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McLennan I: Does the Government Have an Attitude Problem?

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McLennan I: Does the Government Have an Attitude Problem?

by William T. Hutton

It was our frequent experience, a decade ago, to encounter IRS examiners who were entirely unacquainted with conservation easements. Unfamiliarity bred skepticism, and skepticism was often reflected in proposed disallowance of the entire contribution, usually through assertion of a zero value. Fortunately, as the years go by, the IRS seems to be taking a more informed, or at least less thoroughly skeptical, view.

But then along comes a case like that of Elinor and Donald McLennan of Westmoreland County, Pennsylvania, looking for all the world like a garden-variety easement transaction, and the reaction of the Government is the tax-audit equivalent of the demonstration of nuclear superiority. Witness the arguments advanced in the McLennans' Claims Court proceeding:

(1) The taxpayers made no "gift of property", within the meaning of the charitable contribution provisions of the Code, since they reserved numerous rights in the scenic easement property;
(2) The Western Pennsylvania Conservancy (the donee organization) was systematically engaged in a "scenic easement program" which involved the conferral of direct benefits on the McLennans and other conservation easement grantors. Such a program involved prohibited "private inurement" under Section 501(c)(3), and should cause the Conservancy's tax-exempt status to be revoked;
(3) Even if the conveyance of the McLennans' scenic easement is considered a transfer of property, the taxpayers lacked requisite "donative intent" and an "exclusive conservation purpose", and thus their asserted deduction should be denied.

Whew! That list of grievances would be enough to give any land trust board heart palpitations and, perhaps, other glandular disturbances. And if the Western Pennsylvania Conservancy, or its easement program, should fall to this barrage, can the rest of America's 900-odd land trusts be far behind?

Unfortunately, we cannot yet provide a complete answer to that question. The Claims Court, on motions for summary judgment (available only when there are no material issues of fact to be tried) has refuted the first of the three Government contentions set forth above, holding that the subject conservation easement did indeed represent a transfer of value. (There was, of course, ample judicial precedent for that result.)
As for the grenade lobbed in the Conservancy’s direction, the Court in effect snagged it before detonation and threw it back, declining to exercise jurisdiction, since the IRS had taken no action to revoke the Conservancy’s tax-exempt status. (Note that the Justice Department, not the IRS, is responsible for the Government’s case in the Claims Court.) We believe it is safe to predict that there will be no further skirmishing on this front.

But on the government’s final contention, that benefits to the McLennans (other than tax benefits) defeated the deduction, the court was unwilling to render summary judgment. Unable to determine whether such alleged benefits were “merely incidental to a greater public conservation benefit,” the court determined that the facts underlying the issues of donative intent and exclusive conservation purpose “warrant further ventilation.” At trial, then, the McLennans were to bear the burden of proving that those requirements were met.

If you are puzzled about the Government’s stance in this matter, dear reader, you are in good and substantial company. The Claims Court opinion hints that the Government intended to assert that the McLennans were motivated to preserve property values and achieve, by the voluntary easement conveyance, the equivalent of zoning restrictions. Preserving property values by giving up substantial and valuable elements of ownership (as the court has already determined to have occurred), seems a rather peculiar way to go. And as for the achievement of zoning restrictions through an easement program, that is the inevitable object and purpose of any successful conservation effort which uses the conservation easement as a major strategy.

As to the necessary “exclusive conservation purpose”, which the court also required to be “ventilated” at trial, we should note that the McLennan case involves the predecessor to the present conservation easement statute. But if the Government insists upon a subjective application of that requirement, as it would seem it intends to do, a decision in its favor would have dire implications for interpreting the present conservation easement provisions as well. See §170(h)(1)(C).

The posture of the Government’s case is discouragingly reminiscent of the attitude of Treasury at the time the current conservation easement provisions were in gestation. It was then the Treasury’s profound belief that no charitable contribution deduction should obtain when a donor, by conveying an easement, advanced his ardent desire to see his property preserved in perpetuity. Under those circumstances, went the Treasury line, there can be no gift at all. Fortunately, Congress opted for an objective determination of what constitutes a donation in a conservation easement setting. But, as the entanglement of the McLennans with our public servants proves, it is often possible to get a second opinion after Congressional incentives have inspired socially desirable conduct. About the best that can be said about all of this is that it is probably good for us, now and then, to confront these fundamental issues. (The McLennans went back to court in May; the second decision has not yet been reported. We shall keep you posted.)


Of Unrequited Deductions (and Lost Hopes)

by William T. Hutton

The Back Forty Chutzpah Award, bestowed at irregular intervals for breathtaking aspirations in income tax planning, goes this month to Grover and Mary Hope of Dallas, Texas. In 1984, the Hopes, dissatisfied with an administrative condemnation award attributable to the taking of their property for an extension of the Dallas North Tollway, decided to go to court.

In 1986, by judicial decree, their initial award of $1,781,089 (the approximate difference between the property’s alleged fair market value and the total condemnation award). Not surprisingly, the IRS took exception to this treatment, disallowed the charitable contributions of $4,038,623 estimate of value for the condemned property, they claimed a charitable contribution of $1,781,089 (the approximate difference between the property’s alleged fair market value and the total condemnation award). Not surprisingly, the IRS took exception to this treatment, disallowed the charitable deductions, which spanned three taxable years, and asserted liabilities for additional taxes, penalties, and interest of over $1.4 million. The Hopes paid the assessed deficiencies, filed refund claims, and, upon IRS denial of those claims, took their case to the Claims Court.