Land Trust Alliance
Fact Sheet

Easements as Public Support: The 'Zero-Value' Approach

By William T. Hutton
Excerpt from the **Conservation Easement Handbook,** ***first edition 1998.***

A nonprofit land trust or historic preservation organization that seeks to play in the conservation easement arena must vigilantly monitor its fiscal diet to assure that it continues to qualify as a "public charity."[1] Under Section 170(h)(3)of the Internal Revenue Code, only conservation organizations that receive adequate public support, as elaborately defined by statute and regulations, will qualify to receive tax-deductible easement donations.[2] Yet, paradoxically, the receipt of easements themselves -- the raison d'etre for many a land trust's establishment -- may jeopardize its continuing ability to solicit and accept such gifts.

Of all the properties susceptible of charitable conveyance, the typical conservation easement is unique in furnishing little or no measurable benefit to the donee.[3] Under the "before and after" appraisal method, the donor ordinarily determines the proper charitable deduction according to the reduction in value that results from the creation of a "perpetual conservation restriction." See Treas. Reg. § 1.170A-14(h)(3). But the donee rarely finds its balance sheet enhanced by the receipt of such an easement; indeed, most nonprofit easement managers are all too aware that monitoring and enforcement of easement obligations create net balance sheet liabilities (see chapter 7). From the donee's perspective, then, the donated silk purse is transformed, at the moment of conveyance, into a sow's ear destined for perpetual care.

Governmental and Public Support Requirements

In order to illustrate the problem that metamorphosis may pose for the donee organization, let us suppose that the Sturdley Valley Land Trust was incorporated on January 2, 2000, and has just completed its five-year advance ruling period, during which it has intended to establish its entitlement to "public charity" status under I.R.C. § 170(b)(1)(a)(vi) by receiving a "substantial" part of its total support from a combination of government grants and public donations.[4]

Under the regulations, Sturdley Valley will be guaranteed continuance of its public charity status if it can demonstrate that at least one-third of its total support is from governmental and public sources. See Treas. Reg. §§ 1.170A-9(e)(2), (5)(iii)(a). Failing to reach that level is not necessarily fatal; provided that at least 10 percent of the land trust's total support is from governmental and public sources, the trust may qualify upon consideration of all relevant "facts and circomstances." See Treas. Reg. § § 1.170A-9(e)(3), (5)(iii)(a).

For a land trust that attracts substantial easements but little cash, meeting the regulations' threshold may be difficult. Government grants to private land trusts are rare, and private support weighs favorably in the support balance only to the extent that total-gifts from a single source, determined with reference to certain aggregation rules, do not exceed 2 percent of total support for the measuring period.

TABLE 1

Contributions to Sturdley Valley, 2000-2004

Small cash donations (< $100)	$ 5,000
One gift of land (from member)	5,000
Five easements:	
Easement A (from board member)	150,000
Easement B (from board member)	220,000
Easement C	70,000
Easement D	90,000
Easement E	110,000
TOTAL	$ 660,000

TABLE 2

Results Using Donors' Deduction Values: Certain Easements Excluded as "Unusual Grants"

	Total Support	Favorable Support
Small cash gifts	$ 5,000	$ 5,000
Land gift	15,000	7,800*
Easements from board members		
Easement A	150,000	7,800*
Easement B	220,000	7,800*
TOTAL	$390,000	$28,400

Percent Favorable Support: $28,400/$390,000 = 7.28%

*Favorable support from a single source is limited to 2 percent of total support.

See Treas. Reg. § 1.170A-9(e)(6). But substantial contributions or bequests from "disinterested parties" may be excluded from the total support calculation if they are "unusual or unexpected" and, by reason of their size, would adversely affect the organization's support status. See Treas. Reg. § 1.170A-9(e)(6)(ii).The regulations that provide this exception are amplified by Revenue Procedure 81-7, which sets out certain factors guaranteeing, where met, that an easement donation will escape the support calculation as "unusual."5 Among the most troublesome of those factors, particularly for a newly established land trust, is the prohibition against the donor's being a creator, former contributor, or relative of such a person.

Results Using Donors' Deduction Values: Certain Easements Excluded as "Unusual Grants"

Now suppose that for the years 2000-2004 Sturdley Valley received the following in contributions: a number of small cash contributions (none larger than $100) totaling $5,000; five easements valued by their donors for charitable contribution purposes at an aggregate of $640,000; and one gift of land in fee worth $15,000 (see Table 1).Two of the five easements, at a combined value of $370,000, and the single land donation were received from members of the land trust's board.

Unfortunately for Sturdley Valley, the two easement donations from board members are almost certainly barred under IRS guidelines from removal from the total support calculation as unusual grants. Eliminating the other three easements produces a "total support" figure of $390,000, based entirely on charitable contribution amounts: $5,000 cash, $370,000 included easements, and $15,000 real estate in fee (see Table 2).

In calculating the amount of "favorable support," each gift from a single private source must be limited to 2 percent of total support, in this case $7,800 (2 percent of $390,000). That limitation applies to each of the included easement gifts as well as to the fee transfer. Thus the aggregate of favorable support is a mere $28,400. Sturdley Valley fails, therefore, even to meet the 10 percent threshold requisite to making a "facts and circumstances" argument.

Easements Valued at Donors' Deduction Values: All Donations Included

Another, slightly better, alternative is available. By including all of the easement donations at their charitable contribution values (nothing in the regulations compels exclusion of unusual grants), the total support becomes $660,000,and the 2 percent limit on gifts from each private source increases to $13,200. Applying that ceiling to all five easement gifts and the fee donation, favorable support increases to $84,200 or 12.76 percent of total support (see Table 3) -not a comfortable leap over the 10 percent benchmark but sufficient to permit a plea for IRS mercy.

TABLE 3

Easements Valued at Donors' Deduction Values: All Donations Included All Donations Included

	Total Support	Favorable Support
Small cash gifts	$ 5,000	$ 5,000
Land gift	15,000	13.200*
All five easements:		
Easement A	50,000	13,200*
Easement B	220,000	13,200*
Easement C	70,000	13,200*
Easement D	90,000	13,200*
Easement E	110,000	13,200*
TOTAL	$660,000	$84,200

Percent Favorable Support: $84,200/$660,000 = 12.76%

*Favorable support from a single source is limited to 2 percent of total support

All Easements Valued at Zero: The Zero-Value Approach

Now let us contemplate "support" from the donee's vantage. While neither the statute nor the regulations provide definitional help (see I.R.C. § 509(d) and Treas. Reg. § 1.509(d)-1), the Oxford English Dictionary offers several possibly relevant meanings: "bearing or defraying of charge or expense;" "spiritual help;" and "contributing to the success . . . of something." It is submitted that to solve Sturdley Valley's problem, the first of those definitions should be applied. Only by adopting a definition that compels a measurement of value to the donee is it possible sensibly to apply the mechanical test of the regulations. Under that approach, the

TABLE 4

All Easements Valued at Zero: The "Zero-Value" Approach

	Total Support	Favorable Support
Small cash gifts	$ 5,000	$5,000
Land gift	15,000	400*
All five easements		
Easement A	-0-	-0-
Easement B	-0-	-0-
Easement C	-0-	-0-
Easement D	-0-	-0-
Easement E	-0-	-0-
TOTAL	$20,000	$5,400

typical conservation easement, carrying no affirmative rights, will have no measurable value.

This "zero-value" approach is further justified by a common-sense comparison of motives. The donor of cash or securities obviously intends to furnish sustenance to the charitable donee, but the donor of an easement cannot be presumed to have the donee's fiscal welfare in mind. Although the donor satisfies a conservation objective and achieves a tax benefit by a sacrifice of property, in so doing he or she typically imposes a financial burden upon the donee. The spiritual satisfactions of easement acceptance may heighten the organization's claim to exempt status, but they should not weigh in a balance intended to test the public pocketbook appeal of a charitable cause.

In at least one situation, the IRS has evidently accepted this line of reasoning. A local land trust in a western state had attracted very little financial support during its advance ruling period, yet had accepted certain easements not permitted to be excluded from the support calculation as unusual grants. For annual reporting purposes, the organization had booked easements at their contribution value, and it was therefore not surprising that the IRS first proposed to reject the organization's claim to continuing public charity status. Upon review, however, the zero-value approach was endorsed. The examining agent's report simply states that "it was further determined that conservation easements donated to the organization have no market value in the hands of the organization and will not be considered as support."

Elimination of all easement values, in Sturdley Valley's situation, produces a total support figure of $20,000, of which $5,400, or 27 percent, counts favorably (see Table 4). Although Sturdley Valley still falls short of the one-third safe harbor, this substantial level of public support, in combination with the organization's public aspects, should suffice.

Organizations that have the opportunity to attract a significant number of easement gifts in their early years may be tempted to take a different tack and value easements with reference to donors' appraisals, since an adequate volume of easement transactions could conceivably protect public charity status, based upon contribution amounts, quite without regard to cash or other property

donations. Yet over the long term, the zero-value approach may be a safer strategy. The struggle for public charity status, upon which the land trust or historic preservation organization relies for its lifeblood under I.R.C. § 170(h)(3)(A),is a perpetual one, based upon a four-year moving average of support calculations. See Treas. Reg. § 1.170A- 9(e)(4).

A slowing of the flow of easements is likely sooner or later to raise the measurement problem discussed here.

Notes

1. As used herein, "public charity" connotes an organization entitled to be considered an organization other than a private foundation by reason of its satisfaction of the public support requirements of I.R.C. § 170(b)(l)(A)(iv)or § 509(a)(2) and corresponding Treasury regulations. A § 509(a)(3) organization (colloquially known as a "satellite") attains immunity from private foundation status via exclusive support rendered to another public charity, and thus need not be concerned with the relative amounts of its sources of sustenance.

2. See I.R.C.§ 170(b)(A)(vi)and Treas. Reg. § 1.170A-9(e); I.R.C. § 509(a)(2) and Treas. Reg. § 1.509(a)-3. Although the issue discussed herein is of equal theoretical concern to both I.R.C. § 170(b)(l)(A)(vi)and § 509(a)(2) organizations, few conservation organizations in fact seek to maintain public charity status under the latter provision.

3. "Donee" is perhaps a misnomer here, but is used in deference to custom.

4. A new organization generally has five years to establish public charity status. Thereafter, an organization must show that contributions averaged over the preceding four years meet the tests of the regulations. consideration of all relevant "facts and circumstances." See Treas. Reg. §§ 1.170A-9(e)(3), (5)(iii)(a). For a land trust that attracts substantial easements but little cash, meeting the regulations' threshold may be difficult. Government grants to private land trusts are rare, and private support weighs favorably in the support balance only to the extent that total gifts from a single source, determined with reference to certain aggregation rules, do not exceed 2 percent of total support for the measuring period. See Treas. Reg. § 1.170A- 9(e)(6). But substantial contributions or bequests from "disinterested parties" may be excluded from the total support calculation if they are "unusual or unexpected" and, by reason of their size, would adversely affect the organization's support status. See Treas. Reg. § 1.170A-9(e)(6)(ii).The regulations that provide this exception are amplified by Revenue Procedure 81-7, which sets out certain factors guaranteeing, where met, that an easement donation will escape the support calculation as "unusual."[5] Among the most troublesome of those factors, particularly for a newly established land trust, is the prohibition against the donor's being a creator, former contributor, or relative of such a person.

5. 1981-1 C.B. 621. Six factors must be satisfied; the precise requirements of the revenue procedure should be consulted in respect of any easement (or other donation) sought to be excluded. In general, the procedural guidelines require that (1)the donor neither have created the donee organization, have previously contributed substantially to it, nor be related to a creator or substantial contributor; (2) the donor not occupy a managerial role with the donee, be related to a manager (e.g., a director or officer), or be in a position to exercise control over the organization; (3) the donation be in the form of cash, marketable securities, or function-related property (e.g., a conservation easement to a land trust); (4) the donee's entitlement to exempt status as a public charity has been recognized by the IRS; (5)no material restrictions on the gift have been imposed by the donor (the fact that the donation itself may be an aggregate of restrictions upon the donor's use will not violate this requirement); and (6)if the gift is made to underwrite operating expenses, it is limited to not more than one year's budget.

6. For a description of the factors relevant to a "facts and circumstances" determination, see Treas. Reg. § 1.170A-9(e)(3). Th

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