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Article for Tax Management Real Estate Journal  
June 9, 2008

## How Cadillacs and Sewing Machines Affect a Real Estate Developer's Donation of Land

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A homebuilder donates a tract of land to a local school district for the a school; an office building developer donates land to the city for a sports arena; a shopping center developer donates land to the city for an interchange; a land investor donates property to the city for a park; a bank donates an easement to the state highway department to widen the street in front of the bank. Deductible as a charitable contribution under §170(a)?

Surprisingly, in many of these situations, the outcome may be based in part on prior donations of a Cadillac and sewing machines. In 1960 the Supreme Court in *Duberstein*,<sup>1</sup> addressed the transfer of a Cadillac to the taxpayer from a business friend as appreciation for furnishing names of potential customers. The issue was whether the Cadillac was income or an excludable gift under §102(a) to the taxpayer. The criteria of the Supreme Court applicable to income exclusion under §102(a) has been held to apply to deductions under §170(a),<sup>2</sup> and this case has been cited by many courts in connection with the donation of real estate. *Duberstein* says that for a gift to qualify as a charitable contribution, it must be made from a “detached and disinterested generosity.”

The courts have not always followed the *Duberstein* rule. In a 1971 case, *Singer Company*,<sup>3</sup> again often cited by the courts in real estate cases, the Court of Claims addressed sewing machines. In this case, the IRS disputed §170(a) deductions for sewing machines sold at a significant discount to charitable entities including government agencies, churches, the Red Cross, and both public and private schools. In *Singer*, the Court of Claims applied a different rationale from *Duberstein* in approaching the deductibility of a gift: “[I]f the benefits received, or expected to be received, are substantial, and meaning by that, benefits greater than those that inure to the general public from transfers for charitable purposes (which benefits are merely *incidental* to the transfer), then in such case we feel the transferor has received, or expects to receive, a *quid pro quo* sufficient to remove the transfer from the realm of deductibility under section 170.”

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<sup>1</sup> *Comm'r v. Duberstein*, 363 U.S. 278 (1960). This case, which involved only one issue, has been cited over 450 times in other cases.

<sup>2</sup> *DeJong v. Commissioner*, 309 F. 2d 373 (9th Cir. 1962).

<sup>3</sup> *Singer vs. U.S.*, 449 F.2d 413 (Ct. Cl. 1971). This case has been cited in over 50 subsequent cases and rulings.

*Quid pro quo*, which is a key factor in most of the real estate cases, is defined by *Black's Law Dictionary* as “what for what; something for something” and by *Webster* as “one thing for, or in place of, another; tit for tat.” The primary focus of this article is to provide the background and judicial history for real property donations and the issue of *quid pro quo*.

## **General Rules**

The basic element of a charitable contribution under §170(a) is a transfer of money or property to a permissible donee that is voluntarily given without receipt of consideration or value, and is executed in the proper form.<sup>4</sup> Permissible donees are defined in §170 and permit a taxpayer to claim a charitable deduction for contributions to states, cities, school districts, churches, synagogues, and other organizations described in §170(c).<sup>5</sup>

The courts have said the phrase “charitable contribution,” as used in §170(a), is synonymous with the word “gift.”<sup>6</sup> And a gift is generally defined as a voluntary transfer of property by the owner to another without consideration. But the courts have said that this definition does not refer to consideration in a common-law sense, but rather in a more colloquial sense. This means that if a payment proceeds from the incentive of anticipated benefit to the payor beyond the satisfaction which flows from the performance of a generous act, it is not a gift. Analyzing the facts related to a contribution has been called a “thicket of subjective and occasionally ephemeral concepts.”<sup>7</sup>

In defining a gift, the Supreme Court in *Duberstein* said that gifts are made from “a detached and disinterested generosity or from affection, respect, admiration, charity or like impulses.” However, realizing that business entities don’t have love,<sup>8</sup> etc., the Ninth Circuit in *Transamerica Corp.*,<sup>9</sup> said “It does not seem appropriate, however, to demand of a corporate entity such impulses as affection, respect or admiration.” The court went on to say that an absolute requirement of detached and disinterested generosity or lack of any business purpose would tend to render *ultra vires* substantially all charitable

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<sup>4</sup> See Kirschten & Freitag, 863-2nd T.M., *Charitable Contributions: Income Tax Aspects*, II.A.

<sup>5</sup> It should be noted that Reg. Sec. 1.162-15(b) provides that donations to organizations other than those described in §170(a) which bear a direct relationship to the taxpayer’s business may constitute allowable deductions as business expenses.

<sup>6</sup> See *Larry Sutton*, 57 TC 2239 (1971), citing *Harold DeJong*, 36 T. C. 896, (1961), *affd.* 309 F. 2d 373 (C. A. 9, 1962); *Jordon Perlmutter*, 45 T.C. 311 (1965); *James A. McLaughlin*, 51 T. C. 223 (1968), *Harold E. Wolfe*, 54 T. C. 1707 (1970); *Comm’r v. Duberstein*, 363 U. S. 278, 285 (1960); and *Bogardus v. Comm’r*, 302 U. S. 34 (1937).

<sup>7</sup> *Kavi Morton*, TC Memo 1979-484.

<sup>8</sup> There are many businesses set up to encourage love such as eHarmony.com, FTD Florists, Tiffany & Co, and the Vermont Teddy Bear Company, but these and other corporations are motivated by profits not emotional fulfillment.

<sup>9</sup> See *U.S. v. Transamerica Corp.*, 392 F.2d 522 (9<sup>th</sup> Cir. 1968), *affg.* Dist. Ct building on its reasoning from *DeJong v. Comm’r*, 309 F.2d 373 (9<sup>th</sup> Cir. 1962). Note that there is another case involving §170(a) deductions for Transamerica Corp.; in *Transamerica Corp. vs. U.S.*, 902 F2d 1540, the donation of film negatives was at issue.

contributions and thus to frustrate the congressional intent that corporations should enjoy such deductions.

But isn't something expected with most every gift, especially as to businesses? If something is given to the city or state for use by the general public, doesn't the taxpayer who is a member of the general public, benefit? Also, isn't the donated property taken off the tax rolls, thus reducing the donors' property taxes? And when an individual gives to a church or synagogue, does he or she expect this will help in life after death?<sup>10</sup> Additionally, a new business in the area might want to get public attention. In weighing the public benefits against the benefit to the donor, the Court of Claims in *Ottawa Silica Company*<sup>11</sup> said that those benefits that inure to the general public from charitable contributions are incidental to the contribution, and the donor, as a member of the general public, may receive them. It is only when the donor receives or expects to receive "additional substantial benefits" that courts are likely to conclude that a *quid pro quo* for the transfer exists and that the donor is therefore not entitled to a charitable deduction.

The transfer of conservation easements to a qualified conservation organization often provides some substantial benefit to the taxpayer even though the IRS allows deductions for such transfers. A district court in *The Citizens & Southern National Bank of South Carolina*,<sup>12</sup> a real estate case discussed in more detail later in this article, discussed Rev. Rul. 64-205 involving a scenic easement given to the federal government where the taxpayer gratuitously restricted his land which presented a scenic view to a nearby federal highway. The court noted that it was significant that the question of benefit also accruing to the donor was not discussed in this ruling although it appeared obvious that such restrictions would enhance the value of the donor's property in the same way that residential restrictions enhance a residential subdivision. So, although some benefits were received, the deduction was allowed by the court and by the IRS.

The courts are somewhat unclear on land conveyances when the government has the ability to take the property by operation of law. In *Jerome Scheffres*,<sup>13</sup> the Tax Court said a deduction would be allowed "unless the conveyance was compelled by law or enforceable contract or unless the grantors received such a *quid pro quo* in the form of special economic benefit as to make a conclusion that there was a gift or contribution within the capacity of only an overtaxed imagination." In these situations the government would generally be required to pay a fair price for the property and eliminate any claim to a charitable contribution. A taxpayer cannot claim a bargain sale when land

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<sup>10</sup> While spiritual enlightenment is generally not enough to prevent a contribution deduction, the Supreme Court held in *Hernandez v. Comm'r*, 490 U.S. 680 (Sup. Ct. 1989), that the *quid pro quo* exchange of a donation for Church of Scientology "auditing" and "training" sessions prevented a \$170 deduction. The IRS subsequently reached a settlement with the Church of Scientology to permit deduction of payments for these sessions. See Raby, B & Raby, W, "Religious Tuition as Charitable Contribution," *Exempt Organization Tax Review* (Aug 2000).

<sup>11</sup> *Ottawa Silica Company v. U.S.*, 82-1 USTC ¶9308 (Ct. Cl. 1982).

<sup>12</sup> *The Citizens & Southern National Bank of South Carolina v. U.S.*, 243 F.Supp. 900 (D.C.S.C. 1965).

<sup>13</sup> *Jerome Scheffres*, TC Memo 1969-41.

is sold by operation of eminent domain.<sup>14</sup> However, if the government does not actually enforce its legal ability to claim land this alone does not prevent a §170(a) deduction.<sup>15</sup>

Most of the cases and rulings involving the donation of real estate involve contributions of land for roads, parks, wildlife sanctuaries, libraries, schools, and churches. Some developers have been successful and some have not.

Just as in the dealer vs. investor area, there is no bright-line test for determining whether a deduction under §170(a) will be allowed. The outcome is based on the taxpayer's intention and the surrounding facts. The Tax Court has said, citing the Ninth Circuit,

“Determining a taxpayer's incentive, motive, or purpose in making a gift is a factual problem. The inquiry, however, does more than probe the subjective attitude of the donor and the extent to which public spirited and charitable benevolence prompted the transfer. The inquiry seeks to expose the true nature of the transaction: whether the ‘gift’ was made ‘in expectation of the receipt of certain specific direct economic benefits within the power of the recipient to bestow directly or indirectly, which otherwise might not be forthcoming.’”<sup>16</sup>

Also, the Tax Court has said as to valuation of property donated that the valuation “should frankly be recognized as inherently imprecise and capable of resolution only by a Solomon-like pronouncement.”<sup>17</sup>

According to the regulations under §170, the amount of the deduction is determined based upon the fair market value defined as “the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of facts.”<sup>18</sup> The amount of the deduction is reduced by gain that would not have been long-term capital gain if sold on the date of contribution.<sup>19</sup> The deduction for contributed property that is held for sale or held by a dealer would be limited to the taxpayer's basis. To claim a deduction for the full fair market value, the property would need to qualify as held for investment or in a business. And as is commonly known, the valuation of real estate is a very subjective area and often subject to litigation. An analysis of the judicial history of valuation in this area lies outside the scope of this article.

The following is a discussion of significant real estate cases and rulings involving donations of land for (1) roads and highways, (2) libraries, schools, churches, and synagogues, (3) parks and wildlife sanctuaries, and (4) water, sewage, and drainage. This

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<sup>14</sup> *Hope v. U.S.*, 92-1 USTC ¶50,414 (Ct. Cl. 1991).

<sup>15</sup> See *Johnie Vaden Elrod*, 87 TC 1046, where taxpayer conveyed property to government in part because of the government's inability to finance eminent domain acquisitions; *Mary Toole v. Tomlinson*, 63-1 USTC ¶9267 (D.C. Fla. 1963), where taxpayer conveyed land that could have been subject to condemnation and taken by the city if not donated.

<sup>16</sup> *Larry Sutton*, 57 TC 239 (1971), citing *Stubbs v. U.S.*, 428 F.2d 885 (9<sup>th</sup> Cir. 1970).

<sup>17</sup> *Morris Messing*, 48 TC 502 (1967).

<sup>18</sup> Treas. Reg. §1.170A-1(c)(2).

<sup>19</sup> Maule, 590-2nd T.M., *Taxation of Real Estate Transactions — An Overview* III. C. 3. c.

article does not discuss directly the donation of conservation easements, the donation of facades, or the donation of less than all of the interest in real estate.

### **Contributions of Property for Roads and Highways**

It appears the most common scenario and area of dispute with respect to charitable contributions is the donation of land to a municipality for construction of roads and highways. Is the taxpayer motivated by charitable intent when contributing land that will lead to a new highway and improved access to the taxpayer's shopping center, subdivision, or office complex? The answer is highly dependant on facts and circumstances and the case often rests on taxpayer's ability to demonstrate a public benefit.

In *Robert Stubbs*,<sup>20</sup> taxpayers entered into an agreement to purchase property in Tucson, Arizona contingent on its rezoning for a trailer court and shopping center. To assure access to the portion of the property intended for a mobile home development, the plat prepared for the city provided for dedication of a strip as a public road. The road would also provide access or frontage for some of the remaining property, a public school, a church, and a home for the aged. Both the district court and the Ninth Circuit Court found that the transfer to the city was to benefit directly the remaining portions of taxpayers' property, and to assist in obtaining the necessary rezoning. Therefore, no charitable deduction was allowed.

Likewise, in *Larry Sutton*<sup>21</sup> the taxpayer was unsuccessful. Taxpayer owned a small tract of land in Westminster, Calif. in an area where commercial and industrial development was in progress. The City adopted a master plan which permitted land to be used for various purposes. Under the City's ordinance, a permit could not be obtained for the construction of any buildings unless the abutting streets conformed to specified requirements as to width. The street adjoining the taxpayer's property did not meet these requirements, so the taxpayer granted an easement to the City to widen the street.

The taxpayer testified that he was not compelled to make the transfer, and that he had no immediate plans for the commercial development of the land. He claimed a §170(a) deduction in 1966 for the value of the land subject to the easement. The Tax Court disallowed the deduction finding that the taxpayer showed no public spirited, altruistic, benevolent, or charitable purpose. The court found that the easement transfer was made in the expectation of increased utility and value which may be realized through the commercial development of the remainder of the land, a direct economic benefit of the easement. Even though he had no plans to develop the property at the time of the transaction, the easement had the effect of making his land usable for commercial purposes at any time in the future.

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<sup>20</sup> *Robert Stubbs v. U.S.*, 428 F.2d 885 (9<sup>th</sup> Cir. 1970), *affg.* Dist Ct.

<sup>21</sup> *Larry Sutton*, 57 TC 239 (1971). Note that the IRS cited this case in Rev. Rul. 73-339 regarding gifts of easements.

In *Transamerica Corp.*,<sup>22</sup> the taxpayer transferred property to the City of Oakland, California for no consideration. The property was used by the owner as a street in connection with its manufacturing activities, and also was used by its employees and members of the public. The taxpayer had no intention of improving the property for its own purposes, but had been “harassed, badgered and threatened” by the City to improve it for the benefit of the public.

In this context of compulsion, the taxpayer entered into a contract with the City pursuant to which the land was conveyed and money paid toward the cost of improvements. The district court held that this was a capital improvement. The Ninth Circuit agreed with the result but noted that the district court relied on *DeJong* in which the Ninth Circuit previously held that the taxpayer had the burden of proving that the contribution was made from a detached and disinterested generosity or from affection, respect, admiration, charity or like impulses. As mentioned above, the Ninth Circuit did not believe it appropriate to demand of a corporate entity such impulses as affection, respect or admiration. Further, it said an absolute requirement of detached and disinterested generosity or lack of any business purpose would tend to render *ultra vires* substantially all charitable contributions and thus to frustrate the congressional intent that corporations should enjoy such deductions.

Transamerica claimed a deduction of \$37,000 in 1958. It conceded in its brief that the effect of the contribution was to relieve the Company of the continued costs of keeping the street in repair, to reduce City and County real estate taxes and to eliminate its risk of liability to people using the street. The Ninth Circuit agreed with the lower court and disallowed the contribution as the taxpayer received a *quid pro quo* and said it must be capitalized.

In another case, *McConnell*,<sup>23</sup> the court disallowed a contribution of roads and utilities on the grounds that the taxpayer benefited by being relieved of his maintenance obligation. In this case, McConnell and family members developed Pennsylvania farmland into a residential subdivision and donated the streets and utilities to the local municipality upon completion, claiming a \$27,000 deduction in 1982 for the land and cost to build the streets.

The taxpayer was also denied a deduction in *Ottawa Silica Company*.<sup>24</sup> The taxpayer’s real estate subsidiary transferred 49 acres for a high school and 20 acres of right-of-way for two access roads to the school. It claimed a charitable deduction of \$320,000.

The Court of Claims disallowed the deduction as the judge said it was quite apparent that the taxpayer made the transfer fully expecting that as a consequence of the construction of public access roads through its property it would receive substantial benefits. The taxpayer planned residential development on the site and indicated in internal communication that a high school would serve to advance the development of the

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<sup>22</sup> *U.S. v. Transamerica Corp.*, 392 F.2d 522 (9<sup>th</sup> Cir. 1968), *affg.* Dist. Ct.

<sup>23</sup> *William G. McConnell*, T.C. Memo 1988-307.

<sup>24</sup> *Ottawa Silica Company v. U.S.*, 82-1 USTC ¶9308 (Ct. Cl. 1982).

property and significantly increase the value of adjacent property. These benefits did turn out as it subsequently sold the impacted property to developers.

In a somewhat different approach, the taxpayer in *Hope*<sup>25</sup> attempted to claim a charitable deduction for \$1.8 million for the difference in the value of property taken by the Texas Turnpike Authority and the amount he received as compensation. The court disallowed the deduction. It said there was no bargain sale as the Authority was compelled to exercise eminent domain power to acquire the land. Penalties were imposed in this case.

In *Charles Grinslade*,<sup>26</sup> the taxpayer transferred less than an acre of land and a storm drainage easement and a right-of-way to the Mass Transportation Authority of Greater Indianapolis. He attempted to circumvent the *quid pro quo* exchange by separating a single property conveyance into two separate parcels and claimed a contribution deduction for one of the parcels. The court disallowed the separation and found that for both properties he received \$10,000 cash, other land, dismissal of two condemnation suits, and a zoning variance. Not surprising, the court did not allow a §170(a) deduction.

A clear no-no that has been held to be *quid pro quo* is negotiation between a taxpayer and a municipality for zoning purposes. In *Ackerman Buick*<sup>27</sup> the taxpayer and city specifically contemplated construction of a road through the property in question in exchange for a zoning variance to permit the taxpayer to operate a car dealership on the site.

*Karl Pettit*<sup>28</sup> involved a unique fact in obtaining municipality approval. The taxpayer donated 2.75 acres of right-of-way to Princeton, N.J. Township as such dedication was required by the local ordinance. Taxpayer claimed he gave the right-of-way in response to the promulgation of the township's master plan rather than the approval of the subdivision. However, the court did not agree. Thus, it seemed clear that he gave the right-of-way in order to obtain approval for his master plan and accordingly received a *quid pro quo*. However, taxpayer showed the court that the local ordinance was subsequently declared unconstitutional by the New Jersey appellate courts. The Tax Court noted that in its decision in *Jordon Perlmutter*<sup>29</sup> it might have given the impression that the invalidation of an ordinance of this nature subsequent to the date of the conveyance would be a factor in determining the validity of a donation. It concluded here that a subsequent determination that the ordinance was invalid had no effect on the taxpayer's decision at the time of the conveyance and should not be considered in this circumstance.

In *Woodside Mills, Inc.*,<sup>30</sup> the district court disallowed a purported conveyance in 1950 of streets and alleys in the taxpayer's cotton mill village in Greenville, SC as it found that

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<sup>25</sup> *Hope v. U.S.*, 92-1 USTC ¶150,414 (Ct. Cl. 1991).

<sup>26</sup> *Charles Grinslade*, 59 TC 566 (1973).

<sup>27</sup> *Ackerman Buick, Inc.*, TC Memo 1973-224.

<sup>28</sup> *Karl Pettit*, 61 TC 634 (1974).

<sup>29</sup> *Jordon Perlmutter*, 45 TC 311 (1965).

<sup>30</sup> *Woodside Mills, Inc. v. U.S.*, 160 F.Supp. 356 (W.D.C. S.C. 1958).

the taxpayer had already dedicated them to public use. As early as 1918 the streets had been taken over by the public by prescription and the taxpayer no longer considered itself the owner.

A final case in this area in which the taxpayer was unsuccessful and one involving unusual facts, is *Sally Conforte*.<sup>31</sup> Not surprisingly, the Tax Court did not think that the dedication of a road and bridge to the county that linked the public with the taxpayer's house of prostitution in Nevada was for charitable purposes.<sup>32</sup> Apparently the courts did not believe that improved access to a house of ill repute provided public benefit.

While the preceding cases may cause a developer some concern, some taxpayers have had success in obtaining a deduction for land given for roads. In *Mary Toole*,<sup>33</sup> the taxpayer donated two tracts of land to the City of Tampa, Florida in 1957 for the use of street and sewer rights-of-way. If the taxpayer had not donated the rights-of-way, the City could have exercised its power of condemnation, but would have been required to pay reasonable compensation for the property taken.

The district court noted that there was no evidence of a marked increase in property values during 1957 in the vicinity of the taxpayer's property. Without citing any authority, the court allowed a charitable contribution deduction noting that the taxpayer might have "coincidentally benefited" from the donation.

Also, the taxpayer prevailed in *Citizens & Southern National Bank of South Carolina*.<sup>34</sup> The taxpayer, a South Carolina bank, moved into Greenville, South Carolina and decided to build a permanent building on South Main Street in a blighted area. The bank donated land on its property to the South Carolina Highway Department for the construction of a new highway through the city of Greenville that would be part of the U.S. highway system. The bank did construct its new bank building facing on the new highway.

The district court noted that the testimony was clear and convincing that the bank, being a new business in the city, was desirous of doing everything possible to create favorable relations with the community. As a result of the donation, the formerly blighted area was revitalized with increased investment, development of several office buildings, and a park spanning the banks of a river that traveled through the city.

The IRS argued that the bank gave the land before the highway department agreed to build the highway. The court said that such an argument "does a disservice not only to the U.S. Highway itself but also to the South Carolina Highway Department." It said that as to the taxpayer, or any contributor, it is apparent that a deed to property for road

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<sup>31</sup> *Sally Conforte*, 74 T.C. 1160 (1980).

<sup>32</sup> The humor in this case is somewhat similar in its taboo and illicit subject matter to *Nunzio Lombardo*, TC Memo 1985-552. In this case, the taxpayer was placed on supervised probation for five years for a sale and delivery of marijuana. He claimed charitable contributions to a county school fund. The court found that his contributions were part of a plea bargain agreement and thus were given to escape incarceration. Thus the quid pro quo was freedom from prison. See also *Stephen Ruddel*, TC Memo 1996-125.

<sup>33</sup> *Mary Toole v. Tomlinson*, 63-1 USTC ¶9267 (D.C. Fla. 1963).

<sup>34</sup> *The Citizens & Southern National Bank of South Carolina v. U.S.*, 243 F.Supp. 900 (D.C.S.C 1965).

purposes would not be made except upon the belief and expectation that the conveyance would be used. It noted that in South Carolina the right-of-way must be contributed before a project would be undertaken. It said this is true of many other charitable contributions. For example, a new Y.M.C.A or church or university can be built only if land is donated; the United Fund can only take action if the contributions are made. Thus, the fact that the donee requires a donation before it will take action does not invalidate the donation as contended by the IRS.

The district court also discussed Rev. Rul. 64-205 where a scenic easement was given to the federal government where the taxpayer gratuitously restricted his land which presented a scenic view to a nearby federal highway. The court noted that it was significant that the question of benefit also accruing to the donor was not discussed in this ruling although it appeared obvious that such restrictions would enhance the value of the donor's property in the same way that residential restrictions enhance a residential subdivision.

Another interesting case involved future road development and the donation of a baseball stadium. In *Rainier Companies*,<sup>35</sup> the taxpayer owned and operated a minor league baseball team and stadium in Seattle for several decades. Around 1960 the company, a local brewer, decided to exit the baseball business. Rainier sold its team and began leasing its stadium to other clubs as it began to look for ways to divest itself of the land and stadium. The company explored potential uses, such as development of a shopping center or sale to another party. At that time the city of Seattle was planning a new highway that would likely run through or nearby the site of the stadium. Though the highway construction and land acquisition was at least five to ten years in the future, the city negotiated to buy the land from Rainier for this purpose, but did not need the stadium.

The Ninth Circuit agreed with the taxpayer that the transaction included a sale of land and donation of the stadium on the basis that the inclusion of the stadium did not enhance the value of the land and that the taxpayer agreed to sell to the city to allow baseball to continue in Seattle. The taxpayer was permitted a donation of \$100,000 for the bargain sale of the land and stadium to the city. While the authors expect few readers to have baseball stadiums slated for sale or contribution to municipalities, this leaves open the sale for less than fair market value to a city for use in future roads or mass transit when there remains a viable asset that benefits the public.

In another case, *George Collman*<sup>36</sup> the Ninth Circuit Court found no *quid pro quo* as having been received. Taxpayer dedicated 1.8 acres for public roadway purposes and the Court allowed a charitable contribution. The finding was based on the conclusion that a gap of 17 months from the date of the conveyance and the taxpayer's first move towards land development was too great to support the inference that the transfer was made in expectation of zoning changes. The Court also noted that Collman was a life-long citrus

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<sup>35</sup> *Rainier Companies, Inc.*, TC Memo 1977-351; on remand from the Ninth Circuit in an unpublished opinion.

<sup>36</sup> *Collman v Comm'r*, 511 F.2d 1263 (9<sup>th</sup> Cir. 1975).

farmer who had no knowledge of city ordinances that required street improvements for commercial zoning. Unsophisticated donors, as in this case, seem able to argue against a zoning *quid pro quo*. Unfortunately, those reading this article for planning purposes are unlikely candidates to claim ignorance.

Also, a deduction was allowed in connection with the dedication of a right-of-way to the state of Florida in *John Connell*.<sup>37</sup> The court found no evidence that the gift was made in expectation of receiving economic benefits on the remainder of the land. Although the value of the other property increased, it resulted from the setting of the alignment of the right-of-way and the change in zoning rather than from the dedication of the right-of-way itself.

In addition to the cases discussed above, the IRS has issued favorable published and private rulings.

In Rev. Rul. 57-488 the taxpayer contributed land to the county so that a road fronting his property could be widened. The county planning commission required the conveyance in exchange for approval of the taxpayer's development plan. According to the ruling, the cost of the contributed land was to be included in the basis of the taxpayer's remaining property. Though not dealing directly with contributions of property by real estate developers, the IRS in Rev. Rul. 69-90 allowed deductions of money by merchants and property owners to a city for the city to provide unrestricted public parking facilities in the general area. The IRS found that the parking spaces were for the general public. Similarly, in Rev. Rul. 67-446 the IRS allowed deductions from merchants and property owners for the city to purchase substitute facilities for a railroad whose property was in the center of the city. The IRS said that although the donors may receive some benefit, it was incidental in comparison to the benefits accrued to the public at large. No cases were cited in these two rulings. That the IRS has supported this argument in the past should provide some encouragement to those considering a donation that would provide both public and self-serving benefit.

In PLR 9447028 the IRS ruled in favor of the taxpayer where the taxpayer donated land for a state-approved 120 mile beltway around a city. The construction was not economically feasible without the contributions of land, property, and money from various companies and individuals. The taxpayer owned land in the highway's path and contributed some of this land to the state for the beltway, claiming a §170(a) deduction. The taxpayer planned to develop a community adjacent to the highway, but was able to establish to the satisfaction of the IRS that it would not benefit from the highway except for the fact that local highways will be less congested. No favorable zoning was received.

Also, the IRS ruled in favor of the taxpayer in PLR 8421018. A charitable contribution was allowed for transfer of overpass, frontage road, and cost incurred for construction of proposed interchange together with fee and/or easement interest in land. The IRS said that although the interchange might realistically make it easier for tourist, employees and

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<sup>37</sup> *John Connell*, TC Memo 1986-333.

other interested parties to reach the taxpayer's commercial center, the benefit was incidental. Traffic pattern would be markedly improved, providing better, safer flow of traffic. The IRS cited Rev. Rul. 69-90 and *Citizens and Southern National Bank of South Carolina*, both discussed above.

### **Contributions of Property for Libraries, Schools, Churches and Synagogues**

Another common contribution by real estate developers is land for libraries, schools, churches and synagogues. And as with the contributions for roads and highways by developers, some win and some do not.

In *William DuVal*,<sup>38</sup> the taxpayer was a developer of land for sale to homebuilders. In 1985 he acquired a 429-acre tract in Virginia. He only wanted 348 acres as the remaining acreage was more suited for commercial development as it fronted a highway. However, the owner required the taxpayer to acquire all of the 429 acres. He applied for rezoning on the 348 acres as the land was zoned for agricultural use. However the county was reluctant to approve rezoning for less than the entire tract. So the taxpayer applied for residential zoning for the 348 acres and commercial zoning for the balance.

At the time the county was experiencing a period of rapid growth that was outstripping its resources for capital development. Consequently, the county operated under a policy of soliciting dedications of land from developers wherever a proposed development was in the location of a planned capital improvement of the county. It was not clear whether the county could legally required developers to dedicate land as a condition for zoning approval. However, the county assumed it had such authority.

The county's improvement plan included a proposal for a library in the general area of taxpayer's tract. The taxpayer decided to donate land for the library because he was an advocate of education. The Tax Court noted that no one representing the county told the taxpayer that the zoning would not be approved unless they gave the library tract. This finding and assertion of fact is one that can and should be argued in favor of the taxpayer when a deduction is challenged on the grounds that rezoning represents a *quid pro quo*. Based on these facts, and a finding that the tract was not being held by the taxpayer for sale, the Tax Court allowed a deduction under §170(a) at the value of the tract donated.

Also, the taxpayer was successful in *Jerome Scheffres*.<sup>39</sup> The taxpayer was a partner in a partnership that had purchased 390 acres in July 1961. The partnership planned to construct 5,000 garden-type apartments on the tract. The purchase of the tract was contingent on a zoning change. A zoning change would make it necessary for an elementary school to be erected on a portion of the land. Nine months later, in May 1962, the partnership conveyed a 10-acre parcel of land to the Prince George's Board of Education, Maryland in 1962 for a school. The value of the land conveyed was \$51,000. As of the date of the contribution 3,000 units had been constructed.

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<sup>38</sup> *William DuVal*, TC Memo 1994-603.

<sup>39</sup> *Jerome Scheffres*, TC Memo 1969-41.

The Tax Court noted that the Board of Education could obtain the needed land in one of two ways – by a gratuitous transfer or by condemnation. The court also noted that no statute or ordinance compels a developer or applicant for a zoning change to donate to any public body any parcel of land for education or recreational purposes.

The court noted that the reasons of the partnership to convey the 10-acre tract was “obvious” – they were to facilitate zoning and to make the proposed apartments more desirable to prospective tenants and therefore more valuable. However, the Tax Court said that reasons which caused the partnership to agree donate the land instead of having it condemned and be paid its value are “obscure.” One of the partners testified it was done “Just out of a feeling of public spiritedness.” Then the court said it may speculate that additional reasons might have been to cast the transaction in a form tending to support a charitable deduction in an amount greatly in excess of the cost of the property to be conveyed and/or to gain goodwill of county officials exemplified by the obvious good will of the officer of the Board of Education who testified for the taxpayer. In any event, the court said the donation was not caused by any compulsion. The court said it could not see any significant benefit to the partnership as a result of donating the property rather than selling it at a price.

The Tax Court said a deduction would be allowed “unless the conveyance was compelled by law or enforceable contract or unless the grantors received such a quid pro quo in the form of special economic benefit as to make a conclusion that there was a gift or contribution within the capacity of only an overtaxed imagination.” The court then said “the conveyance was not compelled by any statute ordinance even by one of colorable constitutionality.” The court allowed a deduction for the fair market value claimed by the partnership which was equal to the price paid nine months earlier.

But in *Robert Signom II*<sup>40</sup> the taxpayer was not successful. This case involved a series of transactions involving the taxpayer transferring a leasehold interest in and a purchase option for a parcel of real estate to the University of Dayton and the University acquiring property and transferring that property to the taxpayer. All of this was set forth in an exchange agreement. The taxpayer deeded the property to the University using a “Deed of Gift.” The taxpayer claimed a charitable contribution of \$112,000. The Tax Court denied the deduction and also upheld the accuracy-related penalty under §6662 based on the *quid pro quo* received. The Court noted that the taxpayer’s reliance on labels, such as the label “gift,” was meaningless as it is the substance of what transpired that was determinative. The Court determined that the *quid pro quo* received by the University was less than the value received by the taxpayer.

The taxpayer prevailed in *Ben Seldin*.<sup>41</sup> The taxpayer was a partner in a developer partnership that gave two parcels of land to school districts in Omaha, Nebraska. It was not compelled to make the gift. The partnership had acquired a large tract although it only wanted a portion of the tract to develop a shopping center. It also intended to sell a

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<sup>40</sup> *Robert Signom II*, TC Memo 2000-175.

<sup>41</sup> *Ben Seldin*, TC Memo 1969-233.

certain portion to the school district but the school district persuaded the partnership to donate the property which it did.

The Tax Court noted, “It can be said that the presence of the schools at the center of their subdivisions attracted some home buyers to the area and as a result enhanced the value of surrounding commercial properties which the partnership held. However, to hold for such reason alone the conveyances of the partnership were not ‘contributions’ in these particular circumstances would stretch credulity. Compare *Jordon Perlmutter*, supra, and *Sarah Marquis*, supra . . . Furthermore, we would not disallow the deduction on the grounds that the partnership secured for its partners a greater after-tax benefit by casting the transaction as a donation rather than a sale.”

Also, the taxpayer lost in *Foster*.<sup>42</sup> The taxpayer was a partner in a partnership that conveyed as bargain sales three parcels of land - a school site and two church sites. The partnership planned to develop 2,600 acres about 12 miles north of San Francisco and believed the tract could be transformed into a self-contained city named Foster City (after the partner). The partnership claimed a deduction for the value in excess of the sales price. The court noted that the partnership’s sales prospectus and promotional publications touted a complete community including schools and churches.

The Ninth Circuit determined that the transfers were designed to enhance the value of the remaining land and promote its sale. The taxpayer argued that the school site only benefited one particular neighborhood of the development but the court did not agree.

Also, as discussed above, in *Ottawa Silica Company* the taxpayer was not successful in obtaining a deduction for contributing 49 acres of land for a high school along with 20 acres for right-of-ways for access to the school.

*Jordon Perlmutter*<sup>43</sup> was a partner in a partnership that subdivided land, and built and sold homes in two subdivisions in Adams County, Colorado. The regulations of the Adams County Planning and Zoning Board required developers to allocate and convey land to the county for public purposes. The partnership transferred three parcels of land to school districts and one parcel to a recreation district in ostensible compliance with these regulations.

The Tax Court noted that the testimony was not conclusive as to whether the county would have withheld approval of the plans if land had not been transferred. The testimony indicated that no plat had ever been approved without the required conveyance or a payment. There was no testimony that would indicate that the partnership at any time protested, objected to, or otherwise failed to comply with the regulations involved. Perlmutter’s §170(a) deduction was denied.

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<sup>42</sup> *Foster v. Comm’r*, 756 F.2d 1430 (9<sup>th</sup> Cir. 1985).

<sup>43</sup> *Jordon Perlmutter*, 45 TC 311 (1965). It should be noted that the taxpayer was deficient on other issues and tried to reclassify the land contributions from cost of goods sold to §170 deductions to reduce his deficiency.

## **Contributions of Property for Parks and Wildlife Sanctuaries**

There appears to be fewer cases involving contributions for parks and wildlife sanctuaries as these contributions are often made via conservation easements and outside the scope of this article. Of two cases found, one taxpayer won and one lost. In *Allen*,<sup>44</sup> taxpayer purchased a 22-acre tract zoned for one-acre residential lots. He succeeded in having the tract zoned for half-acre tracts on condition that land was preserved for open space. He deeded to the city nine acres of redwoods. Both the district court and the Ninth Circuit allowed a deduction under §170(a). The Circuit Court did remand the case to the district court to determine the basis of the property.

In addressing the charitable deduction issue, the Ninth Circuit said that it is the “dominant purpose” of a transaction that is the determining factor, and that the expectation of a benefit need not be the sole purpose of a transaction. The court agreed that there was an element of *quid pro quo*, but the dominant motive was to preserve the redwoods, and the best way was to give the land to the city. There was a strong dissent, with a dissenting judge opining that the “cunning” taxpayer received four benefits – preservation of trees he cherished, removal of the land from the tax rolls, removal of opposition from density-conscious citizens, and obtaining rezoning.

On the other hand in *William Saba*,<sup>45</sup> the taxpayers donated in 1974 a portion of Beer Can Island in Florida to a town if it would designate it as a wildlife sanctuary and claimed a charitable deduction.<sup>46</sup> The Tax Court said that in determining whether any economic benefit was received in situations of this nature, one must look at (1) the subjective attitude of the grantor at the time of the transfer, and (2) those benefits which the donor expects to directly or indirectly inure to him as a result of the donation.

The taxpayer attempted to show that in 1971, at a time prior to the transfer, that he had donative intent. The Tax Court narrowed the timing for intent, ruling that it is the “intent at the time of the transfer which is important.” It said a grantor’s intent prior to the transaction is helpful only in that it might assist the court in determining the transferor’s state of mind at the crucial time.

Saba attempted to rely on *Singer Company*<sup>47</sup> where the Court of Claims said,

‘It is our opinion that if the benefits received, or expected to be received, are substantial, and meaning by that, benefits greater than those that inure to the general public from transfers for charitable purposes (which benefits are merely *incidental* to the transfer), then in such case we feel the transferor has received, or expects to receive, a *quid pro quo* sufficient to remove the transfer from the realm of deductibility under section 170.’

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<sup>44</sup> *Allen v. U.S.*, 541 F.2d 786 (9<sup>th</sup> Cir. 1976).

<sup>45</sup> *William Saba*, TC Memo 1980-199

<sup>46</sup> The authors assume that the protected wildlife was birds, reptiles, and animals; not discarded beer cans for which the island was named.

<sup>47</sup> *Singer Company v. U.S.*, 449 F.2d 413 (Ct. Cl. 1971).

The Tax Court did not agree with Saba's argument and said it stopped short of holding that if the benefits received are less than the value of contributed property a §170(a) donation would be allowed in *Louisville and Nashville Railroad Company*.<sup>48</sup> Thus it did not compare the benefits that inured to the taxpayer with those that inured to the general public. Thus, no deduction was allowed.

### **Contributions of Property for Water, Sewage, and Drainage**

*Morton*,<sup>49</sup> the taxpayer transferred land to the City of Jacksonville, NC for use in conjunction with the city's water system. The IRS challenged the deduction partially on the grounds that the deed contained three conditions on the city's use of the land: (1) reversion of the sites if the city abandoned the wells, (2) limitation on the style of any buildings or fences constructed, and (3) the furnishing of water from the wells upon request to supply the needs of the taxpayers and their heirs at the same rate paid by others.

The Tax Court noted that there was no legal or economic compulsion of the taxpayer to make the transfer and that the three conditions were "sufficiently remote or incidental" to preclude a §170(a) contribution in this case. The opinion noted that Morton made the transfer with the intent of benefitting the general public and received no benefit in return.

In *Robert Osborne*,<sup>50</sup> the taxpayer successfully defended his ability to claim a §170(a) deduction, but lost most of the benefit of the deduction on challenge of his valuation methodology. Osborne owned property in Colorado Springs, Colorado. Under local law, the city was obligated to provide for the safe discharge of water within a natural drainage system running through the taxpayer's property. Taxpayer installed at a cost of \$183,000 a concrete twin box culvert and related drainage facilities and transferred them to the city. He also granted an easement to the city over the drainage system to facilitate its repair and maintenance.

Taxpayer reported a gift to the city for 1981 of \$183,000 for the cost of the construction and \$93,000 for the value of the easement. The Tax Court noted that Osborne's situation was not the usual one as unlike the taxpayers in many other cases, the taxpayer installed the drainage facilities on his own property and transferred them to the city without legal or contractual compulsion. Also, the taxpayer neither expected nor received from the city any significant action, promise, or permission in exchange for his transfer. However, the court noted that these items did enhance the value of the taxpayer's property.

The court noted that the improvements to his own land were not "direct economic benefits" bestowed on him directly or indirectly by the city, nor were they "incidental" in nature as Osborne claimed. Rather, the court found they were partly nondeductible

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<sup>48</sup> *Louisville and Nashville Railroad Company*, 66 TC 962 (1976). Taxpayer granted an easement to the City of Birmingham to provide street access to the railroad's new passenger terminal in what was deemed a negotiated *quid pro quo* arrangement.

<sup>49</sup> *Kavi Morton*, TC Memo 1979-484.

<sup>50</sup> *Robert Osborne*, 87 TC 575 (1986).

capital expenditures to improve his property. However, the Tax Court said that to the extent that the taxpayer gratuitously benefited the city by providing permanent rather than temporary drainage facilities, and by conveying the easement, he was entitled to a charitable contribution deduction. In determining the amount of the charitable contribution, the court considered the reports and testimony of three experts. Of the three, the court relied upon one of them and allowed a charitable contribution deduction of \$45,000.

Finally, in *Harold Wolfe*,<sup>51</sup> the taxpayer and all the other owners of 62 lots in a subdivision of a village adjacent to Houston, Texas, entered into a contract with a contractor to install water and sewer lines. The residents had been using wells and septic tanks. Once the project was completed, the lines were transferred to the village. The taxpayer deducted his share of the cost of \$1,560 as a §170(a) deduction. He claimed that he had no problems with his well or septic tank and therefore his share of the cost was a contribution. The court denied the deduction as it found the *quid pro quo* was the undertaking of the village to maintain and operate the system. The court even noted that even if the taxpayers had not used the facilities, no deduction would be allowed as it would be available if he decided to use the sewer lines in the future and it would increase the value of his property.

### **Contributions That Do Not Qualify**

What is to be done with real property donations that cannot be deductible under §170(a)? If a donation does not qualify as a contribution, it stands to reason that the deduction would be classified as a business expenditure under §162(a). In *Lots, Inc.*<sup>52</sup> the taxpayer followed this reasoning in arguing that its contribution to the city in exchange for zoning consideration was a current deduction. Taxpayer argued that the contribution was to protect and promote its business. This line of reasoning was disallowed and the current deduction denied as the court ruled that the zoning consideration benefitted the taxpayers' real estate development. It required that these costs be capitalized to the development rather than treated as a current deduction. Though in this case the taxpayer donated improvements to a city-owned park, the opinion drew parallels to the *Perlmutter* case where real property was conveyed.

The cost of land related to a contribution that does not qualify as a deduction under §170(a) should be capitalized to the taxpayer's remaining property;<sup>53</sup> the benefit will not be realized until the remaining property is sold. Where would one allocate the additional basis? Would it be assigned to the remaining land, depreciable improvements, or both?

The Treasury Regulations were amended in 1996 to clarify what deductions may be taken when the taxpayer receives value in exchange for a charitable contribution. Under Treas. Reg. §1.170A-1(h)(1) no deduction is available when the taxpayer receives value unless the contributed value is intended to exceed the value of goods or services received and

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<sup>51</sup> *Harold Wolfe*, 54 TC 1707 (1970).

<sup>52</sup> *Lots, Inc.*, 49 TC 541

<sup>53</sup> See Rev. Rul. 57-488.

the taxpayer transfers property that is in fact greater than the value received. The Regulations were most likely designed to account for scenarios where the value received in exchange for a contribution is a meal, concert ticket, or other item where it is a simple exercise to value the property received. But these regulations seem to equally apply to gifts of real estate. Of course, the problem is in valuing the *quid pro quo* for real estate transactions. For example, when the *quid pro quo* is a zoning change, the value is not so readily available. Could the taxpayer obtain alternate valuations of land both before and after rezoning to determine what value is received and take a deduction for the difference? This is exactly what is done with conservation easements<sup>54</sup> and one could argue this approach with respect to outright donations of real property.

### **Conclusion**

As can be seen from the results of the various cases and rulings involving contributions for roads, libraries, schools, churches, parks, and water systems, no charitable deduction will be allowed for the contribution of real estate if there is a *quid pro quo*. But determining just how much one can receive before the deduction is disallowed is a contentious area for taxpayers and the Internal Revenue Service. In most any gift some benefit is received. One of the few specific areas of insight is that it is an extremely difficult proposition to take a contribution deduction when the return is favorable zoning. On the other hand, often a deduction is allowed for contributions of land for roads and highways in areas where the public is relieved from traffic congestion. The results to taxpayers in cases involving schools, parks, and water systems are varied.

If a contribution of real estate is made and a significant benefit is received, with upfront planning it may be possible to take a deduction based on the difference between the value of the retained property before the contribution and the value of the property after the contribution, similar to the valuation of conservation easements.

With the knowledge that this is a subjective area with no bright-line test, the most important conclusion that can be drawn is that careful thought and consideration should be given to any contribution of real estate. The taxpayer and tax preparer must be able to support the deduction with an analysis of intent, benefit, and valuation of a §170(a) donation of real estate. Surprisingly, when supporting a deduction for a real estate contribution, the analysis will inevitably turn to two non-real estate cases – a Supreme Court case involving the receipt of a Cadillac and a Court of Claims case involving the contribution of sewing machines.

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<sup>54</sup> See Treas. Reg. §1.170A-14(h)(3)(ii).