

# **Bond Case Briefs**

*Municipal Finance Law Since 1971*

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## **IRS LTR: Organization Formed to Promote Conservation Easements Loses Exemption.**

The IRS revoked the tax-exempt status of an organization established to encourage the donation of conservation easements after concluding the organization operated as a conduit for its president — a CPA — to help the president's clients obtain sizable deductions.

Person to Contact/ID Number: \* \* \*

Contact Numbers:

Telephone: \* \* \*

Fax: \* \* \*

UIL Code: 501.03-00

Release Date: 1/31/2014

Date: February 18, 2009

Taxpayer Identification Number: \* \* \*

Form: \* \* \*

Tax Year(s) Ended: \* \* \*

LEGEND:

ORG = \* \* \*

ADDRESS = \* \* \*

Dear \* \* \*:

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO

Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, The Examination Process, and Publication 892, Exempt Organizations Appeal Procedures for Unagreed Issues, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

\* \* \*

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Renee B. Wells

Acting Director, EO Examinations

Enclosures:

Publication 892

Publication 3498

Report of Examination

\* \* \* \* \*

LEGEND:

ORG = Organization name

EIN = ein

XX = Date

State = state

Agent = agent

President = president

RA-1 & RA-2 = 1st & 2nd RA

CO-1 THROUGH CO-5 = 1st THROUGH 5TH COMPANIES

## PRIMARY ISSUE

Whether the IRC Section 501(c)(3) tax exempt status of ORG should be revoked because it is not operated exclusively for tax exempt purposes.

## FACTS

ORG (the "Organization" or "ORG") was incorporated in the State of State on October 16, 20XX. The purposes of the Organization as stated in the Articles of Incorporation are "exclusively for charitable, educational, religious or scientific purposes, within the meaning of Section 501(c)(3) of the Internal Revenue (or corresponding section of any future Federal tax code)."

The Articles state that the Organization will not have members. The Articles contain a proper dissolution clause and address the prohibition on political activity and limited legislative activity in a general way by stating that the Organization shall not carry on any activities that are not allowed by a section 501(c)(3) organization.

The Bylaws do not contain a stated purpose for the Organization. The Bylaws do state that there shall be four initial board members and that number may increase or decrease at the Board's discretion. The Bylaws call for regular meetings, at a time and place to be determined by the Board. Officers of the corporation are chosen by the Board and consist of a President, Vice President, Treasurer, and Secretary. The Bylaws further state that at each annual meeting, the Board would pick the officers for the coming year.

The Bylaws further address the fact that the President, initially and currently President, Certified Public Accountant, would be the chief executive and administrative officer of the corporation. The President may execute all deeds, bonds, mortgages and conveyances in the name of the Organization.

President was the Organization's sole incorporator, was and is a member of the board of directors and has served as president since the Organization's inception. President solicits and receives all cash and non-cash contributions from donors and operates the Organization at his own discretion.

President is a member of the American Institute of Certified Public Accountants and a member of the State Association of Certified Public Accountants. President's vast knowledge and experience in the field of public accounting is demonstrated in his being one of less than 250 non-lawyers, nationwide, to be admitted to practice before the United States Tax Court.

Beginning in 20XX President has been a member of the State State Board of Certified Public Accountant Examiners, which is the governing body for licensing certified public accountants in State. President was the president of this organization during 20XX-20XX, and was again elected president for the organization in 20XX. President is a current member of the executive committee and is a former member of the Professional Standards Committee.

President is a member of the State General Assembly's Revenue Laws Study Committee, and is a member of the Ethics committee of the National Association of state Boards of Accountancy.

The Organization, through President, applied for tax exempt status under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3) on October 20, 20XX. In the Application for Recognition of Exemption filed with the Internal Revenue Service (the "Service"), the corporation stated that the purpose of the Organization was to accept, hold and enforce conservation easements. It also stated that it was concentrating on getting hunting clubs to donate conservation easements. Financial support was to come from contributions made by the general public and from contributions received from donors of conservation easements.

On November 24, 20XX, the Organization was issued a Determination Letter stating that the Organization was found to be exempt from federal income tax under section 501(a) of the Internal Revenue Code as an organization described in section 501(c)(3). As a newly formed organization, the Service did not make a final determination of foundation status, but did determine that the Organization would be treated as a publicly supported organization as described in sections 509(a)(1) and 170(b)(1)(A)(vi). The advance ruling period was to run from October 16, 20XX to May 31, 20XX.

The Determination Letter further states that if after the advance ruling period ends the organization does not meet the public support requirements, then the organization will be classified as a private foundation for future periods. The Determination Letter also states that if the organization is classified as a private foundation, the organization will be treated as a private foundation from its beginning date for purposes of sections 507(d) and 4940 of the Code.

Form 8734, Support Schedule for Advance Ruling Period, was received from President on May 29, 20XX. On the form, President calculated the public support percentage under section 509(a)(1) as \*% and under section 509(a)(2) as \*%.

An interview was conducted with President on January 3, 20XX. In that interview President stated that the purpose of the Organization was to accept, hold and enforce conservation easements. The objective from the Organization's beginning was to convince owners of hunting land to make conservation easement donations to protect the land in a relatively natural state.

During the January 3, 20XX interview, President was unclear as to why the idea of donating conservation easements began. He stated that he came up with the idea to start ORG after conducting some research. At first he approached a conservation organization that accepted conservation easements, but that did not go through because that organization wanted too much control over the land and wanted \$\* as a contribution. It was at that time that President decided to start ORG.

President performs all of the baseline studies and performs all of the annual inspections of each property. During the January 3, 20XX interview, President acknowledged that he has not received any specialized training or even general training in any area relating to the accurate or general analysis of land, conservation aspects relating to a potential donation or any area relating to the environment. President further acknowledged in the January 3, 20XX interview that he does not

possess any specialized experience that would qualify him to perform these studies and inspections. However, he believes that the studies and inspections conform to the law as written.

During the January 3, 20XX interview, President acknowledged that contrary to what is required in the Organization Bylaws, there have not been any meetings of the Board of Directors since the initial meeting to start the corporation. Whereas the Organization Bylaws call for annual appointment of officers, the officers have remained the same since the Organization's inception in 20XX. There is no indication that any of the board members have special expertise or training in the area of environmental conservation.

During the January 3, 20XX interview, President acknowledged that the Organization has never solicited contributions from the general public, does not perform any educational services, does not produce any brochures or newsletters describing the Organization's purpose and has little activity with regard to acquiring conservation easements. The Organization uses printed materials distributed by the Land Trust Alliance, a national conservation organization, for the purpose of providing information to prospective conservation easement donors.

From the Organization's inception in 20XX, through January, 20XX, the Organization has received two conservation easements and one outright property transfer. The first conservation easement received was donated by CO-1. (CO-1) on December 31, 20XX.

CO-1:

During the January 3, 20XX interview, President stated that at one time he hunted on the CO-1 land as a guest of two members. Due to health concerns, President stopped hunting on the land sometime before he created ORG. President prepares the annual tax returns for two of the partners of CO-1. At the time that he created this Organization, and for the year that the donation was made from CO-1 to the Organization, he did not prepare the CO-1 partnership return. President did prepare the CO-1 partnership return for the year after the donation was made.

The CO-1 covers 1807 acres of forested land located near the coast of State and was granted in perpetuity. CO-1 is a partnership of sixteen individuals who use the land exclusively for hunting.

The land has been used for hunting for generations and the intention is to keep the land in a natural state to continue hunting. The stated purpose of the conservation easement is "to assure that the Protected Property will be retained in perpetuity predominately in its natural, scenic, and open condition, as evidenced by the Report."

The easement does not allow public access and the recreational hunting is for members only. The easement does not allow any building on the property except for a 20XX square foot shed. Dividing or sub-dividing is not allowed. The grantor does have the right to convey easements and rights of way over and across roads and easements, to include the conservation easement.

Under grantor's reserved rights, the grantor is allowed to lease the Property for any use permitted under the easement. The grantor is also allowed to build and maintain one dock for use by the grantor and can have two burrow pits, not to exceed two acres each. The burrow pits would be used for providing fill material for road repair on the property. The grantor is permitted to construct a well at the dock and at the storage shed and has the right to develop and maintain those water resources and wetlands necessary for wildlife, private recreation, farming, and other agricultural uses permitted under the easement.

The grantor is also given the right to engage in not-for-profit and for-profit agricultural, farming, and

aqua cultural activities. The grantor is allowed to construct and maintain watering facilities and ponds and can encumber the property with agricultural easements to meet their agricultural objectives. The grantor can use agrichemicals to accomplish agricultural and residential activities permitted by the easement. To the extent that the property is restored back to its natural state, the grantor reserves the right to extract minerals, gases, oil, and other hydrocarbons.

During the January 3, 20XX interview, President expressed surprise at the favorable rights retained by the donor. He stated that CO-1 attorney prepared the conservation easement deed document and that he did not review it prior to his signing for the Organization.

The first appraisal of the property was performed by CO-2, certified land appraisers in State. That appraisal valued the conservation easement at \$\* \* \*. President stated in the January 3, 20XX interview that he requested that CO-1 obtain a second appraisal because he thought the appraised value was too high. A second appraisal of the land was performed by CO-3, certified land appraisers in State. The second appraisal was performed on February 5, 20XX and the appraised value of the conservation easement was \$\* \* \*.

The baseline study for the CO-1 was conducted by President on December 28, 20XX. The baseline study is a one page document that states that the only man-made structures on the property are deer stands, feeders, foot bridges and fiber glass wraps around some trees. It also describes the trails on the property, the one main access road and it also states that there are no recent signs of timber cutting. Attached to the baseline study is a hand drawn map. This map does not set forth the boundaries of the property, or provide any descriptive information beyond identifying fields, trails and a duck pond. The baseline study does not meet the requirements imposed in the Treasury Regulations.

The conservation easement deed states that "the specific conservation values of the Protected Property on the date of this easement are documented in the Baseline Documentation Report." The deed further states that both "parties agree the Report provides an accurate representation of the Protected Property and the condition of the same as of the date of this Easement as required by Treasury Reg. 1.170A-14(g)(5), and is intended to serve as an objective informational baseline for monitoring compliance with the terms of this easement."

President signed the Form 8283 acknowledging the donee's gift, sent the required gift acknowledgement letter and has performed annual monitoring of the property. The monitoring reports consist only of written statements referencing the lack of changes on the property. The reports do not reference the baseline study and do not mention specific findings of any kind.

In a meeting at the property with Revenue Agent Agent, President had trouble identifying the exact or approximate boundaries of the property encumbered by the easement. In a January, 20XX meeting at the property between this agent and President, he appeared to be familiar with the boundaries, even though they were not marked in any way.

The CO-1 partnership tax return for the year ended December 31, 20XX was examined by the Small Business/Self-Employed Division of the Internal Revenue Service and it was determined that the conservation easement had zero value as the proposed plan to build on the property was severely flawed. The entire deduction for the conservation easement was denied. CO-1 acknowledged the Service's findings and signed an agreement with the Service as to the Service's determinations. Subsequent to the Service's findings and CO-1 agreement, CO-1 requested that the conservation easement donated to the Organization be returned.

CO-4 Property Transfer:

The second transaction that the Organization conducted was the acceptance of 12.624 acres of land donated by CO-4. (CO-4) on December 18, 20XX. In a letter from CO-4 to the Organization, dated November 26, 20XX \* \* \* stated that his group was interested in donating 12.8 acres of land to the Organization. The letter did not mention the term conservation easement.

Per the Warranty Deed, the purpose of the conveyance was to ensure that the land is utilized for conservation purposes as defined in section 170(h)(4) of the Internal Revenue Code.

During the January 3, 20XX interview, President was asked about this transaction in relation to the Organization's stated purpose of receiving conservation easements. President stated that he was unsure how the Organization received the entire property instead of just a conservation easement. He stated that there was a miscommunication between the donor and himself. President believed this transaction was to be a conservation easement donation and was surprised when he received the Warranty Deed showing a complete transfer of the property.

President, in his capacity of Certified Public Accountant, prepares the annual tax returns for one of the two partners in CO-4. For 20XX he received \$\* \* \* for that service. President performed the baseline study and it is composed of a single piece of paper with one paragraph describing the land. The paragraph states; "The land upon which the conservation easement was given to ORG by CO-4 \* \* \* is in a natural wooded state, with no signs of recent timbering, and no man made structures." Just as was the case with the CO-1, the baseline study for CO-4 does not meet the standards imposed in the Treasury Regulations.

President signed the Form 8283 and on February 20, 20XX, President sent CO-4 the required donor acknowledgement letter. In that letter he acknowledged receiving the land and \$\* \* \* as a cash donation for performing inspections and enforcing the easement. As this transaction was for the transfer of the entire property and not just a conservation easement, President was asked in a telephone interview, on or about May 15, 20XX, why CO-4 provided a contribution for inspections and enforcement. President had no answer.

In a May 28, 20XX letter from President to the examining agent, President stated that "there are no written inspection reports. I often go by this property when riding my bicycle, but never made notes about it. The important thing is nothing has been disturbed." This admission is in stark contrast to the requirements for annual monitoring and inspection reports. With no reports of any kind, there is no way to tell if the property has been disturbed since the original baseline study was completed.

#### CO-5 Conservation Easement:

The third and final transaction for the Organization for the period of October, 20XX through January, 20XX was the acceptance of a conservation easement consisting of 1.52 acres donated by CO-5 (CO-5) on December 30, 20XX.

President, in his capacity as Certified Public Accountant, prepares the annual tax return for one of the two partners in CO-5. For 20XX, he received \$\* \* \* for those services.

The only baseline documentation provided by President is a one page, unsigned and undated document that was attached as exhibit "A" to the conservation easement deed. The document states that the easement area is currently vacant land and consists of undeveloped wetlands, woodlands and vegetation. It further states that no disturbances nor construction is anticipated nor allowed within the easement area. As is the case with the baseline documentation for the first two transactions the Organization entered into, the baseline documentation for this transaction fails to meet the standards imposed in the Treasury Regulations.

The conservation deed states that the characteristics of the property, its current use and state of improvement are described in Exhibit "A," and that Exhibit "A" is the appropriate basis for monitoring compliance with the objectives of preserving the conservation and water quality values.

The conservation easement deed does not contain a specific conservation purpose, but rather uses a broad approach by stating that; "The property shall be maintained in its natural, scenic, wooded and open condition and restricted from any development or use that would impair or interfere with the conservation purposes of this conservation easement set forth above."

The wording of the preceding paragraph indicates that the Organization could intend the conservation easement to cover both; 1) Protection of a significant relatively natural habitat in which a fish, wildlife, or plant community, or similar ecosystem normally lives, and 2) The preservation of open space.

Article III of the conservation easement deed stipulates that there will be no industrial, commercial or residential use. There will be no agricultural, timber harvesting, grazing or horticultural uses permitted. The vegetation is not to be disturbed and there is to be no mining, excavation or dredging. There shall be no diking, draining or other alteration of the land that would be detrimental to water purity or alter the natural water levels or drainage.

There is to be no dumping, construction or any disturbance of natural features. There are to be no signs unless said signs relate to; no trespassing signs, signs identifying the conservation values of the property, signs giving directions or proscribing rules for use of the land.

The conservation easement deed does not mention public access or any restriction to public access. The abbreviated baseline study does not address this area, and there is no indication as to what access is allowed or not allowed.

The grantee is allowed to prevent any activity which is not consistent with the purposes of the easement. The grantee is allowed to inspect the property to determine if any violations have occurred. If enforcement is necessary to correct a violation, the grantor agreed to bear the cost of enforcing the terms of the easement to include any restoration necessary.

President provided a letter dated May 26, 20XX which was addressed to RA-1 and RA-2 that acknowledged the CO-5 conservation easement donation and receipt of \$\* \* \* from each party.

On January 3, 20XX, at the initial meeting between President and this agent, President was unable to provide the baseline study for either the CO-4 donation or for the CO-5 easement. He also could not produce the Form 8283 for either donation. He stated that he would have to get a copy of those documents from the donors.

President was asked by this agent on several occasions from January 3, 20XX through mid-May, 20XX to produce these documents and failed to do so until May 30, 20XX. President provided the excuse that he was too busy and had health issues. As of the issuance date of this report, the Form 8283 for CO-4 has not been provided and the Form 8283 provided for CO-5 shows that it was not signed by the Organization.

With regard to books and records, the Organization does not maintain any except for the bank statements for the Organization's one account. President stated that with the limited transactions involved and with the low levels of income received, he didn't see the need to maintain books and records that detail every transaction.

Specific Examination Findings

The Organization did not file Form 990, Return of Organization Exempt From Income Tax, for the tax years ending May 31, 20XX, 20XX, 20XX or 20XX. The reason supplied by President was that the income level was below the \$25,000 threshold required for filing. The examination of the Organization covered the tax years ending May 31, 20XX and May 31, 20XX.

The financial documentation provided by President supports his claim that filing was not required for either year ending May 31, 20XX or 20XX. President submitted Form 8734, Support Schedule for Advance Ruling Period, and the information contained therein matched the financial information in the Organization bank statements. The information submitted by the Organization on Form 8734 is summarized below;

On the Form 8734 that President submitted he claims that the Organization qualifies for Foundation status of 509(a)(2). The form shows the public support percentage under section 509(a)(2), as calculated by President, as \*\*\*%.

Calculation of Public Support under Section 509(a)(1) of the Code:

Total support received for the five year period from June 1, 20XX through May 31, 20XX, as reported by the Organization on Form 8734 was \$\$. Two percent of total support equals \$. There were four substantial contributors, all of whom contributed in excess of the \$ two percent threshold. Therefore, the percentage of public support to total support is zero. Subsequently, the Organization fails to qualify for foundation status under section 509(a)(1) of the Code.

Calculation of Public Support under Section 509(a)(2) of the Code:

Total support received for the five year period from June 1, 20XX through May 31, 20XX, as reported by the Organization on Form 8734 was \$\$. Of that amount \$ came from interest income and \$ came from substantial contributors. Neither of those sources of income qualifies for public support, and as such the percentage of public support to total support is zero. Subsequently, the Organization fails to qualify for foundation status under section 509(a)(2) of the Code.

The Organization does not include any non-cash contributions on the form 8734. That stance is consistent with the lack of reporting conservation easements as assets on the Form 990.

## LAW

IRC § 501(c)(3) exempts from Federal income tax: corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Treasury Regulation § 1.501(c)(3)-1(c)(1) provides that an organization will be regarded as “operated exclusively” for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in § 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.

Treasury Regulation § 1.501(c)(3)-1(c)(2) provides that an organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. The words “private shareholder or individual” refer to persons having a

personal and private interest in the activities of the organization per Treas. Reg. sec. 1.501(a)-1(c)

Treasury Regulation § 1.501(c)(3)-1(d)(1)(ii) provides an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Treasury Regulation 1.170A-14(c) provides that to be considered an eligible donee, an organization must be a qualified organization, have a commitment to protect the conservation purposes of the donation, and have the resources to enforce the restrictions. For purposes of this section, the term qualified means:

- (i) a governmental unit described in section 170(b)(1)(A)(v);
- (ii) An organization described in section 170(b)(1)(A)(vi);
- (iii) A charitable organization described in section 501(c)(3) that meets the public support test of section 509(a)(2);
- (iv) A charitable organization described in section 501(c)(3) that meets the requirements of section 509(a)(3) and is controlled by an organization described in paragraphs (c)(1)(i), (ii), or (iii) of this section.

Treasury Regulation 1.170A-14(d)(2) provides that a donation to preserve land areas for the outdoor recreation of the general public or for the education of the general public will meet the conservation purposes of this section. The preservation of land areas for recreation or education will not meet the test of this section unless the recreation or education is for the substantial and regular use of the general public.

Treasury Regulation 1.170A-14(d)(3), Protection of environmental system — provides that the donation of a qualified real property interest to protect a significant relatively natural habitat in which fish, wildlife, or plant community, or similar ecosystem normally lives will meet the conservation purposes of this section. Alteration of the land 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. The example provided in this section refers to land alteration that is allowed if the lake or pond were a nature feeding area for a wildlife community that included rare, endangered, or threatened native species. This section allows for the denial of public access.

Treasury Regulation 1.170(A)-14(d)(4), Preservation of open space — provides that the donation of a qualified real property interest to preserve open space will meet the conservation purposes test of this section if such preservation is:

- (A) Pursuant to a clearly delineated federal, state, or local government conservation policy and will yield a significant public benefit, or
- (B) For the scenic enjoyment of the general public and will yield a significant public benefit.

Treasury Regulation 1.170(A)-14(d)(4)(B) — Illustrations, The preservation of an ordinary tract of land would not in and of itself yield a significant public benefit, but the preservation of ordinary land areas in conjunction with other factors that demonstrate significant public benefit or the preservation of a unique land area for public enjoyment would yield a significant public benefit.

Treasury Regulation 1.170(A)-14(g)(5) — Protection of conservation purpose where taxpayer reserves certain rights. 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.".

In *Better Business Bureau v. United States*, 326 U.S. 279 (1945), the United States Supreme Court held that regardless of the number of truly exempt purposes, the presence of a single substantial non-exempt purpose will preclude exemption under section 501(c)(3).

In *Benedict Ginsberg and Adele W. Ginsberg v. Commissioner*, 46 T.C. 47 (1966), the United States Tax Court held that the organization used its funds primarily to foster private interests and the benefit to the general public was only incidental. As such, the organization was denied exemption under section 501(c)(3).

In *Charles Glass et ux. v. Commissioner*, 124 T.C. 16 (2005), the United States Tax Court held that the conservation easement was donated exclusively for conservation purposes. The Tax Court also stipulated that the donee organization operated at arms length and was a qualified organization.

In *Turner v. Commissioner*, 126 T.C. 16 (2006), The United States Tax Court held that the voluntary restriction to develop less land in and of itself does not meet the qualifications necessary for a charitable deduction. To be a qualified conservation contribution under section 170(h)(1), the conservation easement has to be exclusively for conservation purposes.

In Rev. Rul. 70-186 it was held that the organization was exempt from Federal income tax under section 501(c)(3) of the Code because the benefits derived from their activities flowed principally to the general public and benefits to private landholders did not lessen the public benefit received.

In Rev. Ruls. 76-204 and 78-384 it was held that the land must be “ecologically significant” and that preservation of ordinary farmland was not sufficient to justify charitable status.

#### GOVERNMENT’S POSITION

The IRC § 501(c)(3) tax exempt status of ORG and \* \* \* (the “Organization”) should be revoked because it is not operated exclusively for tax exempt purposes.

The facts show that the Organization is not operated exclusively for a tax exempt charitable purpose. Rather, the Organization has operated as a conduit for President, CPA to help his clients obtain sizable deductions on their tax returns.

All three land transactions that the Organization has entered into were with entities that are in some way connected to President and his accounting practice. For CO-1, President prepared the annual tax returns for two of the sixteen partners. For CO-4, President prepared the annual tax returns for one of the two partners. For CO-5, President prepared the annual tax returns for one of the two partners.

This type of pattern is not coincidental. Instead it shows President’ intent and goals are not concerned with environmental or conservation issues, but rather that he has used the Organization as a vehicle for the enrichment of his clients. This type of private benefit runs counter to the requirements set forth in IRC Section 501(c)(3) with regard to private benefit.

President is considered an expert in the field of public accounting. This position is evidenced by his membership on at least one ethics committee, membership on a revenue laws study committee, and former membership on a professional standards committee, as well as being admitted to practice before the United States Tax Court. In addition, all of these qualifications demonstrate that President is an accountant who understands how to utilize the tax laws for the benefit of his clients.

In stark contrast to his vast experience and knowledge as a certified public accountant, President does not possess the knowledge, training or experience to make educated decisions on whether each conservation easement serves a conservation purpose under section 170(h)(4)(A).

Moreover, he has no expertise in valuing land for conservation purposes. He has acknowledged that he read a few articles and conducted some research on how an organization that accepts conservation easements should perform. The lack of knowledge and experience are strong indicators that the Organization does not possess the level of commitment required under section 1.170A-14(c) of the Treasury Regulations and is not operated a charitable purpose.

As is evidenced by his baseline documentation and inspection reports, President has chosen to follow his own path. Neither the baseline reports nor the inspection reports conform to the requirements set forth in the Treasury Regulations. These documents do not in any way provide the necessary information that the Organization would need to enforce the conservation easements received. These documents and the lack of substantial information contained therein show that the main concern of President was not the protection of open space or natural habitats, but the amount of deductions he could claim for his clients.

The baseline documentation for all three transactions consists of the barest of facts and is not substantiated by pictures, analysis, or expert opinion. There is no description of flora or fauna and each report contains a generic statement that references the natural characteristic of the land. President states that the baseline documentation is in accordance with Treasury Regulation 1.170A-14(g)(5) because the regulation uses the word “may” instead of “shall” with regard to what should

be contained in a baseline report.

President reliance on performing the bare minimum with regard to the protection of conservation values is an indication that the Organization does not pursue conservationism as a primary goal. The lack of detail in the baseline studies shows that the Organization does not possess the level of commitment required under section 1.170A-14(c) of the Treasury Regulations.

The monitoring or annual inspection reports are less descriptive than the baseline documentation. The inspection reports for CO-1 contain one or two handwritten sentences that state that no changes were noted.

For CO-4, there are no inspection or monitoring reports. After several months of inquiring as to the inspection report whereabouts, President wrote that: "there are no written inspection reports. I often go by this property when riding my bicycle, but never made notes about it. The important thing is nothing has been disturbed." This statement reflects the fact that monitoring for compliance was not and is not a top priority for President. This lack of vital documentation also demonstrates that the Organization does not possess the commitment necessary for accepting, holding and monitoring conservation easements.

For CO-5, the inspection reports are available but do not indicate what was done by President in the way of ensuring compliance. For the inspection visit on September 28, 20XX, the report states the following; "For sale sign on adjacent property. According to \* \* \* only 2 buildings could be put on property. Called building inspector to make sure he knew of easement." The inspection report for April 12, 20XX was extremely brief and stated; "Walked by property. OK."

Baseline documentation reports and annual inspection reports that do not contain more descriptive information as to the type, quality or full description of the land as well as the boundaries, are indicators of an organization that is not operating for conservation or environmental purposes and do not meet the requirements of section 1.170(A)-14(g)(5) of the Treasury Regulations.

With the CO-1, President stated in the January 3, 20XX interview that he did not review the easement deed prior to signing. Since he did not read the document, he was unaware as to the rights granted and retained by the donor. President was unaware of the extensive rights retained by the donor until it was brought to his attention by this agent. This situation shows that President does not possess the knowledge, experience or willingness to follow the Treasury Regulations as written with regard to the commitment necessary. This situation also demonstrates a business practice that could be described as poor.

For the CO-4 transaction, President failed to secure a conservation easement deed, but instead received title to the land in its entirety. President has no explanation that would demonstrate how this transaction was a proper business practice for a conservation organization. What this transaction does demonstrate is President lack of experience, knowledge and willingness to act as a proper fiduciary for the Organization. Again, like the CO-1 transaction, President has failed to demonstrate the proper commitment required by section 1.170(A)-14(c) of the Treasury Regulations.

The Organization is not run as a section 501(c)(3) charitable organization. There are no financial records beyond what is contained in the bank statements. There are no solicitations from the general public for support, no receipts, no expense vouchers, and no balance sheets prepared at year end. Considering the fact that President is a certified public accountant, and is considered an expert in this field, this situation is disturbing at best, and at worst demonstrates that President has not been working in the best interests of the Organization.

Considering that the Organization has only received two conservation easements and one land transfer in four plus years shows that the commitment to perform as a conservation organization as described in the Treasury Regulations is not present.. There are no educational events developed and sponsored by the Organization. The Organization does not appear to hold itself out to the public as a charitable conservation organization, except through word-of-mouth, and of course, President' clients.

The Organization has not been operated in accordance with the Organization Bylaws. There are no meetings of officers or board members, and there are no elections. In essence, President has sole control and is operating his own business under his own terms. There are no internal controls and only the bare minimum with regard to records and recordkeeping.

President' lack of expertise in the area of conservation easements and the lack of detail in the baseline studies and inspection reports show that the Organization does not have clear established criteria for accepting easements, nor adequate procedures in place for enforcing the easements. President prepares the baseline studies and makes decisions on whether or not easements qualify as valid conservation easements. Neither of the two conservation easement deeds state exactly what the purpose of the easement is. Instead there are generic statements that do not provide a clear representation as to the purpose as stated under section 1.170(A)-14 of the Regulations. The Organization does not take the steps necessary to ensure that each easement accepted serves a conservation purpose under section 170(h)(4)(A) of the Code. There is no one associated with the Organization that has any formal education, training or expertise in conservation matters and it is not known whether the appraisers that appraised the donated easements had qualifications in valuing conservation easements. However, any mention of conservation purposes in the appraisals does not aid the Organization because no one on the Organization's governing body has any formal education on conservation matters. The Organization's monitoring activities (such as they are) cannot further a charitable purpose under these circumstances where there is no knowledge as to whether the easements the Organization has accepted serve the conservation purposes under section 170(h)(4)(A). Moreover, there is no evidence that the Organization possesses sufficient resources to enforce easement restrictions in instances where any donor were to use an underlying property contrary to a conservation purpose.

The Organization fails to meet the requirements set forth in Regulation § 1.501(c)(3)-1(c)(1), in that it is not operated exclusively for an exempt purpose. More than an insubstantial part of its activities are the acceptance of conservation easements or property transfers for which there is not proper documentation. The organization has failed to establish that the acceptance of these easements furthers an exempt purpose under section 501(c)(3) of the Code. In short, ORG fails to operate for a charitable conservation purpose.

The Organization also fails to meet the requirements set forth in Regulation § 1.501(c)(3)-1(d)(1)(ii), in that they are not operated exclusively for one or more exempt purposes because it serves the private interests of President and his clients.

The presence of a single substantial non-exempt purpose precludes exemption under section 501(c)(3). See *Better Business Bureau v. United States*, 326 U.S. 279 (1945). This Organization exists not to serve the greater good of the general public, but rather fits the needs of President clients to have sizable deductions on their tax returns.

President, who is a certified public accountant, submitted Form 8734, Support Schedule for Advance Ruling Period and it was calculated incorrectly. On the form he calculated the public support percentage for foundation status 509(a)(1) as \* \* \*% and for foundation status 509(a)(2) as \* \* \*%. President failed to take into account that all monies that were received came from substantial

contributors, which by definition are disqualified persons. Any income received from disqualified persons is excluded from the calculation of public support, both for 509(a)(1) and 509(a)(2).

When the monies received from substantial contributors is removed from the calculation, public support under both 509(a)(1) and 509(a)(2) equal zero. As such, the Organization can not be considered publicly supported and if revocation of exempt status is not pursued, reclassification to a private foundation should occur.

The first year under examination is the first year that the Organization operated, the fiscal year ending May 31, 20XX. The Organization's status as an organization described under § 501(c)(3) should be revoked, effective October 16, 20XX, because it did not operate exclusively for exempt purposes. If revocation of exempt status is not upheld, then the Organization should be reclassified as a private foundation and be subject to Chapter 42 excise taxes.

#### TAXPAYER'S POSITION

The taxpayer wishes to keep its exempt status and believes its activities serve a significant public benefit with regard to preservation and conservation of natural land areas.

President also believes that if the Organization is reclassified to a private foundation based on not meeting the public support requirements, then the Organization would still be able to hold the conservation easements already in the Organization's possession. President has stated that there is no mention in either the Code or the Treasury Regulations that would prohibit a private foundation from holding conservation easements that were acquired during an Organization's advance ruling period.

#### CONCLUSION

The Organization is not being operated as an exempt IRC § 501(c)(3) organization. The charitable exempt status should be revoked effective October 16, 20XX.

#### ALTERNATIVE ISSUE #1

Should ORG be reclassified as a private foundation?

#### FACTS

President submitted Form 8734, Support Schedule for Advance Ruling Period, and the information contained therein matched the financial information in the Organization bank statements. The information submitted by the Organization on Form 8734 is summarized below;

On the Form 8734 that President submitted it purports that the Organization qualifies for Foundation status of 509(a)(2). The public support percentage as reflected on the form shows \*\*\*%.

Calculation of Public Support under Section 509(a)(1) of the Code:

Total support received for the five year period from June 1, 20XX through May 31, 20XX, as reported by the Organization on Form 8734 was \$\$. Two percent of total support equals \$. There were four substantial contributors, all of whom contributed in excess of the \$ two percent threshold. Therefore, the percentage of public support to total support is zero. Subsequently, the Organization fails to qualify for foundation status under section 509(a)(1) of the Code.

Calculation of Public Support under Section 509(a)(2) of the Code:

Total support received for the five year period from June 1, 20XX through May 31, 20XX, as reported by the Organization on Form 8734 was \$\* \* \*. Of that amount \$\* \* \* came from interest income and \$\* \* \* came from substantial contributors. Neither of those sources of income qualifies for public support, and as such the percentage of public support to total support is zero. Subsequently, the Organization fails to qualify for foundation status under section 509(a)(2) of the Code.

The Organization does not include any non-cash contributions on the form 8734. That stance is consistent with the lack of reporting conservation easements as assets on the Form 990.

## LAW

### IRC § 509 Private Foundation Defined:

509(a) GENERAL RULE — For purposes of this title, the term “private foundation” means a domestic or foreign organization described in section 501(c)(3) other than —

509(a)(1) an organization described in section 170(b)(1)(A) (other than in clauses (vii) and (viii));

509(a)(2) an organization which —

509(a)(2)(A) normally receives more than one-third of its support in each taxable year from any combination of —

509(a)(2)(A)(i) gifts, grants, contributions, or membership fees, and

509(a)(2)(A)(ii) gross receipts from admissions, sales of merchandise, performance of services, or furnishing of facilities, in an activity which is not an unrelated trade or business (within the meaning of section 513), not including such receipts from any person, or from any bureau or similar agency of a governmental unit (as described in section 170(c)(1)), in any taxable year to the extent such receipts exceed the greater of 5,000 or 1 percent of the organization’s support in such taxable year,

from persons other than disqualified persons (as defined in section 4946) with respect to the organization, from governmental units described in section 170(c)(1), or from organizations described in section 170(b)(1)(A) (other than in clauses (vii) and (viii)).

### IRC § 170 Charitable, Etc., Contributions and Gifts:

170(b)(1)(A)(vi) an organization which normally receives a substantial part of its support (exclusive of income received in the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption from a governmental unit referred to in subsection or from direct or indirect contributions from the general public,

### IRC § 4946: Definitions and Special Rules

4946(a) DISQUALIFIED PERSON. —

4946(a)(1) IN GENERAL — for purposes of this subchapter, the term “disqualified person” means, with respect to a private foundation, a person who is —

4946(a)(1)(A) a substantial contributor to the foundation,

Treasury Regulation § 1.507-6. Substantial contributor defined

## (a) Definition

(1) In general. — the term “substantial contributor” means, with respect to a private foundation, any person (within the meaning of section 7701(a)(1)), whether or not exempt from taxation under section 501(a), who contributed or bequeathed an aggregate amount of more than \$5,000 to the private foundation, if such amount is more than 2 percent of the total contributions and bequests received by the private foundation before the close of the taxable year of the private foundation in which a contribution or bequest is received by the foundation from such person.

## GOVERNMENT’S POSITION

As set forth above, it is the government’s primary position that the tax exempt status of ORG should be revoked. Alternatively, ORG should be reclassified as a private foundation.

The Organization was created in 20XX and since that time has failed to meet the requirements for public support as outlined in the Code. The Organization has only received contributions from substantial contributors which by definition are disqualified persons. Public support does not include any receipts from disqualified persons as defined in IRC section 4946. As such, the Organization does not qualify for foundation status under sections 509(a)(1) or 509(a)(2) of the Code.

If revocation of exempt status is not achieved, then the Organization should be reclassified as a private foundation effective June 1, 20XX, the end of the advance ruling period, as it fails to qualify for any foundation status as described in section 509(a) of the Code.

## TAXPAYER’S POSITION

President also believes that if the Organization is reclassified to a private foundation based on not meeting the public support requirements, then the Organization would still be able to hold the conservation easements already in the Organization’s possession. President has stated that there is no mention in either the Code or the Treasury Regulations that would prohibit a private foundation from holding conservation easements that were acquired during an Organization’s advance ruling period.

## CONCLUSION

ORG does not qualify for tax exempt status under IRC section 501(a) as an organization described in section 501(c)(3) of the Code. The lack of any qualified exempt activity indicates that the Organization should not be allowed to continue as a tax exempt organization. Revocation of the tax exempt status of ORG is proposed with an effective date of October 16, 20XX.

Alternately, ORG should be reclassified as an organization that is a private foundation as defined in section 509(a) of the Code effective June 1, 20XX, the end of the advance ruling period.

A closing conference was held by telephone with President, president of ORG on July 28, 20XX

Citations: LTR 201405018