Treatment.

QUALIFIED ORGANIZATION AS DONEE.

1. A deduction for a Conservation Easement requires the participation of a **qualified organization** as defined in Code Section 170(h)(3). Acceptable organizations include governmental units and 501(c)(3) organizations that "**normally receive**" a substantial part of their support from direct or indirect contributions from the general public. Such 501(c)(3) organizations are generally referred to as public charities. A Qualified Organization must have the "**commitment**" to protect the conservation purposes of its donations and the "**resources**" to enforce the restrictions, but "need not set aside funds to enforce" the Conservation Easements to which it is a party. Treasury Regulation Section 1.170A-14(c)(1). There are numerous national, regional, and local Land Trusts in operation in the US.

2. In 2009 the IRS revoked the tax-exempt status of a purported Land Trust founded by a CPA which, in the opinion of the IRS, was operated for the benefit of the CPA's clients, and not exclusively for the tax-exempt charitable purposes of land conservation. *See* IRS Release 201405018. The facts of IRS Release 201405018 we be detailed as a part of our **CASE STUDIES** discussion.

3. With respect to any noncash charitable contribution of more than $500, a taxpayer must submit an IRS Form

8283, Noncash Charitable Deductions, with its tax return for the year of gift. Form 8283 must be **signed** by the Donor, **joined in** by the Qualified Appraiser in Part III, the Declaration of Appraiser, and **acknowledged** by the Qualified Organization under Part IV. By joining in Part IV of the Form 8283, the Qualified Organization, by the express terms of the Form, is **not** representing any "agreement with the claimed fair market value" of the gift. IRS Notice 2017-29, issued on May 1, 2017, clarified that Land Trusts are not "**material advisors**" under Code Section 6111 for purposes of **Notice 2017-10** (discussed below). Therefore, a Land Trust need **not** file an IRS Form 8918 for merely being the Donee of a Conservation Easement **in a listed transaction** or in a **similar transaction**.

EXHIBIT I

EXHIBIT 1

SOME TAX ISSUES PERTAINING TO DEFEASANCE GIFTS OF REAL ESTATE

1. **Purpose, Limitations, and Disclaimer.** This memorandum (the "**Memo**") lists some federal income tax issues encountered in connection with outright conveyances of real estate by an LLC to a tax-exempt donee (a "**Gift**"). **THIS MEMO IS NOT INTENDED AS TAX ADVICE TO ANYONE.** This Memo is **only** a partial listing of **some** issues. All readers and their own accounting, financial, legal, and other consultants (each an "**Advisor**") are assumed to be familiar with the Internal Revenue Code, Treasury Regulations, and case law concerning **Conservation Easements**, including, without limitation, IRS Notice 2017-10.

2. **No Partnership Deduction.** By virtue of Section 703(a)(2)(C), in the case of Gifts **no** deductions **at the partnership level** arise. Instead, partnership Gift deductions are taken recognized by the **partners** as **separately stated** items under Section 702(a)(4).

3. **Partner's "Outside" Basis.** Under present law, partnership Gift deductions are **not** limited by the **outside** basis of a partner, or her at-risk investment under Section 704(d).

4. Economic Substance Doctrine. We assume that the **Economic Substance Doctrine** (the "**ESD**"), as codified under Section 7701(o), is **not** applicable. ESD considerations are beyond the scope of this Memorandum.

5. Donative Intent. In order to give rise to a federal income tax deduction, every Gift, including a Conservation Easement, must proceed from the detached and disinterested generosity of the donor and should represent a transfer of property without adequate consideration.

6. Annual Partner Limits. In general, a non-cash charitable **Gift** of property by an LLC can result in a deduction of up to **30**% of an individual member's **contribution base**. Under present law, any deductible Gift in excess of the 30% limitation can be treated as a carryover to the succeeding **5** years.

7. Enhanced Treatment for CEs. Proper **conservation easements** under **Code Section 170(h)** are annually allowed for **50%** of an individual's contribution base and may be carried over for up to **15** years.

8. Section 170(e) Effect. Conservation Easements **and** in-kind Gift deductions are subject to reduction to the extent that the affected property, if sold, would produce gain which would **not** have been long-term capital gain.

9. Fundament Difference. One of the intrinsic differences between Gifts **and** Conservation Easements arises because Conservation Easements are subject to an express statutory exception related to **partial interests**. Subject to narrowly defined provisions in Section 170(f)(2)(B), a fee simple Gift must relate to the taxpayer's entire interest in the donated property.

10. **<u>Conservation Purpose and Perpetuity</u>.** In Conservation Easements, **conservation purpose** and **perpetuity** must be present. These considerations are **irrelevant** and **not** at issue for **Gifts**.

11. <u>Donative Intent, Holding Period, Valuation, and ESD</u>. Material requirements which common to **both** Gifts and Conservation Easements include: (a) the presence of donative intent, with absence of any ***quid pro quo*** consideration; (b) at least a 12-month holding period by the donor; (c) valuation issues; and (d) the absence of ESD factors.

12. <u>Valuation Issues</u>. Some qualified appraisers note that the determination of value should initially proceed in identical fashions for Gifts and for the **before** value of a Conservation Easements. Treasury Regulation Section 1.170A-14 by its terms is only applicable to Conservation Easements.

13. <u>The "Look-Back" for Gifts</u>. Under Section 6050L if the qualified organization **sells**, **exchanges**, **or otherwise disposes of** any property within 3 years of the Gift, it must file a return with the IRS **and** the taxpayer/donor. The return must disclose the name, address, and taxpayer identification number of the donor, the date of contribution, and date of disposition of the property.

14. <u>Possible Ramifications of 6050L Returns</u>. If a return made pursuant Section 6050L discloses that the terms of disposition are **materially different** in valuation from the original Gift valuation claimed by the taxpayer/grantor, then the IRS is free to challenge the value of the **original** Gift.

15. <u>Consistent Transactional Details</u>. In a Gift transaction, the grantor should deliver an owner's title policy in the amount Gift. In most jurisdictions, the ***ad valorem*** value declared by the grantee should also be consistent with the reality of the transaction.

16. <u>IRS Form 8283 for Gifts</u>. An IRS Form 8283, Noncash Charitable Contributions, is to be attached to the grantor/taxpayer's Form 1065, U.S. Return of Partnership Income. In addition to the items requires to be disclosed for conservation easements there is an additional disclosure of any restriction, either temporary or permanent, on the right to dispose of the property on the part of the donee.

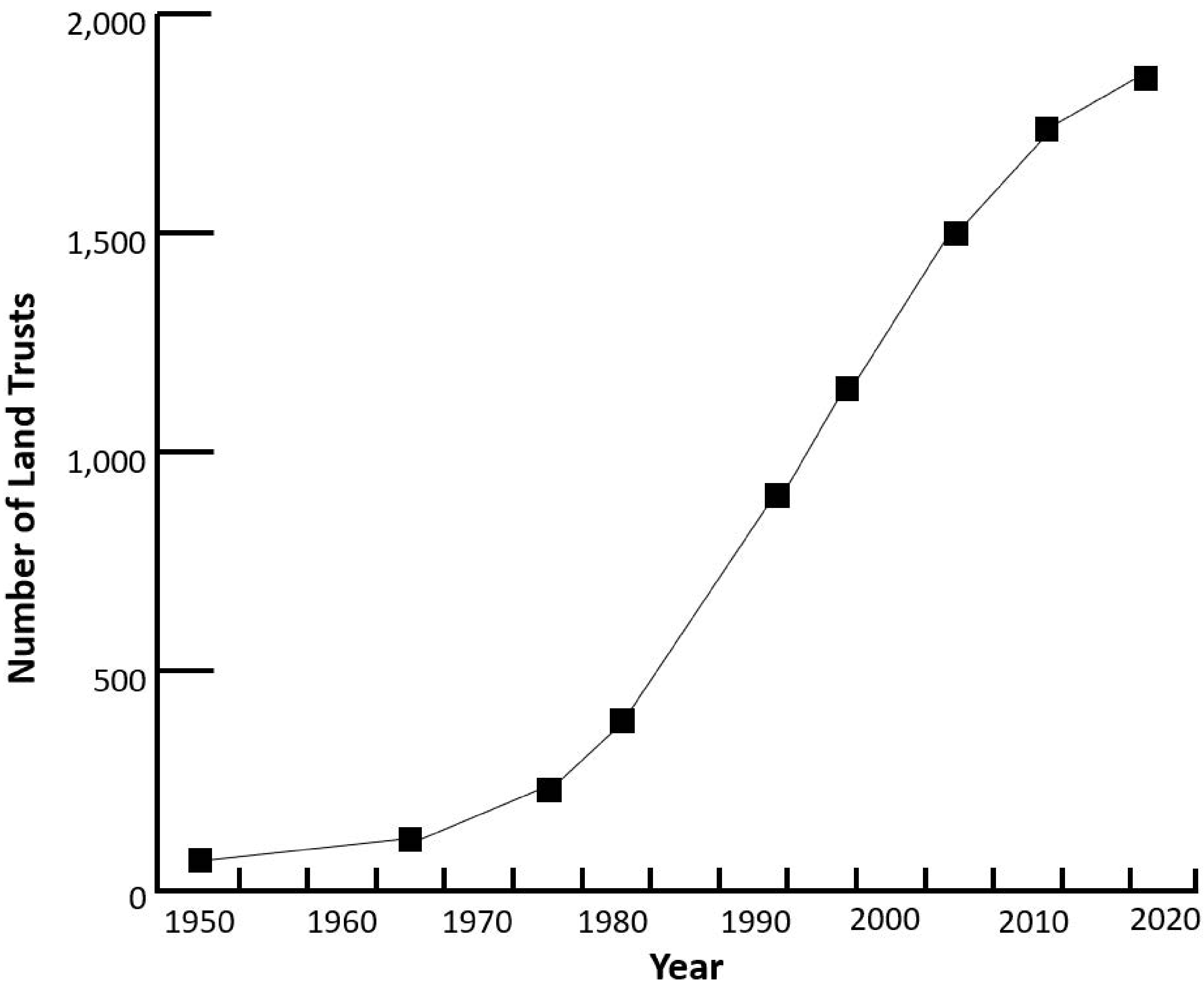
17. <u>IRS Scrutiny of Gifts and CE Transactions</u>. The IRS and taxpayers are often at odds concerning **both** Gifts **and** Conservation Easements. **Both** have been a part of the IRS's annual "Dirty Dozen" transactions. **Both** show up on the Most Litigated Issues reported to Congress under Section 7811.

18. <u>IRS Notice 2017-10</u>. The IRS released Notice 2017-10 on December 23, 2016, establishing as **listed transactions** certain **Syndicated Conservation** Easements Transactions. Disclosure is required of transactions that are **the same as**, **or substantially similar to** that described in section 2 of Notice. In part because of the significant penalties that could be applicable, the **tolling** of the statute of limitation consequences if a Gift transaction were improperly omitted, and the lack of guidance from the IRS concerning the applicability to Gifts, many tax advisors recommend that at least **protective** IRS Forms 8886 and 8918 be made for certain Gift transactions.

19. **Current Proposed Legislation.** Separate bills called the "*Charitable Contribution Easement Program Integrity Act of 2021"* were introduced to the 117th Congress on June 24, 2021. **Neither** the Senate **or** the House bill has been favorably acted upon by committees or been the subject of any formal debate. The bills are styled as amendments to **Section 170(h)**. At this time, this legislation has **no** application to Gifts. **THERE CAN BE NO ASSURANCES THAT THE LEGISLATION COULD NOT BE BROADENED AND MADE APPLICABLE TO GIFTS**.

EXHIBIT II

Number of State and Local Land Trusts




MARKETING STRATEGY