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INTERNAL REVENUE SERVICE
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OFFICE OF
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INTERNAL REVENUE SERVICE NATIONAL OFFICE FIELD SERVICE ADVICE

MEMORANDUM FOR: Associate Area Counsel, Small Business/Self Employed
ATTN: Mary Hamilton CC:SB:1:BOS

FROM: Associate Chief Counsel (Income Tax & Accounting)
Branch 2
CC:IT&A:B02

SUBJECT: Deductibility under I.R.C. § 170 of a contribution of a portion of taxpayers' interests in a cooperative apartment to a public charity

This Chief Counsel Advice responds to your memorandum dated May 11, 2001. In accordance with I.R.C. § 6110(k)(3), this Chief Counsel Advice should not be cited as precedent.

DISCLOSURE STATEMENT

This writing may contain privileged information. Any unauthorized disclosure of this writing may have an adverse effect on privileges such as the attorney client privilege. If disclosure becomes necessary, please contact this office for our views.

LEGEND

= taxpayers

= "the cooperative housing corporation"

= Apartment Z

= donee

= donee's address

	=	the Service's appraiser
	=	appraisal corporation
	=	appraiser
	=	X shares
	=	Y shares
	=	Z shares
$	=	Amount A
$	=	Amount B
$	=	Amount C
$	=	Amount D
$	=	Amount E
$	=	Amount F
$	=	Amount G
$	=	Amount H
$	=	Amount I
$	=	Amount J
$	=	Amount K
$	=	Amount L
$	=	Amount M
$	=	Amount N
	=	Date 1
	=	Date 2

= Date 3

= Date 4

= Date 5

= Date 6

= Date 7

= Month 1

= Month 2

= Month 3

= Month 4

= time T

= Year 1

ISSUE

Whether taxpayers may deduct pursuant, to I.R.C. § 170, a contribution of a portion of their cooperative housing shares and proprietary lease to a public charity and, if a deduction is allowed, whether the taxpayers properly valued the contribution.

CONCLUSION

Further factual development is needed before it can be determined whether taxpayers' contribution of a portion of their cooperative housing shares and proprietary lease satisfies the requirements of I.R.C. § 170 and whether the taxpayers properly valued that contribution.

FACTS

Taxpayers, a married couple, purchased a cooperative apartment from "the cooperative housing corporation" for Amount A on Date 1. Taxpayers have used the apartment as their personal residence. At the time of purchase, taxpayers' cooperative apartment was assigned X shares of the "cooperative housing corporation", and designated as Apartment Z. Taxpayers maintain that on Date 2, they contributed Y shares assigned to the cooperative apartment (75% of their total shares), together with a proportionate share of the rights and obligations under a Proprietary Lease related

to Apartment Z, to the donee, at Donee's address. The donee is an entity eligible to receive charitable contributions. There was no deed evidencing the transfer of shares to the donee, as such documents are not used in transferring cooperative shares.

By letter to taxpayers dated Date 3, the donee acknowledged receipt of the Y shares of stock of "the cooperative housing corporation", along with a proportionate share of rights and obligations under a Proprietary Lease related to Apartment Z, and stated that the taxpayers received neither goods nor services in exchange for their contribution. The letter also referenced a gift agreement between taxpayers and the donee, dated Date 2. It appears that taxpayers attached a copy of this letter to their Year 1 income tax return.

On Date 4, the gifted shares, as well as taxpayers' remaining Z shares, were sold to an unidentified buyer for Amount B. Taxpayer retained Amount C in proceeds from the sale (25% of Amount B sale price). You have noted that there is no information thus far on how the sale was conducted and that no deed exists evidencing the transfer as such documents are not used in transferring cooperative shares. The Service's appraiser assigned to this case, has noted that she is not aware of any relationship between either the taxpayers and the donee or the taxpayers and the purchasers.

Taxpayers represented that their basis in the X cooperative shares was Amount D at the time of the gift. Taxpayers retained Appraisal corporation to appraise their cooperative apartment. By an appraisal letter dated Date 5, Appraiser, President of the corporation, noted that the sale price of Amount B represented the fair market value of the cooperative apartment based his knowledge of the apartment, the surrounding neighborhood, and on sales of comparable properties that occurred prior to or in Month 4 of Year 1.

On Schedule A of their Year 1 joint return, taxpayers reported a charitable contribution of Amount E in property. On their Charitable Contributions Worksheet, taxpayers listed this amount under the category of 30% limit appreciated property. Taxpayers claimed a charitable contribution deduction of Amount F and calculated their contribution carryover to be Amount G. [1] Taxpayers also claimed other charitable contributions totaling Amount H on their worksheet.

Taxpayers attached a Form 8283, Noncash Charitable Contributions, to their Year 1

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[1] Taxpayers also completed form 6251 AMT Charitable Contributions Worksheet listing the same amounts for charitable contributions for Year 1. We note that the difference between the fair market value of the donated property and the adjusted basis of property was no longer treated as a tax preference item for alternative minimum tax purposes in Year 1. The tax preference for contributions of appreciated property (provided in section 57(a)(6)) was repealed effective for contributions made after June 30, 1992. Thus, taxpayer is allowed to claim a deduction for both regular tax and AMT purposes in the amount of the property's fair market value, subject to the limitations contained in section 170, discussed below.

return. Taxpayers indicated on this form their real property contribution, which they described as Y shares no par value of "the cooperative housing corporation", known as Apartment Z, together with a proportionate share of their rights and obligations under their proprietary lease. Taxpayers attached a description of the property, which noted the date of their gift as Date 2, the Amount B appraisal value based on the Date 4 sale price, the contribution amount of Amount E (75% of the value of the cooperative shares), and the Amount A in basis in the gifted portion of the property (75% of total basis of Amount D). The form also contained an acknowledgment from the donee that it is a qualified organization under section 170(c), and that it received the donated property on Date 2. Appraiser, President of Appraisal corporation, the appraiser, signed a declaration on the form stating that the company is not the donor, donee or any other party to the transaction or related to any of these parties, that the company engages in appraisals on a regular basis, and is qualified to make appraisals of the type of property being valued. A letter from Appraiser, containing an appraisal of the taxpayers' cooperative shares, was also attached to taxpayers' Year 1 return. The letter, dated Date 5, described the apartment's layout, rated the building's condition as excellent, listed and described three recent sales of similar properties, and set a fair market value of the cooperative shares at the time of sale (late Time T of Year 1) at Amount B. Taxpayers also attached a resume prepared by Appraiser that set forth his professional qualifications, past appraisal experience for residential properties in the vicinity of taxpayer's property, education, and professional association memberships.

On Form 2119, Sale of Your Home, also filed with their Year 1 return, taxpayers reported the sale price of their 25% portion of the shares to be Amount C, the difference between the Amount B sale price and Amount E, representing the donee's interest. After subtracting Amount K in expenses relating to the sale, and Amount L, which taxpayers represented on their return as the allocated basis, taxpayers reported a gain of Amount M on the sale of their remaining shares. Taxpayers claimed an exclusion of this gain pursuant to section 121.

On Form 8282, Donee Information Return, the donee reported the contribution of Y shares of "the cooperative housing corporation" by taxpayers on Date 2. [2] The donee reported the amount it received from the Date 4 sale of the donated shares to be Amount N.

LAW AND ANALYSIS

Charitable Contribution Deduction

[2] A donee is required to file Form 8282 if the donee disposes of contributed property within two years after the date of receipt. Treas. Reg. § 1.6050L-1.

Section 170 permits a deduction for any charitable contribution made within the taxable year provided that it is verified with the regulations thereunder. I.R.C. § 170(a)(1). A charitable contribution is defined as a contribution to or for the use of certain organizations, including corporations or foundations organized and operated exclusively for charitable or educational purposes, no part of net earnings of which inures to the benefit of a private shareholder or individual and which is not disqualified from tax exemption under section 501(c)(3) by reason of lobbying activities. I.R.C. § 170(c). See also Rev. Rul. 67-246, 1967-2 C.B. 104 (to be deductible, charitable contribution must be made without receiving adequate consideration and with donative intent). A contribution is deductible if it is made to or for the use of any organizations that are qualified under section 170(c).

Pursuant to Treas. Reg. § 1.170A-1(c)(1), if a contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution, reduced as provided in section 170(e) and Treas. Reg. § 1.170A-4. The amount of a charitable contribution deduction of an interest in appreciated property is affected by the following factors: the type of organization to which the property is contributed, the donor's adjusted gross income, amount of time for which donated property is held, the type of property donated, whether a partial interest is donated, and whether taxpayer retained control over the donated property. Each of these factors will be discussed below.

Identity of the Donee Organization

A charitable contribution deduction is subject to contribution limitations set forth in section 170(b) and Treas. Reg. § 1.170A-8, 1.170A-9 that pertain to the identity of the donee. Based on the identity of donee organization, a taxpayer's contribution deduction may be limited to 50%, 30%, or 20% of a taxpayer's contribution base. Contribution base is defined in section 170(b)(1)(F) as adjusted gross income (computed without regard to any net operating loss carryback to the taxable year under section 172). Accordingly, a taxpayer may be entitled to deduct contributions that do not exceed 50%, 30%, or 20% of a taxpayer's adjusted gross income in a taxable year. If the taxpayers are married and file jointly, the aggregate of their contributions is considered, and the limitations are based on the aggregate contribution base of both spouses. Treas. Reg. § 1.170A-8(a)(1). Any excess contribution amount which a taxpayer could not deduct in the year of contribution may be carried over to the five succeeding taxable years pursuant to section 170(d).

Contributions made to public charities and certain types of private foundations qualify for the 50% limitation applied to a taxpayer's contribution base. I.R.C. § 170(b)(1)(A), Treas. Reg. § 1.170A-8(b), 1.170A-9. Contributions made "for the use of" (as opposed to a contribution "to") 50% limitation organizations, as well as contributions to semi-public and private charities, nonoperating private foundations, veterans organizations, fraternal organizations, or public cemeteries qualify for the 30% limitation applied to

a taxpayer's contribution base. I.R.C. § 170(b)(1)(B); Treas. Reg. § 1.170A-8(b).

The Service publishes Publication 78, entitled Cumulative List of Organizations Described in Code Sec. 170(c), which indicates whether an organization has been issued a ruling from the Service indicating that it is eligible to receive deductible contributions under section 170(c), and the applicable contribution limitation based on the type of organization to which the contribution is made.

In the present case, the donee is classified in the edition of Publication 78 revised to Date 6 as an organization eligible to receive charitable contributions under 170(c) and as a public charity with a 50% deductibility limitation. It appears from the facts provided that since taxpayers transferred Y of their cooperative corporation shares, as well as a proportionate share of the rights and obligations under a Proprietary Lease to the donee, the contribution is not merely "for the use of" the donee, and thus the deductibility limitation would not be reduced to 30% under Treas. Reg. § 1.170A-8(b).

Section 170(e) Limitations on Contributions of Certain Appreciated Property

Section 170(e) excludes from certain charitable contribution deductions of appreciated property (depending on whether the property fits within the definition of "ordinary income property" or "section 170(e) capital gain property," the type of property donated, and the identity of the donee) the amount of gain which would have been realized had the property been sold at its fair market value on the date of the contribution.

Under section 170(e)(1)(A), the amount of charitable contribution shall be reduced by the amount of gain which would not have been long-term capital gain if the property contributed had been sold by taxpayer at its fair market value. Treas. Reg. § 1.170A-4(a)(1) explains that this provision applies to the donation of "ordinary income property." Ordinary income property is defined in the regulations as property in which any portion of the gain would not have been long-term capital gain if the property had been sold by the donor at its fair market value on the contribution date. Treas. Reg. § 1.170A-4(b)(1). Ordinary income property includes property held by the donor primarily for sale to customers in the ordinary course of its trade or business, artworks created by the donor, letters and memoranda prepared for the donor, a capital asset held by the donor for less than one year, and stock described in section 306(a), 341(a), or 1248(a) to the extent that, after applying such section, gain on its disposition would not have been long-term capital gain. Treas. Reg. § 1.170A-4(b)(1).

Section 1221 defines a capital asset as property held by the taxpayer (whether or not connected with his trade or business) but does not include: (1) stock in trade of the taxpayer; (2) property used in his trade or business, of a character subject to

depreciation; [3] (3) a copyright; (4) accounts or notes receivable acquired in the ordinary course of business; (5) a publication of the United States Government. Section 1222(3) provides that "long-term capital gain" is gain from the sale or exchange of a capital asset held for more than one year.

In the present case, section 170(e)(1)(A) does not apply to limit the contribution amount to the taxpayers' basis in the cooperative shares. The cooperative shares do not fit within the regulations' definition of ordinary income property. Taxpayers' cooperative shares are capital assets since they do not fall within any of the specified exclusions for non-capital assets under section 1221. At the time of the contribution, taxpayers held the cooperative apartment shares for a period exceeding one year.

Section 170(e)(1)(B) provides that if the sale of contributed property at its fair market value at the time of the donation would have yielded long-term capital gain, then in certain circumstances the amount of the charitable contribution deduction must be reduced by the amount of the long-term capital gain that would have been realized. The circumstances to which this limitation applies are set forth in section 170(e)(1)(B)(i), (ii), as well as Treas. Reg. § 1.170A-4(b)(2), which labels such contributed property as "section 170(e) capital gain property."

Section 170(e) capital gain property applies to reduce long-term capital gain in two types of charitable contributions. The first type of contribution is one of tangible personal property that is used by a charity for a purpose unrelated to the purpose or function constituting the basis of the charitable organization's exemption under section 501. I.R.C. § 170(e)(1)(B)(i); Treas. Reg. § 1.170A-4(b)(2)(ii), (3). The second type of contribution is to or for the use of a private foundation (as defined in section 509(a)), other than a private foundation described in 170(b)(1)(E), unless the donor contributes qualified appreciated stock within the meaning of section 170(e)(5). I.R.C. § 170(e)(1)(B)(ii); Treas. Reg. § 1.170A-4(b)(2)(i).

Neither of the provisions in section 170(e)(1)(B) applies to reduce taxpayers' charitable contributions by the amount of long-term capital gain that would have been realized had the property been sold. Taxpayers did not contribute tangible personal property, as required by section 170(e)(1)(B)(i). Taxpayers did not contribute their cooperative shares to a private foundation specified in section 170(e)(1)(B)(ii), but to a public charity. You specifically asked whether the qualified appreciated stock exception under section 170(e)(5) was applicable to the present facts. Section 170(e)(5)(A) states that 170(e)(1)(B)(ii) shall not apply to any contribution of qualified appreciated stock. Thus, the exception for qualified appreciated stock applies only to contributions of such stock to private foundations covered by 170(e)(1)(B)(ii). Since the taxpayers

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[3] Certain property used in a trade or business (as defined in section 1231(b)) shall generally be treated as a capital asset for purposes of Treas. Reg. § 1.170A-4(b)(1), (2). See Treas. Reg. § 1.170A-4(b)(4). This does not apply here, as taxpayers did not use their cooperative shares in a trade or business.

did not contribute their cooperative shares to a private foundation specified in 170(e)(1)(B)(ii), there is no need to consider whether the qualified appreciated stock exception applies.

Based on the foregoing, section 170(e) does not operate to limit the taxpayers' contributions to their basis in the cooperative shares. [4]

Contribution Limitations in Section 170(b) for Certain Capital Gain Property

Section 170(b) contains percentage limitations that are to be applied after determining whether or not a charitable contribution deduction must be reduced under section 170(e). Treas. Reg. § 1.170A-4(a). Since section 170(e) does not apply to reduce the taxpayers' contribution deduction, we will now examine the percentage limitations of section 170(b).

Section 170(b)(1)(C)(i) provides that in the case of charitable contributions of certain capital gain property to 50% limitation charitable organizations to which the 100% long-term capital gain reduction of section 170(e)(1)(B) does not apply, the total amount of contributions shall not exceed 30% of the taxpayer's contribution base for the year. Section 170(b)(1)(C)(iv) defines capital gain property as any capital asset the sale of which at its fair market value at the time of the contribution would have resulted in gain that would have been long-term capital gain. See Treas. Reg. 1.170A-8(d)(3), which refers to such property as "30-percent capital gain property."

In the present case, taxpayers' cooperative shares fit the regulations' definition of "30-percent capital gain property." Although the taxpayers contributed their cooperative shares to a 50% limitation organization, section 170(b)(1)(C) applies to reduce their charitable contribution deduction to 30% of their contribution base since a sale of the cooperative shares at their fair market value would have resulted in long-term capital gain on the contribution date, and since 170(e)(1)(B) does not apply to reduce the amount of the contribution for the reasons set forth above. As stated previously, the sale of the cooperative shares would have resulted in long-term capital gain to taxpayers since such property does not fall within any of the specified exclusions for

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[4] Rather than deducting the donated property's fair market value, a donor may elect to have section 170(e)(1)(B) apply to all charitable contributions of 30% capital gain property, as provided in Treas. Reg. § 1.170A-8(d)(2). I.R.C. § 170(b)(1)(C)(iii). This election would limit a donor's charitable contribution to the basis of the donated property. The election entitles taxpayers to use a 50% (rather than a 30%) contribution base pursuant to section 170(b)(1)(C)(iii). I.R.C. § 170(b)(1)(D)(iii). There is no indication that the taxpayers made such an election with respect to the donated cooperative shares.

non-capital assets under section 1221 and taxpayers held the cooperative apartment shares for a period exceeding one year.

Treas. Reg. § 1.170A-8(d)(1) provides that charitable contributions of 30-percent capital gain property made during a taxable year to a charitable organization described in section 170(c) may be deducted to the extent that such contributions in the aggregate do not exceed 30% of taxpayer's contribution base. Contributions of 30-percent capital gain property paid during the taxable year shall be taken into account after all other charitable contributions paid during the taxable year. Id. A taxpayer may carry over any contributions of 30-percent capital gain property in excess of 30% of his or her contribution base. I.R.C. § 170(b)(1)(D)(ii); Treas. Reg. § 1.170A-8(d)(1).

Taxpayers reported the following charitable contributions on their Year 1 Schedule A Charitable Contributions Worksheet: Amount E (representing 75% of the Amount B fair market value of the X cooperative corporation shares) under the category of "Appreciated Property 30% limit" and Amount H under the 50 percent limitation column of the worksheet. The 50% contribution limitation restricts the deduction to Amount I (50% of taxpayers' adjusted gross income of Amount J). Taxpayers' deduction consists of the entire Amount H of the 50% limitation contributions and Amount F (30% of their Year 1 adjusted gross income of Amount J) of the 30-percent capital gain property, namely the cooperative shares. The remaining Amount G (total contribution amount of Amount E minus the 30% limitation amount of Amount F) is not deductible in Year 1, but may be carried over five years pursuant to section 170(d).

Contributions of Partial Interests

The Code generally prohibits deductions where a taxpayer contributes a partial interest in property. I.R.C. § 170(f)(3)(A). This provision was enacted in response to Congress's concern that a donee may not obtain all or the undivided portion of significant rights in property so that the amount of a charitable deduction may not correspond to the value of the benefit received by the donee. See H.R. Rep. No. 91-413, 91st Cong., 1st Sess. 57 (1969). There are three exceptions that allow a taxpayer to deduct charitable contributions not in trust of a partial interest in property: first, a contribution of a remainder interest in personal residence or farm; second, a contribution of an undivided portion of the taxpayer's entire interest in property; and third, a qualified conservation contribution. I.R.C. § 170(f)(3)(B)(i)-(iii). If one of the above exceptions applies, taxpayer is entitled to deduct the fair market value of the partial interest at the time of the contribution. Treas. Reg. § 1.170A-7(c).

In the present case, the exceptions under section 170(f)(3)(B)(i), (iii) are inapplicable, as taxpayers did not contribute a remainder interest or make a qualified conservation contribution. With respect to the second exception, Treas. Reg. § 1.170A-7(b)(1)(i) explains that an undivided portion of donor's entire interest constitutes a portion of every substantial right or interest owned by the donor in property and must run for

entire term of the donor's interest. The donor must give the donee the right, as a tenant in common with the donor, to possession, dominion and control over the property for a portion of each year appropriate to its interest in such property. Id. The exception does not apply for purposes of a contribution in perpetuity of an interest in property not in trust where the donor transfers some specific rights and retains other substantial rights in the donated property. Treas. Reg. § 1.170A-7(b)(1)(i). Thus, if the only property rights retained by the donor are insubstantial, then the exception will apply.

It is not clear whether taxpayers' contribution falls within the exception for the contribution of an undivided portion of the taxpayers' entire interest. This determination depends on the nature of the ownership interest in the cooperative apartment that taxpayers possessed, taxpayers' ability to transfer only a portion of their interests under Massachusetts law and the rules governing "the cooperative housing corporation", as well as whether evidence exists that taxpayers transferred possession, dominion and control over the donated portion of the shares and proprietary lease. Before examining whether the taxpayers parted with dominion and control over each of the property interests transferred to the donee, we will examine the ownership interest in a cooperative housing corporation.

Nature of Interest in Cooperative Housing Corporation

Chapter 157B of the Annotated Laws of Massachusetts contains provisions relating to Cooperative Housing Corporations. This chapter does not specifically define cooperative housing corporation or the interests which a purchaser of cooperative shares acquires. The Supreme Judicial Court of Massachusetts has defined a housing cooperative as a "multidwelling complex in which each owner acquires a "property interest in the entire structure" and an "owners' [or proprietary] lease in the apartment." Bronstein v. Prudential Insurance Company, 459 N.E.2d 772, 775, 778 (Mass. 1984). The shareholder/tenants in a cooperative apartment do not own either the units or the building, but shares in the corporation, along with a right to occupy a specific unit pursuant to the proprietary lease. Born v. Board of Assessors of City of Cambridge, 1997 Mass. Tax LEXIS 12 (Mass. App. Tax Bd. 1997). Thus, each shareholder in a cooperative must lease his or her apartment unit from the landlord corporation, rather than owning the unit, placing the shareholder/tenants of the cooperative corporation in the same position as a traditional tenant renting an apartment. 1010 Memorial Drive Tenants Corporation v. Fire Chief of Cambridge, 677 N.E.2d 219, 221 (Mass. 1997). Chapter 157B, section 4 defines a proprietary lease as an agreement between a cooperative housing corporation and its stockholders for occupancy of a dwelling unit owned by the cooperative housing corporation. MASS. ANN. LAWS Ch. 157B § 4 (2000). Shareholder/tenants have their percentage interest in the building linked to the fair value of their unit in relation to the value of the building as a whole. 1010 Memorial Drive Tenants Corporation, 677 N.E.2d at 220. A stock certificate is normally issued to the purchaser of shares in a cooperative corporation, and this

document contains the number of shares assigned to that apartment. 15A AMERICAN JURISPRUDENCE, CONDOMINIUMS AND COOPERATIVE APARTMENTS § 82, at 850 (2d ed. 2000).

The proprietary lease and the shares must generally be transferred together. 15A AMERICAN JURISPRUDENCE, CONDOMINIUMS AND COOPERATIVE APARTMENTS § 62, at 829, 830. When a tenant/stockholder sells his or her cooperative shares, he or she relinquishes all ownership in the cooperative corporation and the right to possession of that unit under the proprietary lease. Id. § 82 at 850. The right to transfer shares and assign the proprietary lease is almost always restricted by the cooperative board, typically by requiring a stockholder to first offer the shares to the cooperative corporation and/or obtaining the board's approval of the transferee. Id.; ISRAEL PACKEL, THE ORGANIZATION AND OPERATION OF COOPERATIVES § 20 at 97 (1971). Such restrictions are usually set forth in the proprietary lease, certificate of incorporation, or the bylaws. 15A AMERICAN JURISPRUDENCE, CONDOMINIUMS AND COOPERATIVE APARTMENTS § 83, at 851. The Massachusetts statute provides that the articles of organization that a cooperative housing corporation is required to file with the state must address whether transfer of its stock is restricted. MASS. ANN. LAWS Ch. 157B § 6(1) (2000). These restrictions exist to protect cooperative corporations by providing assurance that the transferee has the financial means to pay his or her share of the carrying and maintenance charges, including taxes, interest, amortization of the mortgage, labor, heating, and repair costs. 15A AMERICAN JURISPRUDENCE, CONDOMINIUMS AND COOPERATIVE APARTMENTS § 83, at 851. The cooperative board has the right to withhold approval of a transferee. Id. at 852. The extent to which a cooperative board may exercise this right depends on the bylaws, proprietary lease, and the laws of the state. Id.

It is not clear whether a shareholder/tenant may transfer a portion of his or her shares assigned to the apartment and a portion of his or her rights in a proprietary lease to another person or entity. This issue would probably be governed by the articles of organization, bylaws, and/or the proprietary lease of the particular cooperative housing corporation, and possibly under Massachusetts law.

We suggest that you examine Massachusetts law, as well as the terms of the cooperative's bylaws and proprietary lease, to determine whether taxpayers had the right to transfer a portion of their shares, along with a proportionate share of the proprietary lease. If the cooperative board rules and Massachusetts law allow a shareholder/tenant to transfer only a portion of his or her shares, the portion of the shares transferred would constitute a partial interest in taxpayer's total "property interest in the entire structure." The interest transferred in the proprietary lease must be commensurate with the number of shares transferred and would give the donee the right to occupy the apartment for a share of time equivalent to its share interest.

Even if the interests contributed by taxpayers were partial interests, they may not have contributed an undivided portion of each and every substantial interest or right they owned. In order to have an undivided portion of the taxpayers' interest, donee would not only have to possess the cooperative corporation shares, but also possess a proportionate share of the proprietary lease with right to occupy the apartment. Along with the rights in a proprietary lease, the donee would also have the obligation to pay a share of the maintenance and carrying charges. We advise you to investigate several issues to ensure that the property interests donated were commensurate with their stated value. It is important to find out whether taxpayers sought the cooperative board's approval of the share transfer to the donee, and, if so, whether the board approved of the transfer of the proprietary lease to the donee equivalent to the 75% share interest, or whether this right was simply recited by the donee in its Date 3 letter acknowledging the contribution. If the board approved of the transfer of a portion of the proprietary lease, you should find out whether, pursuant to the bylaws or proprietary lease, the donee was required to occupy the apartment for a proportionate amount of time, and, if so, whether the donee actually occupied the property at any time between the date of the share transfer and the date of the sale. [5] If you find out who paid the maintenance and carrying charges to the cooperative corporation for this period, then this may be some evidence of who occupied the apartment and whether a portion of the proprietary lease was transferred to donees. Such information may appear in the gift agreement. If the taxpayers continued to occupy the apartment between the contribution and sale dates, you should also find out whether they paid the donee any rent for the use of the apartment during the time in which it had a right to occupy.

Whether taxpayers relinquished control over donated property at time of contribution

In addition to examining whether taxpayers transferred an undivided portion of each and every substantial interest owned by them, it is necessary to determine whether taxpayers retained control over the donated property through arranging for a sale to occur shortly after the contribution.

A charitable contribution of appreciated property does not result in the realization of

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[5] It is possible that if the bylaws or proprietary lease did not require donee to occupy the apartment, it is sufficient for purposes of the undivided interest exception that donee have only the right to occupy the apartment. In Winokur v. Commissioner, taxpayer donated to a museum a 10% undivided interest in artworks which entitled the museum to possession of the artworks for a portion of each year. Winokur v. Commissioner, 90 T.C. 733, 735 (1988). The Court held that this was a valid charitable contribution of an undivided interest in the artworks despite the fact that the museum never took possession of the paintings for any period of time immediately following the contributions. Id. at 739. The Court noted that it was the donee's entitlement to possession, and not actual physical possession, which controlled for purposes of applying the undivided interest exception to the partial interest rules. Id

income to the donor, provided the donor gives the property away absolutely and parts with title to it before the property gives rise to income by means of a sale. Grove v. Commissioner, 490 F.2d 241, 246 (2d Cir. 1973); Ankeny v. Commissioner, T.C. Memo. 1987-247. If a taxpayer sells his or her appreciated property and subsequently donates the sale proceeds to a charity, then the donor must recognize any gain as income pursuant to I.R.C. § 61. Where a taxpayer arranges to contribute appreciated property to a charity and the charity sells the property shortly after the contribution, the transaction should be examined to determine whether the sale was part of an overall plan prearranged by the taxpayer to avoid the recognition of gain. Two doctrines under which recognition of gain by the donor may be required are the assignment of income doctrine and the step transaction doctrine, both of which focus on the substance of the transaction over its form. We will examine cases that have applied these doctrines in the context of charitable contributions of appreciated property, as well as their applicability to the present transaction.

Assignment of Income Doctrine

Where there is evidence that a taxpayer's right to proceeds from the disposition of property has matured at the time of a donation, the transfer is an anticipatory assignment of income for which the donor realizes income from the sale proceeds regardless of the purported transfer of the property. Humacid Co. v. Commissioner, 42 T.C. 894, 913 (1964) (gift of appreciated property does not result in income to donor as long as he gives property away absolutely and parts with title thereto before property gives rise to income through a sale). See also Kinsey v. Commissioner, 477 F.2d 1058, 1063 (2nd Cir. 1973); Hudspeth v. United States, 471 F.2d 275, 277 (8th Cir. 1972); Morgan Guaranty Trust Co. v. United States, 585 F.2d 988, 994 (Ct. Cl. 1978). The assignment of income doctrine also applies to cases where the donor retains sufficient power and control over the donated property or the receipt of income so as to make it reasonable to treat the donor as the recipient of income. Greene v. United States, 13 F.3d 577, 582 (2d Cir. 1994), aff'g 806 F. Supp. 1165, 1169 (S.D.N.Y. 1992).

On the other hand, where there is merely an anticipation or expectation, (rather than a certainty) of income, there is no assignment of income. Greene v. United States, 806 F. Supp. at 1169 (fact that taxpayer could reasonably anticipate at the time of the contribution that donee would immediately sell donated property does not necessarily convert donation into anticipatory assignment of income). Accord Ferguson v. Commissioner, 108 T.C. 244, 257 (1997), aff'd, 174 F.3d 997 (9th Cir. 1999); Palmer v. Commissioner, 62 T.C. 684, 695 (1974). There is always a reasonable probability that income will be derived from a contribution of appreciated property to a charitable organization, and the mere fact that a donee sells appreciated property after it is donated does not mean that taxpayer assigned its income. S.C. Johnson & Son v. Commissioner, 63 T.C. 778, 785, 786 (1975).

Whether the anticipatory assignment of income doctrine applies in a particular case is a question of fact that must be determined by examining the facts and circumstances of each case to ascertain whether at the time the donations were made the sale was practically certain to be completed despite the remote and hypothetical possibility of an abandonment. Peterson Irrevocable Trust #2 v. Commissioner, T.C. Memo. 1986-267. The reality and substance of events determine incidence of taxation, rather than formalities and remote hypothetical possibilities. Ferguson v. Commissioner, 108 T.C. at 258. "In determining the reality and substance of a transfer, the ability, or lack thereof, of the transferee to alter a prearranged course of disposition with respect to the transferred property provides cogent evidence of whether there existed a fixed right to income at the time of the transfer." Ferguson v. Commissioner, 108 T.C. at 259. Whether the taxpayer has a legally enforceable right to income is not dispositive of the anticipatory assignment of income analysis, but is only one factor in the Tax Court's inquiry into the reality and substance of the events surrounding a taxpayer's transfer. Ferguson, 108 T.C. at 264.

In Ankeny v. Commissioner, the Court held that donor anticipatorily assigned his income from the sale of property where he entered into a contract to sell the property to a third party prior to transferring an interest in that property to the donee. The Court observed that the donee had no control over any interest in the property since its interest was subject to the sales contract with the third party. Ankeny v. Commissioner, T.C. Memo. 1987-247. See also Rollins v. United States, 302 F. Supp. 812, 816 (W.D. Tex. 1969) (donor held taxable on proceeds of sale by donee of contributed stock since contract of sale executed before contribution of stock and donor knew that third party obtained financing for purchase of stock and date of purchase was set). Compare Rogers v. Commissioner, 38 T.C. 785, 789 (1962) (anticipatory assignment of income doctrine inapplicable to donor's gift of $10,000 worth of standing timber where donor relinquished all title and interest in timber upon transfer to donee).

The assignment of income doctrine has been raised in several cases involving the transfer by a shareholder of closely held stock to a charity followed shortly thereafter by the corporation's redemption of the donated stock. In Palmer v. Commissioner, petitioners had voting control of a corporation and a tax-exempt private foundation. Palmer, 62 T.C. 684 (1974), aff'd on other gds., 523 F.2d 1308 (8th Cir. 1975). The foundation purchased shares of the corporation, and petitioners contributed stock from this corporation to the charitable foundation so that the foundation owned 80 percent of the corporation's shares. Id. at 689. The following day, the corporate shareholders (including the foundation) agreed that the donated shares would be redeemed from the foundation in exchange for certain corporate assets. Id. at 689. Petitioners deducted the value of the shares contributed to the foundation. Id. at 690. Respondent maintained that the contribution of stock was an anticipatory assignment of the proceeds from a redemption which petitioners had the power to effect. Id. at 690. The Court held that the assignment of income doctrine was inapplicable, since the

foundation was not a sham or an alter ego of petitioners, and petitioners made an actual gift to the foundation. Id. at 694. The Court added that although the shareholders' vote to redeem the shares was anticipated, the foundation was not legally obligated to proceed with the redemption of the donated shares at the time it received them, could have prevented the redemption if it so chose, and the foundation had complete dominion and control over the shares. Id. at 694, 695. Based on these facts, the Court concluded that "the redemption had not proceeded far enough along . . . to conclude that the foundation was powerless to reverse the plans of the petitioner." Id. at 695. Following the Palmer decision, the Service issued Rev. Rul. 78-197 in which it announced that in cases which are factually similar to Palmer, it will treat proceeds from the redemption of stock as income to the donor only if the donee is legally bound or can be compelled by the corporation to surrender the shares for redemption. Rev. Rul. 78-197, 1978-1 C.B. 83.

In S.C. Johnson & Son, Inc. v. Commissioner, 63 T.C. 778, 782 (1975), taxpayer donated two appreciated foreign exchange forward contracts to a charity, which subsequently sold them to a third party. Respondent maintained that taxpayer assigned its income in the forward contracts to the charity since at the time of the contribution, realization of income was reasonably probable, as taxpayer could have realized gain by simply making a telephone call to close the contracts. Id. at 783, 784. The Court determined that taxpayer had no fixed right to receive income from the contracts at the time of their contribution since no event occurred prior to the contribution that created a right to the income, taxpayer made no efforts prior to its contribution to ensure that it would realize gain (through, for example, entering into negotiations to sell the contracts), donee had control over the timing of receipt of the income and the ability to prevent receipt of the income through its inaction, and donee was exposed to potential liabilities due to currency fluctuation prior to the contracts' maturity date. Id. at 787- 789. The Court noted that there was merely an expectancy of gain on the part of the taxpayer. Id. at 786.

In Greene v. United States, 806 F. Supp. 1165 (S.D.N.Y. 1992), aff'd, 13 F.3d 577 (2d Cir. 1994), taxpayers donated futures contracts to a charity, but retained the right to a portion of the income (i.e. short-term gain) from the subsequent sale of the contracts by the charity. Greene, 13 F.3d at 579. Taxpayers reported short-term capital gain income, and deducted the long-term gain as a charitable contribution. Id. Defendant maintained that the donation represented an assignment of income and consequently, taxpayers should be taxed on the fair market value of the futures contracts. Id. The Court held that the assignment of income doctrine did not apply. Id. at 582. Even though taxpayers retained the right to any short-term capital gain resulting from the sale of the futures contracts, taxpayers had no fixed right to income in the donated futures contracts, as there was neither an express condition on the gift that donee sell the contracts, nor was there an informal agreement to this effect. Greene, 13 F.3d at 582. In determining whether the assignment of income doctrine should apply, the Court addressed the issue of whether the income donated to the charity was a fixed

right to income or a mere expectancy of profit from a future sale. Id. The Court held that donee had absolute control over the donated futures contracts, and complete discretion to determine if and when to sell them. Id. Taxpayers had no control over the contracts once they were donated, and thus it was not reasonably certain that they would realize short-term gains after they donated the futures contracts. Id. at 581.

Several cases have held that the anticipatory assignment of income doctrine applied where taxpayers contributed stock to a charity after the corporation adopted a plan of liquidation. In Kinsey v. Commissioner, 477 F.2d 1058, 1059 (2d Cir. 1973), a corporation adopted a plan of liquidation prior to contributing its stock to a charitable organization. The Court held that the assignment of income doctrine applied since at the time of the gift, it was certain that the stock would be liquidated (even though an enforceable right to the liquidation proceeds had not yet accrued). Id. at 1060. Accord Jones v. United States, 531 F.2d 1343, 1345 (6th Cir. 1976) (gift of stock after corporation adopted plan of complete liquidation, practically certain to be completed, resulted in donor being taxed on proceeds of liquidation based on assignment of income doctrine); Hudspeth v. United States, 471 F.2d 275, 277 (8th Cir. 1972) (assignment of income doctrine applied where majority shareholder donated stock after adoption of liquidation plan due to practical certainty of stock's liquidation, his power to control liquidation and donee's inability to thwart donor's intention to liquidate); Estate of Applestein v. Commissioner. 80 T.C. 331 (1983) (taxpayer assigned proceeds from a merger since at the time of the gift, taxpayer's right to the merger proceeds had matured and any possibility that the merger would be abandoned was remote and hypothetical).

More recently, the Tax Court, in Ferguson v. Commissioner, held that donors were taxable under the anticipatory assignment of income doctrine on gain from appreciated stock donated after donors entered into a merger agreement and after a tender offer was made for the stock, but prior to the completion of the merger. Ferguson, 108 T.C. 244, 252-253. Donors contributed the stock to donees, which subsequently sold it pursuant to a tender offer. Id. at 253. Donors argued that the gain could not be attributed to them since the donees were not legally obligated and they could not be compelled to sell the stock (relying on the Tax Court's decision in Palmer), and the date at which the right to the tender offer proceeds matured followed the contribution date. Id. In examining whether the assignment of income doctrine applies to a particular case, the Court observed that the inquiry is not limited to whether taxpayer has a legally enforceable right to the income at the time of the contribution, but must also encompass the reality and substance of the events which occurred in reference to the merger agreement, tender offer, and the charitable contributions. Id. at 264. [6]

[6] On appeal, the Ninth Circuit observed that the Tax Court need only have ascertained that by the contribution date, the surrounding circumstances sufficiently demonstrated that the merger and tender offer were practically certain to occur. Ferguson, 174 F.3d at 1004. Formalities such as a shareholder vote were sufficient, rather than necessary, conditions to find that the right to receive cash for the stock had matured.

The Court concluded that based on the fact it was practically certain on the date of the contribution that the merger agreement and the tender offer would be successfully completed (more than 50% of the stock had been tendered), as well as the donee's inability to render ineffective the donors' intent to proceed with the merger and tender offer, the stock was converted from an interest in a corporation to the right to receive cash before it was contributed to the charities. Id. at 260, 261.

Based on the above precedent, a key element in determining whether taxpayers had a fixed right to the income at the time of the contribution is the degree of control that the donor had over the property after the donation. In Ankeny, the taxpayer's entry into a contract of sale with a third party prior to the donation of part of its interest to a charity clearly indicated that taxpayer retained control over the donated property. In Kinsey, Jones, Hudspeth, Applestein, and Ferguson, the occurrence of a specific event in reference to the subject property (i.e. approval of a plan of merger or liquidation) created a right to the income from the property that was taxable to the donor. A key factor that led the courts to apply the anticipatory assignment of income doctrine in these cases was the donee's inability to prevent the liquidation from occurring. In Palmer, in contrast, it was donee's ability to disallow the redemption of its donated shares that was a key fact that led the Tax Court to conclude that there was no assignment of income.

Under the present facts, it must be determined whether taxpayers had, in effect, realized gain in the value of the Y cooperative shares/proprietary lease before the donation such that the donation was an assignment of only a right to receive the gain. If, prior to the donation, the taxpayers arranged for the sale of the donated property to a specific purchaser and after the donation, retained influence over the sale of the donated shares such that the donee had no power to decide whether, when, or to whom the donated property would be sold, then the donation could be viewed as an anticipatory assignment of income since taxpayers' realization of gains on the donated shares would have been virtually certain, as noted in all of the above-referenced cases. Evidence of such an arrangement requires an examination of the "reality and substance of the transfer." Ferguson, 108 T.C. at 260, 261.

Taxpayers clearly stood to realize a large amount of taxable long-term capital gain upon the sale their appreciated cooperative shares. Because the fair market value of the Z shares which taxpayers retained and subsequently sold was less than the $500,000 exclusion amount under section 121 (which will be discussed later), taxpayers did not recognize any gain from the subsequent sale, since they had already donated the balance of their shares (on which they would have recognized gain upon sale) to the donee.

Id.

Based on the manner in which cooperative housing corporations generally operate, it is highly likely that taxpayers would be required to obtain the approval of the cooperative board before transferring any portion of their shares and proprietary lease to the donee. As noted above, it is not known whether taxpayers sought the board's approval for the donation of a portion of their shares and a portion of their proprietary lease. Assuming that the cooperative board approved of the transfer to the donee, and that such a transfer was not in violation of Massachusetts law, it is also highly likely that the cooperative board would not have sanctioned such a joint ownership arrangement between the taxpayers and the donee unless the board was assured that all of the cooperative shares assigned to Apartment Z would be sold and the proprietary lease transferred to a purchaser in the near future. To receive assurance of an imminent sale, it is quite probable that the board would have required taxpayers to present it with a fully executed contract of sale with a purchaser, or short of this, some written evidence that a purchaser had been found, such as a binder agreement. In addition to receiving assurance of an imminent sale, the board would most likely have wanted to investigate the chosen purchaser's financial history to assure that the purchaser to whom the apartment would ultimately be sold would be able to meet his or her financial obligations as an owner prior to approving the transfer to the donee. It is therefore likely that prior to the donation, cooperative board approval would have been required for both the donation of a portion of the shares/proprietary lease to the donee and the subsequent sale of all of the shares/proprietary lease. If this is the case, it would have been extremely difficult for the donee to violate the taxpayers' intent and plan to sell the cooperative apartment to a specific purchaser at a specific time.

Moreover, it is possible that the Date 2 gift agreement between taxpayer and the donee (referenced in the donee's acknowledgment letter of Date 3) required the donee to sell its portion of the shares, along with the donor, to a specific purchaser. The board may, in fact, have required such a provision in the gift agreement between the taxpayers and the donee to assure that the donee would be obligated to sell its portion of the shares within a certain time period to a purchaser whom the board had the opportunity to investigate and approve.

If you find evidence that prior to the donation, taxpayers entered into a contract of sale with a purchaser or that the gift agreement (or other document between taxpayers and the donee) required donee to sell the property, to sell the donated property to a specific purchaser, or to sell the property within a certain time period, then taxpayers may be considered to have anticipatorily assigned their income from the sale of property since taxpayers would have a fixed right to receive gain. Donee's interest in the contributed property would be subject to the contract of sale. See Ankeny v. Commissioner, T.C. Memo. 1987-247. In that instance, the transaction should be treated as a sale of the X cooperative shares (for which taxpayers would be required recognize gain), and a cash donation of a portion of the sale proceeds to the donee.

If you do not find evidence of a written document requiring the donee to sell of the donated property, you should examine the facts and circumstances surrounding the transfer of the property and subsequent sale to determine whether the taxpayers retained control over the donated shares, or whether the donee had complete discretion to determine if, when, and to whom it would sell the donated property. The Tax Court has recently indicated that whether a taxpayer has a legally enforceable right to income is not dispositive of the anticipatory assignment of income analysis, but is only one factor in the inquiry into the reality and substance of the events surrounding a taxpayer's transfer. Ferguson, 108 T.C. at 264. The Second Circuit also noted in Greene that in addition to an express condition on a gift, an informal agreement that donee sell the donated property may be considered in deciding whether taxpayers had fixed right to income. Greene, 13 F.3d at 582.

Examining the substance of the events surrounding the transfer at issue, it is likely that prior to the donation, taxpayers had located a purchaser or purchasers for the apartment and presented their names to the cooperative board for approval. Even if at that time there was no contract of sale or other document evidencing an imminent sale of the apartment to a purchaser, taxpayers and the board would probably have informally agreed that the entire interest in the cooperative apartment would be sold to a specific purchaser within a specific amount of time to address any concerns the board might have had regarding the length of time the property would be held by both taxpayers and the donee. The board would have reasonably relied upon this information in deciding to allow taxpayers to donate a portion of their interests to the donee. In addition to obtaining board approval, it would most likely have been impossible for the donee to sell its Y shares in the cooperative apartment to a third party purchaser. A prospective purchaser would in all likelihood want to own all of the cooperative corporation shares allocated to the apartment and have full occupancy rights, and the board would in all likelihood have disapproved of a transaction in which only a portion of the shares were transferred. In this respect, the present case differs from the facts in Greene, where the donee had complete discretion to determine if and when to sell the donated partial interest, without a need to first consult with the donor or another entity such as a cooperative board.

If taxpayers acted alone in their efforts to obtain a purchaser and those efforts commenced prior to taxpayers' donation, this supports the view that taxpayers retained control over the donated property by virtue of restricting the timing of the sale of donee's shares and its choice of a purchaser. The above analysis assumes that the taxpayers acted in finding a purchaser and presenting the purchaser to the cooperative board for approval. The extent to which the donee participated in seeking a purchaser for the cooperative apartment, or whether it was free to solicit bids from prospective purchasers and decide to whom it would sell its share of the donated property is not known. If the donee actively sought and selected a purchaser for the shares and approached the board for approval, then these facts would weaken the argument that taxpayers retained control over the donated property.

Step Transaction Doctrine

Another means by which courts determine the substance of a transaction over its form is through the step transaction doctrine. Like the assignment of income doctrine, the step transaction doctrine focuses on the reality and substance of events to determine the incidence of taxation, rather than formalities and remote hypothetical possibilities. Ferguson, 108 T.C. 244, 257 (1997); Sheppard v. United States, 361 F.2d 972, 973 (Ct. Cl. 1966). There are several tests that are used to apply the step transaction doctrine: the binding commitment test, the end result test, and the interdependence test. Under the binding commitment test, the narrowest of the tests, a number of transactions are compressed if when the first step is taken, there was a binding commitment to enter into the later step. Penrod v. Commissioner, 88 T.C. 1415, 1429 (1987). Under the end result test, the broadest of the tests, the step transaction doctrine will apply if a series of steps are prearranged parts of one transaction which are intended to reach an ultimate result. Id.; Greene, 13 F.3d at 583. The interdependence test examines whether a series of formally separate steps were, in substance, so integrated, interdependent, and focused on one result, they should be treated as one transaction. Penrod, 88 T.C. at 1430.

In Sheppard v. United States, taxpayer owned a one-half interest in a racehorse. Sheppard, 361 F.2d at 973. Taxpayer donated a one-third interest out of his one-half interest to each of two charities. Id. at 976. Taxpayer planned to sell his remaining interest to a closely held corporation in which he served as President and majority shareholder, and, following the donation, to cause the corporation to offer to purchase the charities' interests. [7] Id. at 975. Both charities accepted the corporation's offer to purchase their respective interests. Id. at 976. Defendant maintained that taxpayer effectively sold his entire one-half interest to the corporation, and subsequently donated a portion of the sales proceeds to the charities, and should thus be taxed on the gain realized on the transfer of the entire one-half interest. Id. at 977. The Court disagreed, explaining that the step transaction doctrine did not apply since there was no evidence that taxpayer made prearrangements or commitments with the charities or placed any conditions on his gifts. Id. at 977. The Court pointed out that the charities could do what they wished with their interests, and by donating the interests without any conditions, taxpayer assumed the risk that the charities might sell their interests to another party for additional money, thus defeating his plan to have the corporation buy their interests. Id.

Respondent invoked the step transaction doctrine in the Palmer case, cited above, by maintaining that petitioners controlled both parties to the transfer, and thus the

[7] Taxpayer wanted the corporation to own a 100% interest in the racehorse. Id. The corporation had already purchased the other one-half interest. Id.

contribution of stock lacked substance. Palmer, 62 T.C. at 691. The Court disagreed, noting that there was substance and independent significance to petitioners' actions since they made an actual gift to the foundation, the foundation had dominion and control over the stock received from petitioners despite the fact that petitioners had voting control in the corporation and foundation, and there was no legally enforceable commitment which would have forced the foundation to proceed with the redemption. Id. at 693, 694. The Court observed that if there was evidence that petitioners arranged for a redemption of the stock shares and then contributed the assets acquired under the redemption, then it was possible that the gift would not have had independent significance. Id. at 691, 693. See also Behrend v. United States 73-1 U.S. Tax Cas. ¶ 9123 (4th Cir. 1972) (although contributors of stock planned to redeem it from charity, step transaction doctrine held to be inapplicable since charity not compelled to proceed with redemption and corporation relinquished all interest in stock); Carrington v. Commissioner, 476 F.2d 704 (5th Cir. 1973).

In Grove v. Commissioner, taxpayer donated stock over a number of years to a charity, while retaining a life interest in any income from the stock. Grove, 490 F.2d 241, 242 (2nd Cir. 1973). Between one and two years after the donation, the charity would offer the stock for redemption to the corporation of which taxpayer was the majority shareholder, vice-president, and a director. Id. at 242. The charity invested the redemption proceeds, the income from which was transferred to taxpayer. Id. Respondent contended that the step transaction doctrine should apply to treat the redemption proceeds as having been received by taxpayer. Id. at 245. In concluding that the step transaction doctrine was inapplicable, the court noted that taxpayer made a valid, binding, and irrevocable gift of the stock, there was no informal agreement between taxpayer and donee that donee would offer the contributed stock for redemption, and taxpayer had no control over whether the corporation would redeem the stock. Id. at 246.

In Greene, cited above, the Second Circuit also examined whether the step transaction doctrine applied. Defendant argued that taxpayers' overall plan consisted of liquidating the donated futures contracts, retaining a portion of the proceeds (which they were unable to deduct under section 170 due to the realization of short-term gain), and avoiding tax liability on the long-term capital gain. Greene, 13 F.3d at 585. The Court rejected this argument, stating that there was no evidence of a legally binding agreement or informal agreement between taxpayers and the charity that the charity sell its portion of the donated futures contracts. Id. These facts led the Court to conclude that the charity's sale of the futures contracts was an event entirely independent from the donation. Id.

The step transaction doctrine was held to apply in Blake v. Commissioner. Taxpayers donated their stock to a charity with the understanding that the charity would sell it and use the sale proceeds to purchase taxpayer's yacht at a price in excess of its fair market value. Blake, 697 F.2d 473, 476, 478 (2nd Cir. 1982), aff'g T.C. Memo. 1981-

579. Taxpayers argued that they relinquished all of their interest in the donated stock, and the charity was under no binding, enforceable obligation to purchase the yacht. Id. at 476. Applying the step transaction doctrine, the Court considered the "gift" of the low basis stock as a step which taxpayer took with the expectation of receiving cash from the sale proceeds of the yacht in an amount roughly equal to the fair market value of the stock. Id. at 476. The Court thus characterized the substance of the transaction as a charitable contribution of the yacht and a sale of the stock by taxpayer on which he should recognize gain. Id. at 480. The Court relied on evidence that there was a legal obligation, based on the doctrine of promissory estoppel, between taxpayer and donee prior to the gift that the donee would use the stock sale proceeds to purchase the yacht. Id. at 480. Even though there was no legally binding agreement providing that the charity purchase the yacht, the Court pointed to evidence of an understanding between donee and taxpayer regarding their purchase of the yacht which the charity agreed to undertake so as to assure that it would receive future donations. Id. The Court, in *dicta*, questioned the conclusion Rev. Rul. 78-197 that in cases similar to Palmer, redemption proceeds will be treated as income to the donor only if the donee is legally bound, or can be compelled by the corporation, to surrender the shares for redemption. Id. at 480. The Court noted that where the donor has a reasonable expectation, with an understanding prior to the donation, that the donee charity will purchase an asset with proceeds of donated stock, the transaction will be viewed as a unitary one. [8]

The Service recently issued Notice 99-36, 1999-26 I.R.B. 3, in which it relied upon Blake in applying the step-transaction doctrine in the context of charitable split-dollar insurance transactions. These transactions generally entail the purchase of a cash value life insurance policy by a charity or an irrevocable life insurance trust formed by a taxpayer who designates the charity and the trust as beneficiaries. The taxpayer transfers funds to a charity with the understanding that the charity will pay premiums that benefit not only the charity, but also the taxpayer's family. Citing Blake, the Service observed that although no legal obligation binds the charity to use the funds transferred by the taxpayer for premium payments, there is a mutual understanding between the parties that the funds will be used in this manner. The Service determined that substance of these transactions consists of the purchase of an insurance policy by taxpayer, payment of the premiums, and transfer of part of the rights under the policy to a trust and the remainder of the rights to the charity. Since only a portion of the rights are transferred to the charity, the Service concluded that the split dollar transaction does not fall within the exceptions to the partial interest rules under section 170(f)(3).

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[8] The Tax Court noted that its facts were factually distinguishable from those in Grove, Palmer, and Johnson. In those cases, there was evidence that the charities had complete discretion to retain or sell the donated property, as donors relinquished complete control over the donated property after the donations, and the property was donated before any income had been realized. Blake v. Commissioner, T.C. Memo. 1981-579.

In the present case, it must be determined whether each of the separate steps, consisting of the transfer to the donee and the subsequent sale, has economic significance apart from tax avoidance. If you find that the charitable gift of the cooperative shares was absolute and unconditional, and that the subsequent purchase by the third party was an entirely separate transaction that was not prearranged, then the transactions may be considered as independent of one another, and the step transaction doctrine will not apply, as was the case in Sheppard, Palmer, Grove, and Greene. If, on the other hand, you find that taxpayers have restricted donee's control of the donated property so that all that remains to be done is for taxpayers to carry out a prearranged plan for the sale of the entire interest in the cooperative apartment, then the separate steps will be disregarded in favor of the substance of the transaction (i.e. a sale followed by a donation of the proceeds).

In applying the binding commitment, end result, or interdependence tests, it is necessary to determine whether there was a prearranged plan by which taxpayers used the donee to sell a portion of its cooperative shares to avoid recognizing long-term capital gain. This determination, as with the assignment of income determination, depends on whether taxpayers retained control over the donated property after their contribution. Greene, 806 F.Supp. 1165, 1173 (S.D.N.Y. 1992); Sheppard v. United States, 361 F.2d at 978. We recommend that you find out whether under the circumstances, the donee was free to decide whether, when, and to whom it should sell the donated property. In the absence of any evidence of a written agreement legally binding the donee to sell its interests to a purchaser, an informal agreement or understanding between the taxpayers, donee, and cooperative board may suffice under Blake or Greene.

Substantiation of Contribution

Section 170(f)(8) and Treas. Reg. § 1.170A-13 set forth a series of substantiation rules with which a taxpayer must comply in order to qualify for a charitable contribution deduction.

Section 1.170A-13(b) contains recordkeeping and return requirements for taxpayers who deduct charitable contributions of property other than money in taxable years after December 31, 1982. Taxpayers must maintain for each contribution a receipt from the donee showing: (i) the donee's name; (ii) date and location of the contribution; and (iii) a description of the property in detail reasonably sufficient under the circumstances (the receipt need not state the property's fair market value). A letter from the donee acknowledging receipt of the contribution, date of the contribution, and a description of the property contains sufficient information to constitute a receipt. Id.

In this case, taxpayers submitted with their Year 1 return a letter from the donee dated Date 3 containing donee's acknowledgment of its receipt of the Y shares of stock of

"the cooperative housing corporation", as well as a proportionate share of taxpayers' rights and obligations under a Proprietary Lease relating to Apartment Z described in a gift agreement dated Date 2. In addition, the donee signed a Form 8283 in which it acknowledged that on Date 2 it received Y shares of no par value of "the cooperative housing corporation" known as Apartment Z, along with a proportionate share of rights and obligations under taxpayers' proprietary lease.

The regulations also contain special substantiation requirements for taxpayers who deduct more than $5,000 charitable contributions of property after December 31, 1984. Treas. Reg. § 1.170A-13(c). Such a deduction is barred unless taxpayer meets three requirements in Treas. Reg. § 1.170A-13(c)(2). First, the donor must obtain a qualified appraisal for the property contributed. Treas. Reg. § 1.170A-13(c)(2)(i)(A). If the property contributed consists of a partial interest, then the appraisal shall be of the partial interest. Id. Donor must keep the qualified appraisal in its records as long as it may be relevant for federal income tax purposes. Treas. Reg. § 1.170A-13(c)(3)(iv)(C). Second, taxpayer must attach a fully completed appraisal summary to the tax return. Treas. Reg. § 1.170A-13(c)(2)(i)(B). Third, taxpayer must maintain records containing the information required by Treas. Reg. § 1.170A-13(b)(2)(ii). Treas. Reg. § 1.170A-13(c)(2)(i)(C). Each of these substantiation requirements is discussed below.

Qualified Appraisal

A qualified appraisal is defined in Treas. Reg. § 1.170A-13(c)(3) as an appraisal document that meets four specifications. First, the document relates to an appraisal made no earlier than 60 days prior to the contribution date and no later than the due date of the return on which the charitable contribution deduction is first claimed. Treas. Reg. § 1.170A-13(c)(3)(i)(A). In the present case, this requirement is met, as the letter containing the appraisal of the X cooperative shares by Appraiser of Appraisal corporation was dated Date 5. [9]

Second, the document is prepared, signed, dated by qualified appraiser, as defined in Treas. Reg. § 1.170A-13(c)(5). Treas. Reg. § 1.170A-13(c)(3)(i)(B). The requirements for a qualified appraiser, set forth below, are contained in Section B, Part III, of Form 8283 entitled "Declaration of Appraiser," which the appraiser must sign. A qualified appraiser is defined in the regulations as an individual who holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis, and based on his or her qualifications the appraiser is qualified to make appraisals of the type of property being valued. Treas. Reg. § 1.170A-13(c)(5)(i)(A), (B). To be a qualified appraiser, the appraiser must not be the donor or donee of the property, a party to the transaction in which the donor acquired the property being appraised

[9] On the Form 8283, Mr. Mullin indicated the appraisal date as Month 4 Year 1.

(unless the property is donated within 2 months of the date of acquisition and its appraised value does not exceed its acquisition price), any person employed by any of the foregoing persons, a related party to any of the foregoing under section 267(b) or the spouse of a related party. Treas. Reg. 1.170A-13(c)(5)(i)(C), (c)(5)(iv)(F). In addition, an appraiser who is regularly used by the donor, a party to the transaction or the donee of the property, and who does not perform a majority of appraisals during his or her taxable year for other persons, is not a qualified appraiser. Id. The appraiser must acknowledge that an intentionally false or fraudulent overstatement of the value of the property described in the qualified appraisal or appraisal summary may subject the appraiser to a civil penalty under section 6701 for aiding and abetting an understatement of tax liability, and such appraisals may be disregarded pursuant to 31 U.S.C. § 330(c). Treas. Reg. § 1.170A-13(c)(5)(i)(D). Moreover, if the donor had knowledge of facts that would cause a reasonable person to expect the appraiser to falsely overstate the value of the donated property (e.g., the donor and the appraiser make an agreement concerning the amount at which the property will be valued and the donor knows that such amount exceeds the fair market value of the property), then the appraiser is not a qualified appraiser under Treas. Reg. § 1.170A-13(c)(5)(ii).

In the present case, Appraiser, as President of Appraisal corporation, prepared, signed and dated the appraisal. In addition, Appraiser signed the Declaration of Appraiser in Section B, Part III of Form 8283. We recommend that you conduct discovery to verify the information contained in this declaration, including whether or not there was an agreement between the taxpayer and the donee as to the fair market value of the cooperative shares.

Third, a qualified appraisal must contain the information specified in Treas. Reg. § 1.170A-13(c)(3)(ii). This information includes a description of the property in sufficient detail for a person not generally familiar with the type of property to ascertain that the property which was appraised was that which is being contributed; the date or expected date of contribution to the donee; the terms of any agreement or understanding entered into by or on behalf of donor or donee that relates to use, sale, or other disposition of property contributed (for example an agreement or understanding that restricts a donee's right to use or dispose of the donated property, reserves to, confers upon anyone other than the donee any right to income from the contributed property or to the possession of property or earmarks it for a specific use); the name, address, and taxpayer identifying number of the qualified appraiser and the entity engaging the appraiser; qualifications of the qualified appraiser (background, experience, education, and membership in professional associations); a statement that the appraisal was prepared for income tax purposes; the date on which property was appraised; the appraised fair market value of the property on the contribution date; the method of valuation used to determine fair market value; and the specific basis for the valuation (for example comparable sales transactions). Treas. Reg. § 1.170A-13(c)(3)(i)(C); 1.170A-13(c)(3)(ii).

The appraisal letter signed by Appraiser, dated Date 5, indicated the address of the appraisal company and the cooperative apartment, a description of the apartment's layout, a statement that the apartment building was in excellent condition, and that the appraisal was requested by taxpayers. Although the appraisal letter did not specifically state the method of valuation used by the appraiser, the appraiser appears to have employed the comparable sales transactions method, as the appraisal letter lists "three recent sales" (before or in Month 4 of Year 1) in buildings similar to those in which the cooperative apartment was located. [10] The letter did not contain the date or expected date of contribution to the donee, the terms of any agreement or understanding entered into by the donor or donee relating to the use of the property, the taxpayer identification number of Appraisal corporation, (this number was contained on Form 8283), the background and qualifications of the appraiser (this information was contained on a separate undated document entitled "Brief Resume" a copy of which was attached to the Year 1 return), the fact that the appraisal was prepared for income tax purposes, the date on which the property was appraised (Form 8283 indicates Month 4 Year 1 as the appraisal date), and the appraised fair market value of the property on the contribution date. Rather than indicating the date on which the property was appraised or the fair market value on the contribution date, the letter states that the Amount B (the price for which the property was sold in Month 4, Year 1) was a fair market price.

Treas. Reg. § 1.170A-13(c)(2)(i)(A) requires that if a donor contributes a partial interest in property, then the appraisal shall be of the partial interest. The appraisal did not indicate the value of the partial interest or the value of each share. As noted above, we have not found any authority involving the transfer of a portion of shares/proprietary lease assigned to a cooperative unit. Prior to determining whether the Y shares and portion of the proprietary lease are freely transferable for 75% of the fair market value of the entire interest, we recommend that you ascertain whether under the rules of the cooperative or Massachusetts law, taxpayers could transfer a portion of their shares and proprietary lease. If the cooperative board approved of the transfer, we suggest you look at their minutes to see if there was any discussion relating to nature and value of the interests taxpayers contributed. Even if a partial interest could be transferred, it is doubtful that the valuation of the donated portion of the property at 75% of the Amount B sale price is sufficient. It is highly unlikely that an objective third party would have paid 75% of the fair market price of a full interest in a cooperative apartment for a 3/4 interest in that apartment.

Fourth, the appraisal must not involve an appraisal fee prohibited by Treas. Reg.

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[10] You note that the recent sales cited in the appraisal were for condominium, rather than cooperative, units. Fair market value is a question of fact. We recommend that you verify the fair market value of the cooperative shares and portion of the proprietary lease.

§ 1.170A-13(c)(6). Treas. Reg. § 1.170A-13(c)(3)(i)(D). Treas. Reg. § 1.170A-13(c)(6) generally prohibits appraisal fee arrangements based on a percentage of the property's appraised value. This prohibition does not apply where a is fee paid to a generally recognized association that regulates appraisers provided all of the following requirements are met: (A) the association is not organized for profit and no part of the net earnings of the association inures to the benefit of any private shareholder or individual (these terms have the same meaning as in section 501(c)); (B) the appraiser does not receive any compensation from the association or any other persons for making the appraisal; and (C) the fee arrangement is not based in whole or in part on the amount of the appraised value of the donated property, if any, that is allowed as a deduction under section 170 after Internal Revenue Service examination or otherwise.

In the present case, Appraiser signed the Declaration of Appraiser on the Form 8283 in which he certified that the appraisal fees were not based on a percentage of the appraised property value. We recommend that you verify the appraisal fee arrangement between Appraisal corporation.

Appraisal Summary

The second requirement for substantiation of a charitable deduction in excess of $5,000 under Treas. Reg. § 1.170A-13(c)(2) relates to the taxpayer's obligation to attach a completed appraisal summary to the tax return on which taxpayer first reports the deduction. Treas. Reg. § 1.170A-13(c)(2)(i)(B). An appraisal summary, which summarizes the qualified appraisal discussed above, must meet the following requirements pursuant to Treas. Reg. § 1.170A-13(c)(4): the summary must be made on the form prescribed by the Internal Revenue Service; must be signed and dated by the donee and the qualified appraiser who prepared the qualified appraisal. Treas. Reg. § 1.170A-13(c)(4)(A)-(C). The individual who signs the appraisal summary on behalf of the donee must be an official authorized to sign the tax or information returns of donee, or a person specifically authorized by the donee to sign appraisal summaries. Treas. Reg. § 1.170A-13(c)(4)(iii). Section B of Form 8283, entitled "Appraisal Summary" includes the information required by the regulations to be shown on an appraisal summary. The donor must furnish the donee with a copy of the appraisal summary. Treas. Reg. § 1.170A-13(c)(4)(iv)(E).

Pursuant to Treas. Reg. 1.170A-13(c)(4)(i)(D), an appraisal summary must include the following information: (A) the name and taxpayer identification number of the donor (social security number if the donor is an individual); (B) a description of the property in sufficient detail for a person who is not generally familiar with the type of property to ascertain that the property that was appraised is the property contributed; (C) in the case of tangible property, a brief summary of the overall physical condition of the property at the time of the contribution; (D) the manner of acquisition and acquisition date of the property by the donor; (E) the cost or other basis of the property adjusted

as provided by section 1016; (F) the name, address, and taxpayer identification number of the donee; (G) the date the donee received the property; (H) a statement explaining whether or not the charitable contribution was made by means of a bargain sale and the amount of any consideration received from the donee for the contribution; (I) the name, address, and (if a taxpayer identification number is otherwise required by section 6109 and the regulations thereunder) the identifying number of the qualified appraiser who signs the appraisal summary; (J) the appraised fair market value of the property on the date of contribution; (K) the declaration by the appraiser described in section 1.170A-13(c)(5)(i); (L) a declaration by the appraiser stating that (1) the fee charged for the appraisal is not of a type prohibited by section 1.170A-13(c)(6); and (2) appraisals prepared by the appraiser are not being disregarded pursuant to 31 U.S.C. § 330(c) on the date the appraisal summary is signed by the appraiser; and (M) such other information as may be specified by the form. Treas. Reg. § 1.170A-13(c)(4)(ii).

In the present case, taxpayers completed a Form 8283 and provided an attachment, both which they filed with their Year 1 tax return. These documents contained the information required by Treas. Reg. § 1.170A-13(c)(4)(i)(D). The attachment contained taxpayers' names, social security numbers, a description of the property transferred, the date of the gift, the total appraised value of the X shares, the appraised value multiplied by 75%, (representing the value of Y contributed shares), taxpayers' total basis in the X shares, and taxpayers' basis in the Y contributed shares. An individual purporting to represent the donee signed the form and dated it Date 7. It is not clear whether the individual who signed the appraisal summary on behalf of the donee was an official authorized to sign the tax or information returns of donee, or a person specifically authorized by the donee to sign appraisal summaries. The title of the person who signed the form on behalf of the donee is not legible on our copy of the Form 8283. As noted above, Appraiser signed the declaration of appraiser as President of Appraisal corporation.

<u>Maintenance of Records required by 1.170-13(b)(2)(ii)</u>

The third substantiation requirement of Treas. Reg. § 1.170A-13(c)(2)(i) obligates a taxpayer to maintain records containing information enumerated in Treas. Reg. § 1.170A –13(b)(2)(ii). Taxpayer must maintain the following information, and such information must be stated in the taxpayers' income tax return if required by the return form or instructions: (A) the name and address of the donee to which the contribution was made; (B) the date and location of the contribution; (C) a description of the property in detail reasonable under the circumstances (including the value of the property); (D) the fair market value of the property at the time the contribution was made, the method utilized in determining the fair market value, and, if the valuation was determined by appraisal, a copy of the signed report of the appraiser; (E) in the case of property to which section 170(e) applies, the cost or other basis, adjusted as provided by section 1016, the reduction by reason of section 170(e)(1) in the amount

of the charitable contribution otherwise taken into account, and the manner in which such reduction was determined; (F) if less than the entire interest in the property is contributed during the taxable year, the total amount claimed as a deduction for the taxable year due to the contribution of the property, and the amount claimed as a deduction in any prior year or years for contributions of other interests in such property, the name and address of each organization to which any such contribution was made, the place where any such property which is tangible property is located or kept, and the name of any person, other than the organization to which the property giving rise to the deduction was contributed, having actual possession of the property; (G) the terms of any agreement or understanding entered into by or on behalf of the taxpayer which relates to the use, sale, or other disposition of the property contributed, including for example, the terms of any agreement or understanding which: (1) restrict temporarily or permanently the donee's right to use or dispose of the donated property; (2) reserve to, or confer upon, anyone (other than the donee organization or an organization participating with the donee organization in cooperative fundraising) any right to the income from the donated property or to the possession of the property, including the right to vote donated securities, to acquire the property by purchase or otherwise, or to designate the person having such income, possession, or right to acquire, or (3) earmarks donated property for a particular use. Treas. Reg. § 1.170A –13(b)(2)(ii).

In the present case, taxpayers provided on Form 8283 and the attachment the information required in § 1.170A–13(b)(2)(ii)(A) – (C) above. Regarding section 1.170A–13(b)(2)(ii)(D), the fair market value of the property at the time of the contribution was provided on the attachment to the Form 8283. The appraisal letter prepared by Appraisal corporation. indicated that the Amount B sales price was a fair market price based on sales of comparable properties in Month 1 Year 1, Month 3, Year 1 and Month 2, Year 1. Taxpayers attached a copy of the signed appraisal letter, containing this information, to their Year 1 return. As noted, the appraisal did not indicate the fair market value of the Y shares on the date of contribution, but appraised the X shares assigned to the entire cooperative apartment. With regard to section 1.170A – 13(b)(2)(ii)(F), taxpayers contributed less than their entire interest in the cooperative apartment and indicated on Form 8283 and Schedule A of their Year 1 return the amount claimed as a deduction computed by multiplying the fair market value of the X shares assigned to the apartment by 75%. Regarding Treas. Reg. § 1.170A – 13(b)(2)(ii)(G), it is not clear whether taxpayers entered into any other agreement relating to the use, sale, or other disposition of the property contributed. Donee’s Date 3 letter to taxpayer acknowledging receipt of the contribution, references a gift agreement dated Date 2. We recommend that you request a copy of this agreement and examine its terms, any other agreements between taxpayers and the donee. As stated above, you should also investigate whether taxpayers entered into a contract of sale or other agreement evidencing an intent to sell the entire cooperative apartment.

Exclusion of Gain under I.R.C. § 121

Section 121, relating to the exclusion of gain from the sale or exchange of a taxpayer's principal residence, was amended by Public Law 105-34 (111 Stat. 788 (TRA 1997)), and further amended by the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206 (112 Stat. 805 (RRA 1998)). TRA 1997 generally applies to sales or exchanges made after May 6, 1997. [11]

Section 121(a) currently provides that gross income does not include gain from the sale or exchange of property if, during the 5-year period ending on the date of the sale or exchange, such property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 2 years or more.

Under section 121(b)(1), the amount of gain that may be excluded generally is limited to $250,000. Section 121(b)(2) permits married couples to exclude up to $500,000 of gain if: (A) they file a joint return for the year of the sale; (B) either spouse has owned the residence during the period described in subsection (a); (C) both spouses meet the use requirements of subsection (a); and (D) pursuant to section 121(b)(3), neither spouse has applied the exclusion to any other sale during the 2-year period ending on the date of the sale.

Section 121(d)(4) provides that if the taxpayer holds stock as a tenant-stockholder (as defined in section 216) in a cooperative housing cooperation (as defined in such section), the holding and use requirements of subsection (a) shall be applied

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[11] Prior to the amendments made by TRA 1997, permanent exclusion of gain under section 121 was available to taxpayers under much narrower circumstances than current section 121 permits. However, taxpayers generally could defer recognition of gain on the sale or exchange of their principal residence under section 1034 if they reinvested in a new residence within a prescribed period (generally 2 years before or after the date of sale of the old residence).

Although TRA 1997 generally repealed section 1034 for sales and exchanges of principal residences after May 6, 1997, TRA 1997, as amended by RRA 1998, permitted a taxpayer to elect the application of section 1034 to a sale or exchange (1) made on or before August 5, 1997, (2) made pursuant to a binding contract in effect on August 5, 1997, or (3) that would qualify under section 1034 by reason of a new residence acquired on or before August 5, 1997 or pursuant to a binding contract in effect on August 5, 1997. H.R. Rep. No. 356, 105th Cong., 1st Sess. 18 (1997); S. Rep. No. 174, 105th Cong., 2d Sess. 151 (1998). The taxpayers in this case, however, did not elect to have section 1034 apply.

respectively to the holding of such stock and to the house or apartment in which the taxpayer, as such stockholder, is entitled to occupy.

Rev. Rul. 84-43, 1984-1 C.B. 27, holds that the sale of a life estate in a principal residence qualifies for exclusion under the pre-TRA 1997 version of section 121, if the life estate is the taxpayer's entire legal and equitable interest in the residence. It was unnecessary for the taxpayer to own the entire fee interest in the residence to qualify for the exclusion.

Based on the information provided, it appears that taxpayers meet all the section 121 requirements. Accordingly, we conclude that taxpayers, as tenant-shareholders, are entitled to exclude up to $500,000 of gain from the disposition of their shares of stock in their cooperative apartment in Year 1. This conclusion applies regardless of whether the form of taxpayers' transaction is respected or if the transaction is treated as a sale of taxpayers' entire interest and a donation of 75% of the proceeds. If taxpayers are treated as contributing Y of their X shares in their cooperative apartment and a corresponding portion of their proprietary lease to the donee, then taxpayers will be entitled to deduct the fair market value of this property as a charitable contribution (subject to specified carryover rules cited above). If, however, taxpayers are treated as if they first sold 100% of their stock to the third party followed by a cash contribution of 75% of the cash proceeds to the donee, then taxpayers would still be entitled to a charitable contribution deduction, but would lose the advantage of claiming a fair market value deduction and be subject to the rules governing cash contributions.

Resolution of the section 170 issue will affect the amount of gain realized and recognized, but will not otherwise affect the applicability of section 121. If the form of the transaction is respected, taxpayers, who by analogy to Rev. Rul. 84-43 disposed of their entire interest when they sold their remaining Z shares, will have a realized gain of Amount M. [12] That gain will be excluded in its entirety under section 121(b)(2), as it is less than $500,000. If the transaction instead is characterized as a sale by the taxpayers of 100% of their cooperative shares, followed by a cash contribution of 75% of the sale proceeds, the taxpayers will exclude $500,000 of the gain under section 121(b)(2), with the deduction of the balance being governed by section 170.

CASE DEVELOPMENT, HAZARDS AND OTHER CONSIDERATIONS

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[12] In computing the realized gain on their Form 2119, taxpayers indicated that their adjusted basis in the Z cooperative shares in the property was Amount L. It is not clear how taxpayers derived this amount. Although the figure may be correct, we note that it is substantially less than either 25% of the Amount D basis in the X shares or 25% of the Amount A initial cost basis. Although we do not believe that the amount allocated to basis on the sale portion of the transaction affects our analysis under section 121, we recommend that you ascertain through discovery how taxpayers arrived at Amount L as their adjusted basis.

[13]

the issue of whether a gift of appreciated property results in income to the donor is not determined solely by the presence of a legally binding obligation on the part of the donee. See Ferguson, 108 T.C. at 264 (whether the taxpayer has a legally enforceable right to income is only one factor in the Tax Court's inquiry into the reality and substance of the events surrounding a taxpayer's transfer); Greene, 13 F.3d at 582 (in deciding whether taxpayers had fixed right to income in the donated property, court examined whether there was an express condition on the gift or merely an informal agreement that donee sell the donated property); Blake, 697 F.2d at 478 (even though no legally binding agreement existed providing that the charity purchase taxpayer's yacht, understanding between donee and taxpayer was sufficient to create legal obligation through promissory estoppel theory).

Although in Ferguson the Tax Court has recently taken a broader view of the type of evidence it will consider in determining whether the assignment of income doctrine applies, it must be noted that Palmer has not been overruled and Revenue Ruling

[13]

78-197 has not been revoked. As noted above, the Tax Court, in Palmer, held that the anticipatory assignment of income doctrine did not apply based on the fact that the charity was not legally obligated to proceed with the redemption of the donated shares at the time it received them, could have prevented the redemption if it so chose, and the foundation had complete dominion and control over the shares. Palmer, 62 T.C. at 694, 695. The Service followed the Palmer decision through its publication of Rev. Rul. 78-197 in which it stated that in cases factually similar to Palmer, it will treat proceeds from the redemption of stock as income to the donor only if the donee is legally bound or can be compelled by the corporation, to surrender the shares for redemption. Rev. Rul. 78-197, 1978-1 C.B. 83.

It is not certain whether the Tax Court would find Palmer and Rev. Rul. 78-197 applicable to the facts of this case in the absence of evidence that donee was legally bound or could not be compelled to sell the property. However, based on the facts you have provided thus far and on the nature of the donated property, this transaction is factually distinguishable from Palmer and the Revenue Ruling. Under the Palmer facts, although the parties anticipated that the redemption would proceed, there was neither a legally binding obligation on the part of the donee, nor could it be compelled to proceed with the redemption of the donated shares. Rather, the donee had the power to decide whether the stock should be redeemed. Under the present facts, the donated property consists of shares in a cooperative housing corporation, which generally imposes specific rules regarding their transfer. Although it is not clear to what extent the donee was legally obligated or could be compelled to carry out the taxpayers' plan to sell the property to a specific buyer at a specific time, it is highly likely that taxpayers needed the approval of the cooperative board to transfer a portion of the shares to the donee and subsequently arrange for the sale of the shares for the entire apartment. Consequently, the donee in this case would be more limited in its ability to reverse the taxpayers' plans and to decide whether, when and to whom to sell its portion of the shares than the donee in Palmer.

In addition to Ferguson, you may argue based on Blake that if you find evidence of an understanding or informal agreement between taxpayers and the donee that donee would sell its portion of the shares and proprietary lease at a certain time to a certain purchaser, this may be sufficient to sustain an argument that taxpayers retained control over the donated property. Moreover, since it is quite likely that the board would mandate that both transactions be preapproved, the board would have relied upon the taxpayers' oral representations as to the identity of the buyer and the time of the sale, and thus created a legal obligation on the part of the donee to sell its interests to that buyer based on the doctrine of promissory estoppel. It must be noted, however, that it is not clear whether Blake would be followed outside of the Second Circuit. Moreover, Blake is factually distinguishable from the present case since the taxpayer in Blake received a tangible benefit in exchange for his appreciated stock, since he donated the stock with the understanding that the donee would sell it and use the cash proceeds to purchase his yacht at an inflated price. It is not clear whether

a court outside of the Second Circuit would apply Blake under these facts, or how the facts of Notice 99-36, which relied on this case, would be viewed by a court.

Please call (202) 622-7900 if you have any questions.

Sincerely,
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