INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

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Taxpayer's Name:
Taxpayer's Address:

Taxpayer's Identification No
Year(s) Involved:
Date of Conference:

LEGEND:

Corp X	=
Sub A	=
Sub B	=
Sub C	=
Group D	=
Tax Years 1 through 4	=

ISSUE:

Whether the taxpayer's conveyances of its railroad rights-of-way to qualified trail providers pursuant to 16 U.S.C. § 1247(d) constitute charitable contributions deductible under I.R.C. § 170(a).

CONCLUSIONS:

The taxpayer's conveyances of its railroad rights-of-way are transfers of partial interests in real property. Provided that the transfers otherwise satisfy the requirements of I.R.C. § 170, the transfers would constitute deductible charitable contributions, only if the possibility that the property will revert to the taxpayer or its assigns is remote under

Income Tax Regulations § 1.170A-7(a)(3). The determination of remoteness is factual for each conveyance.

The parties have taken an unusual procedural stance in this TAM. They have effectively argued that the conveyances at issue are deductible or not under I.R.C. § 170, as a *matter of law*. Examination reads the conditions imposed by the Rails to Trails Act on “rail bank” transfers as creating an impermissible, substantial remainder in the Taxpayer. Taxpayer reads the same provisions as transferring its interest (except for a remote possibility of reversion) to trail providers for public, charitable purposes. We disagree with both parties’ interpretation. We have concluded that the relevant provisions of U.S.C. Title 16 neither prevent nor compel deductions under I.R.C. § 170. The ultimate determination of deductibility, is factual, i.e., how remote is the possibility of the property reverting to the taxpayer or its assigns. Because Examination and the taxpayer did not provide us with an agreed factual record, we return this case to Examination for factual development and the ultimate determination of remoteness under the legal standards discussed herein.

FACTS:

Corp X and Subs A, B, and C are railroads, collectively referenced here as the taxpayer. In Tax Years 1 through 4, taxpayer conveyed its interests in certain railroad rights-of-way for interim trail use under 16 U.S.C. § 1247(d). There were seven such conveyances, all of which followed taxpayer’s required applications to the Interstate Commerce Commission (ICC) or the Surface Transportation Board (STB) to abandon the taxpayer’s rights-of-way.

Ceasing rail service and abandoning railroad rights-of-way are important business decisions. Railroads decide to abandon line that they consider unprofitable and economically unsustainable. The file documents the taxpayer’s extensive consideration of the proposal to abandon the lines of Subs A and C. The taxpayer’s decision making process on Sub B’s line is less documented, but the taxpayer represents that the consideration of all abandonment decisions is similarly thorough and extensive.

Railroads are regulated public utilities and must receive governmental approval of changes in operation, especially abandonment. Pursuant to the relevant administrative procedures, the taxpayer applied to the ICC and STB to cease rail service and to abandon its rights-of-way. The government regulators may take one of two actions: (1) allow the railroad to abandon the right-of-way outright and permanently or (2) allow the railroad to cease operations and “abandon” the right-of-way temporarily (often indefinitely) during a period of interim trail use under 16 U.S.C. § 1247(d). 16 U.S.C. § 1247(d) was added to the National Trails System Act to encourage interim trail use and discourage outright abandonment.

Under the process, a railroad indicates that it desires to convey an interim trail use to a qualified trail provider. Under the Rails to Trails regime, a “qualified trail provider” is defined as a state, political subdivision, or qualified private organization that is prepared

to assume full responsibility for management of railroad rights-of-way and for any legal liability arising out of such transfer or such use, and for the payment of any and all taxes that may be levied or assessed against the railroad rights-of-way. Section 1247(d).

If the railroad intends to enter into an interim trail use, or "rail bank", agreement, the STB will issue either a "Certificate of Interim Trail Use or Abandonment" (CITU) or, in the case of a proceeding involving the exemption of a route from federal regulation, a "Notice of Interim Trail Use or Abandonment" (NITU). The CITU or NITU will provide that any interim trail use is (1) subject to future restoration of rail service and (2) conditioned on the trail provider continuing to meet the financial obligations of the right-of-way. When the STB issues a CITU or NITU, the railroad can discontinue operations, remove track, and take any other measures consistent with the cessation of railroad operations.

The railroad and the trail provider execute an agreement governing the interim trail use (conveyance or transfer agreement). Typically, the railroad will be allowed to discontinue current service while retaining the right to resume rail operations on the line in the future. In the interim, the right-of-way may be used as a trail as long as the trail provider continues to assume responsibility for the property. Interim trail use under a CITU or a NITU may cease on the occurrence of either of two events: (1) the trail provider decides to cease trail operations; or (2) railroad service resumes (reactivation). The railroad that conveyed the interim use may petition the STB to vacate the trail use order so that it may reactivate the line. Also, parties other than the conveying railroad, for example competitor railroads or customers in the service area, may request permission to reactivate the rail line. Third parties seeking reactivation must obtain the concurrence of the abandoning railroad, if available, and must obtain authorization (under 49 U.S.C. §10901) or exemption (under 49 U.S.C. §10502) to construct and operate a rail line over the right-of-way. See, Iowa Power, Inc.—Construction Exemption—Council Bluffs, IA, 8 I.C.C. 2d 858 (1990).

Trail use agreements typically address the possibility of reactivation. Four of the seven conveyances include agreements requiring the railroad to compensate the trail provider should the taxpayer reactivate the lines. In two of the agreements the taxpayer is required to pay the provider the fair market value of the right-of-way upon reactivation. The other two agreements do not specify an amount of compensation but require the taxpayer to pay a reasonable amount for any improvements that the user made to the property.

Taxpayer conveyed its railroad rights-of-way to the trial providers via quitclaim deed. In some instances, the taxpayer and its subsidiaries owned some of the property underlying the rights-of-way in fee simple. More commonly, the taxpayer had a non-fee interest, an easement.

LAW AND ANALYSIS:

Rails to Trails

As the demand for rail transportation has declined, railroads have sought to discontinue service on unprofitable lines and abandon certain rights-of-way. Before legislative intervention, a railroad that (with regulatory approval) discontinued rail service on its right-of-way had two options: (1) hold and maintain the unused right-of-way or (2) abandon its right-of-way. The first option preserved the railroad's property for potential reactivation of the line; but it was usually too economically burdensome. The second option was unattractive because it was permanent and did not preserve the reactivation option. Railroad rights of way are normally easements carved from underlying fee estates. Under common law (most local law), an abandoned easement reverts to the underlying fee estate. Most abandoned railroad easements would revert permanently to the owners of the land from which the easement was carved. Unconditional or permanent abandonment terminates the right-of-way and eliminates the possibility of future rail service in that corridor.

Congress enacted the legislation, described below, to allow railroads to cease rail service and to avoid the costs of maintaining an unused right-of-way, while preserving the rights-of-way for possible future rail use. In enacting legislation, Congress stated that it viewed the preservation of railroad rights-of-way as an important national interest.

Congress first enacted the National Trails System Act in 1968 (Pub. L. 90-543) (codified as amended at 16 U.S.C. §§ 1241 et seq.) to establish a nationwide system of nature trails. Congress reserved to itself the right to designate scenic and historic trails, and delegated to the Secretaries of the Interior and of Agriculture the authority to designate recreational trails, and to develop and administer the entire trail system. See 16 U.S.C. §§ 1243, 1244, 1246. As originally enacted, the Trails Act made no specific provision for the conversion of railroad rights-of-way to trails.

In 1976, concerned about the loss of railroad rights-of-way, Congress included in the Railroad Revitalization and Regulatory Reform Act of 1976 (Pub. L. 94-210), several provisions to promote the conversion of railroad lines to trails. Among other things, the act authorized the Secretary of the Interior to provide financial, educational, and technical assistance to various government entities for programs to convert unused railroad rights-of-way to recreational and conservation uses.

In 1983, Congress determined that previous measures were not successful in encouraging conversion of railroad rights of way to trails. H.R. Rep. No. 28, 98th Cong., 1st Sess. 8 (1983); S. Rep. No. 1, 98th Cong., 1st Sess. 9 (1983). A major impediment was the state of the property interest; the rights-of-ways were easements. Adjacent property owners claimed that the abandoned property (easements) reverted to them upon abandonment. Congress removed the impediment with a provision known as the "Rails to Trails Act," a part of the National Trails System Act Amendments of 1983 (Pub. L. 98-11)(codified as 16 U.S.C. § 1247(d)). This law provided:

> If a State, political subdivision, or qualified private organization is prepared to assume full responsibility for management of such rights-of-way and for

> any legal liability arising out of such transfer or use, and for the payment of any and all taxes that may be levied or assessed against such rights-of-way, then the Board shall impose such terms and conditions as a requirement of any transfer or conveyance for interim use in a manner consistent with this chapter, and shall not permit abandonment or discontinuance inconsistent or disruptive of such use.

This amendment ensures that the interim trail use of a railroad right-of-way will not be treated for purposes of any law as a permanent abandonment of such right-of-way for railroad purposes. "By deeming interim trail use to be like discontinuance rather than abandonment,…Congress prevented property interests from reverting under state law.…" Preseault v. I.C.C., 494 U.S. 1, 8 (1990). The provision preserves the right-of-way for future railroad use even though service is discontinued presently and the tracks removed. H.R. Rep. No.28, at 9 .

The statutory scheme accomplishes a very specific goal: preservation of the railroad right-of-way in case of future need. In effect, a railroad may discontinue rail service and permanently abandon the right-of-way, only if the railroad cannot reach an agreement with a trail provider within the time period prescribed by the CITU or NITU and any extensions. Both the conveying railroad and any other interested railroads retain the right to request reactivation of the rights-of-way transferred for trail use. The conveying railroad has a possibility of reverter of the easement (right-of-way). The conveying railroad reactivates the right-of-way by petitioning the STB to vacate the trail use order. Third parties seeking reactivation must obtain the concurrence of the abandoning railroad, if available, and must obtain authorization or exemption to construct and operate a rail line over the right-of-way.

Under the statutory scheme, an incentive for railroads to contribute the use of the rights-of-way is a possible charitable deduction. 16 U.S.C. § 1246(k) states:

> For the conservation purpose of preserving or enhancing the recreational, scenic, natural, or historical values of . . . the national trails system, . . . landowners are authorized to donate or otherwise convey qualified real property interests to qualified organizations consistent with section 170(h)(3) of Title 26, including, but not limited to, right-of-way, open space, scenic, or conservation easements, without regard to any limitation on the nature of the estate or interest otherwise transferable within the jurisdiction where the land is located. The conveyance . . . shall be deemed to further a Federal conservation policy and yield a significant public benefit for purposes of section 6 of Public Law 96-541.

Describing section 1246(k), House Report 98-28 states that the statute:

> authorizes a wide variety of interests in land which can be utilized to protect trail areas and environs such as easements which would not require a qualified grantee to own fee title to appurtenant lands.

> This provision does not change existing tax law or regulations, but is intended to better define the types of interests in land that qualify under existing law when related to trail purposes. The Committee's intent is that easements donated pursuant to this provision shall have the same tax benefits to the donor as provided in [I.R.C. § 170].

H. Rep. No.28 at 8.

Under 16 U.S.C. § 1246(k) contributions of rights-of-way for interim trail use are deemed to further a "Federal conservation policy", as well as yield a "significant public benefit", and consequently, may qualify as charitable contributions if they otherwise meet the requirements of I.R.C. § 170. However, 16 U.S.C. § 1246(k) does not create or constitute an independent basis for deduction under I.R.C. § 170, as the taxpayer at one point in this case argued.

Charitable Contribution Deduction under I.R.C. §170

I.R.C. § 170(a) allows a deduction for charitable contributions described in § 170(c). In relevant part, § 170(c) defines the term "charitable contribution" as a contribution or gift to or for the use of qualifying entities (not operating for private benefit, engaging in prohibited lobbying and political activities, etc.). The taxpayer has represented that the trail providers are qualifying entities, and Examination has not challenged that representation.

I.R.C. § 170(f)(3)(A) generally disallows a deduction for the contribution of a partial interest in property. The taxpayer makes several arguments to avoid the prohibition of the deduction under this section.

Full Interest Not Conveyed

First, the taxpayer argues that it transferred its full interest in the property to the trail provider. That is, taxpayer had only an easement interest in the property, transferred that easement interest, retained no real property interest, and has only an option to repurchase the easement. If so, the transfer would not be a gift of a partial interest under I.R.C. § 170(f)(3)(A) and would qualify for a deduction under I.R.C. § 170(a) as a charitable contribution defined in I.R.C. § 170(c)(2). (Taxpayer would also contend that the transfer of its full interest in the property to the trail provider would be a "qualified conservation contribution" within the meaning of I.R.C. § 170(h)(1), because 16 U.S.C. § 1246(k) deems a rail bank conveyance to "further a Federal conservation policy and yield a significant public benefit…")

Examination disagrees. It views the conveyances as transfers of only part of the taxpayer's interest in the property to the trail providers. That is, the taxpayer retains a partial interest in the property: the right to use the easement in the future upon

application to the appropriate government authority for reactivation of rail service. We agree with Examination.

The taxpayer states that the transfer agreements generally require the taxpayer to pay the trail provider to reactivate rail service. Four of the agreements actually provide that the taxpayer would have to pay the trail provider compensation of either the fair market value of the easement or for any improvement costs. With respect to the three remaining agreements not specifically providing for compensation, the taxpayer argues that compensation would be imputed. The taxpayer argues that, in effect, it has to repurchase the full interest in the easement held by the trail user. The taxpayer reasons that, if it has to repurchase what it conveyed to the trail provider, the taxpayer must have conveyed its full interest in the easement. In other words, the taxpayer would not have to buy the property had it retained such interest.

The taxpayer cites Rev. Rul. 76-151, 1976-1 C.B. 59, as support for this position. The ruling held that a corporation's conveyance of land and a building to a charitable organization was a charitable contribution, even though the corporate donor reserved the right to repurchase the land and building at its fair market value if the charitable organization ceased to use the property (for charitable purposes) and decided to dispose of it. The revenue ruling merely mentioned the reserved repurchase option and did not analyze its impact on the contribution. We agree with the taxpayer that Rev. Rul. 76-151 implies that repurchase at fair market value may be a factor indicating that the taxpayer conveyed substantially all its interest in the property. However, even if the taxpayer must expend funds in order to reactivate the line, the right to repurchase in the present case is distinguishable from the situation in the revenue ruling because the taxpayer has the power to reacquire the property independent of whether the donee wants to keep the property (and continue using it for public purposes). Taxpayer retains a power adverse to the donee and can effectively terminate the donee's interest by successfully applying to reactivate the rail line. In Rev. Rul. 76-151, control over the possible reacquisition ran the other way. The donee's actions were the default condition triggering the donor's option to repurchase. In the present case, the taxpayer controls the exercise of the option to reacquire, and has the right to interfere with, and terminate, the donee's use of the property. We think that the taxpayer's right to reacquire the property (right-of-way easement), adverse to the trail provider, is tantamount to a retained property interest making the taxpayer's contribution a partial interest under I.R.C. § 170(f)(3)(A).

Substantial Retained Interest

Taxpayer also argues that, even if it retains an interest in the property (right-of-way), the retained interest is so *insubstantial* that its deduction should be allowed. Treas. Reg. § 1.170A-7(b)(1)(i) provides an insubstantiality exception to I.R.C. § 170(f)(3)(A)'s prohibition on the deductibility of partial interests. Stark v. Commissioner, 86 T.C. 243 (1986) is the leading case on the insubstantiality rule. The Internal Revenue Service has also recognized the principle in several published rulings analyzed in the Stark opinion.

We think that insubstantiality rule embodies a de minimis exception to the general prohibition against substantial private benefit redounding to a donor of a charitable gift. At 86 T.C. 252, the Stark court explained the basis of the exception:

> We hold that the "insubstantiality rule" expressed in Rev. Ruls. 75-66 and 76-331 represent an accurate legal conclusion. Where the interest retained by the taxpayer is so insubstantial that he has, in substance, transferred his entire interest in the property, the tax treatment should so reflect. Such a taxpayer satisfies the original congressional purpose behind section 170(f)(3), and under section 1.170A-7(b)(1)(i). Income Tax Regs., a minor deviation from a literal application of the statute is appropriate.

Examination views the taxpayer's conveyances as attempts to gain a substantial economic benefit, i.e., avoid the cost and burden of maintaining unused rights-of-way but retain the right to reactivate service (a valuable asset) in the future should it become economically advantageous. Examination stresses that, absent 16 U.S.C. § 1247(d), the taxpayer's conveyances of its rights-of-way (for non-railroad use) would have failed under state law; the taxpayer's property interests (easements) would have terminated and the property would have permanently reverted back to the land from which they were carved. In that event, the taxpayer would have abandoned its easements and had no remaining property to convey to the trail provider. 16 U.S.C. § 1247(d) gave the taxpayer the ability to "rail bank" the property, i.e., to prevent reversion by agreeing to interim use by a trail operator. Examination contends that section 16 U.S.C. § 1247(d) operated to permit the taxpayer to retain a substantial interest in the property. Examination, argues that the arrangement violates the prohibition against substantial retained interests in Treas. Reg. § 1.170A-7(b)(1)(i).

As explained, we think that the taxpayer has retained a partial interest in the rights-of-way that it has conveyed to trail providers. The interest is a possible reversion upon reactivation of rail service. That retained interest has *potential* value to the taxpayer.

The substantiality of a retained interest is usually judged in terms of its value. The Stark court explained at 86 T.C. 252 and 253:

> To be entitled to any deduction, the taxpayer must prove that her situation comes within a particular statutory provision. New Colonial Ice Co. v. Helvering, 292 U.S. 435 (1934). We therefore construe the insubstantiality rule narrowly. See Commissioner v. National Alfalfa Dehydrating & Milling Co., 417 U.S. 134 (1974). A charitable contribution deduction should be allowed only where the retained interest has a de minimis value. Cf. E.I. duPont de Nemours & Co. v. United States, 432 F.2d 1052, 1055 (3d Cir. 1970), where, in determining whether the transfer of patent rights constituted a sale, the court stated, "To determine whether the taxpayer did transfer all of the *substantial* rights in the patents in question, the key question is whether the transferor retained any rights which, in the aggregate, have substantial *value*." (Emphasis supplied. [by the court])

> Moreover, the insubstantial retained interest must not potentially interfere in any manner with the donee's interest.

Taxpayer makes two arguments that the agreements with the trail providers demonstrate that its possibility of reverter has de minimis value. First, in order to reactivate the lines, the taxpayer would have to either repurchase the right-of-way from the trail provider or compensate the provider for improvements to the property. In other words, the taxpayer would have to make quite substantial payments in order to realize the benefits. Second, the potential value to the taxpayer of the reversion interest in the property, discounted for the taxpayer's payment to reacquire the use of the right-of-way, would probably be insubstantial.

Also, the taxpayer contends that 16 U.S.C. § 1246(k) states that rail bank conveyances "shall be deemed to further a Federal conservation policy and yield a significant public benefit for purposes of section 6 of Public Law 96-541." The taxpayer argues that the statute contains a clear indication that Congress considered these conveyances to be predominately for the public benefit. Consequently, Congress must have viewed the private benefit inherent in the statutory scheme to be incidental and insubstantial.

The taxpayer also contends that the possibility of reacquisition and reactivation (reverter) is very remote, therefore the interest can not be very valuable. Clearly, remoteness affects value. The value of a benefit with a remote possibility of realization is usually considered less than the value of a similar benefit likely to be realized. However, even though value and remoteness are closely related factors, neither factor is completely determinative of the other. The regulatory scheme distinguishes the factors and treats remoteness as a separate inquiry. See Treas. Reg. § 1.170A-7(a)(3). We address remoteness separately in the next section.

However, in Stark v. Commissioner, 86 T.C. 243, 252-53 (1986), the court cited another important factor for determining insubstantiality: "Moreover, the insubstantial retained interest must not potentially interfere in any manner with the donee's interest."

The taxpayer argues that its power to reacquire under the National Trails Act scheme is insubstantial because the statute gives other railroad carriers an equivalent or similar power to reactivate. See, Norfolk and Western Railway – Abandonment Between St. Mary's and Minster in Auglaize County, OH, 9 I.C.C. 2d 1015 (1993); Iowa Power, Inc.—Construction Exemption—Council Bluffs, IA, 8 I.C.C. 2d 858 (1990). The taxpayer thinks that the sharing of the power to reactivate with other parties and agency review of reactivation requests dilute the taxpayer's ability to interfere with the donees' interests. The taxpayer's argument is not persuasive, because it concedes that it has retained the interest (possibility of reverter) in the property (the easement).

Examination stresses the fact that the taxpayer can initiate an administrative action for reactivation at its pleasure. Examination thinks that power enables the taxpayer to interfere with the donee's property interest in contravention of the Stark standard. We agree that the taxpayer's power to initiate (unilaterally or in concert with potential

customers and/or other carriers) an administrative action to reacquire and reactivate the lines could constitute a substantial interference with the donees' (trail providers') interest in the property.

Remoteness Exception for Partial Interests

Under Treas. Reg. §1.170A-7(a)(3), a deduction of a partial interest of property will not be disallowed merely because the interest which passes to, or is vested in, the charity may be defeated by the performance of some act or the happening of some event, if on the date of the gift it appears that the possibility that such act or event will occur is so remote as to be negligible. See also Treas. Reg. § 1.170A-1(e).

The language "so remote as to be negligible" in Treas. Reg. § 1.170A-7(a)(3) is identical to the language in the estate tax regulations. Hence, beginning with Briggs v. Commissioner, 72 T.C. 646 (1979), courts have used the standards in estate tax precedent to determine remoteness for I.R.C. § 170 purposes. At 72 T.C. 656 and 657, the Briggs court explained:

> The phrase "so remote as to be negligible" as it appears section 20.2055-2(b), Estate Tax Regs., has been defined as "a chance which persons generally would disregard as so highly improbable that it might be ignored with reasonable safety in undertaking a serious business transaction." United States v. Dean, 224 F.2d 26, 29 (1955). It is likewise a chance which every dictate of reason would justify an intelligent person in disregarding as so highly improbable and remote as to be lacking in reason and substance. Estate of Woodworth v. Commissioner, 47 T.C. 193, 196 (1966). See United States v. Provident Trust Co., 291 U.S. 272 (1934). Because the operative language of section 20.2055-2(b), Estate Tax Regs., is identical to that contained in section 1.170A-1(e), Income Tax Regs., we believe that these prior interpretations of the "so remote as to be negligible" language of section 20.2055-2(b), Estate Tax Regs., are instructive in this [I.R.C. § 170(c)] case.

See also 885 Investment Co. v. Commissioner, 95 T.C. 156, 161-62 (1990). In addition, courts have applied these standards regarding remoteness in conservation easements cases. See Satullo v. Commissioner, T.C. Memo 1993-614, aff'd without published opinion, 67 F.3d 314 (11th Cir. 1995); Stotler v. Commissioner, T.C. Memo 1987-275. The Service has consistently ruled that the chances of an event occurring is "so remote as to be negligible" under estate tax regulations when the chance that the event will occur is less than 5 percent. See Rev. Rul. 85 -23, 1985-1 C.B. 327; Rev. Rul. 78-255, 1978-1 C.B. 294; Rev. Rul. 77-374, 1977-2 C.B. 329.

Probability and possibility are factual concepts. Treas. Reg. § 1.170A-7(a)(3) contemplates a factual determination of the remoteness of the possibility of reverter. The case law is consistent. Consequently, we disagree with Examination that the taxpayer's conveyances of its rights-of-way to a trail providers pursuant to 16 U.S.C. § 1247(d) fail, *as a matter of law*, to constitute charitable contributions deductible under

I.R.C. § 170. Whether the possibility of reverter is so remote as to be negligible depends on the facts of each transfer.

The case law looks to specific factors to determine the likelihood of the contribution being defeated: (A) whether the donor and donee intend at the time of the donation to cause the event's occurrence, (B) the incidence of the event's occurring in the past, (C) the extent to which the occurrence of the event would defeat the donation, and (D) whether the taxpayer has control over the event's occurrence. Examination should follow the standards described above to make its factual determination on remoteness of the possibility of reversion.

Factual Determination

As stated above, Examination and the taxpayer have failed to submit an agreed statement of facts. In largely parallel submissions, the parties challenge each other's assertions of critical facts concerning intent, the number and scale of reactivations that have occurred in the past, and the power of the taxpayer to effect a reactivation. For that reason, this office can not reach a conclusion on the facts underlying the issues of remoteness and substantiality. Therefore, we are returning the case to Examination for the final determination based on further factual development.

CAVEAT(S):

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.