CONSERVATION EASEMENTS, LEGITIMATE RISKS, AND TAX RESULT INSURANCE

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With the IRS aggressively auditing "syndicated"' partnerships that make conservation easement donations, some partnerships obtain a financial product known as tax result insurance, but the IRS has started to question this practice.

Introduction

The IRS is aggressively attacking so-called "syndicated" partnerships that make conservation easement donations to charity. Some of its favorite weapons include (1) identifying certain easements as "listed transactions" in Notice 2017-10, thereby mandating the filing of Forms 8886 (Reportable Transaction Disclosure Statement) and Forms 8918 (Material Advisor Disclosure Statement) by various parties; (2) launching a "compliance campaign" and enlisting the services of dozens of specialized Revenue Agents; (3) featuring easements on the IRS's "dirty dozen" list; (4) engaging in a widespread practice of completely disallowing easement-related tax deductions and imposing severe penalties, regardless of the strength of the facts in a particular case; and (5) employing a throw-everything-at-the-wall-and-see-what-sticks philosophy when it comes to raising technical, legal, tax, procedural, and valuation-based arguments. This creates risks for partnerships, and lots of them.

In an effort to cope with these risks, some partnerships obtain a financial product known by many names, among them tax gap insurance, tax result insurance, tax protection insurance, or tax indemnity insurance ("Tax Result Insurance"). The IRS, suspecting nefarious motives at every turn, has started questioning this practice. This article provides an overview of the conservation easement donation process, the evolution of IRS challenges, the recent attention to Tax Result Insurance, and the realities facing the IRS if it continues down this path.

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Overview of the conservation easement donation process

One must first have a basic understanding of the applicable terms and concepts in order to appreciate the significance of this article.

What is a qualified conservation contribution? Taxpayers generally may deduct the value of any charitable contribution that they make during a year.[1] However, taxpayers are not entitled to deduct donations of property, if they consist of less than their entire interest in such property.[2] One important exception is that taxpayers can deduct a donation of a partial interest in property (instead of an entire interest), provided that it constitutes a "qualified conservation contribution."[3] To meet this critical definition, taxpayers must show that they are (1) donating a qualified real property interest ("QRPI"),

(2) to a qualified organization, (3) exclusively for conservation purposes.[4]

What is a QRPI? A QRPI can be one of several things, including a restriction, granted in perpetuity, on the use of a particular piece of real property.[5] This is known by many names, among them "conservation easement" and "conservation restriction."[6] Regardless of what you call them, QRPIs must be based on legally enforceable restrictions, memorialized in a Deed of Conservation Easement filed with the proper court or other location, preventing uses of the property, forever, which are inconsistent with the conservation purposes.[7]

For what purposes can land be conserved? A donation has a "conservation purpose" if it meets one of the following requirements: (1) it preserves land for outdoor recreation by, or the education of, the general public; (2) it preserves a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem; (3) it preserves open space (including farmland and forest land) for the scenic enjoyment of the general public and will yield a significant public benefit; (4) it preserves open space (including farmland and forest land) pursuant to a federal, state, or local governmental conservation policy, and will yield a significant public benefit; or (5) it preserves a historically important land area or a certified historic structure.[8] Such conservation purposes must be protected forever in order to trigger the tax deduction. Indeed, a donation is not treated as "exclusively for conservation purposes," unless the conservation purposes are "protected in perpetuity."[9]

Can taxpayers reserve rights in the protected property? A taxpayer can retain certain "reserved rights," still make a qualified conservation contribution, and thus qualify for the tax deduction. However, in keeping something for themselves, taxpayers must ensure that the reserved rights do not unduly conflict with the conservation purposes.[10] The IRS openly recognizes, in its Conservation Easement Audit Techniques Guide ("ATG"), that reserved rights are ubiquitous. The ATG states the following about taxpayer holdbacks:

> *All conservation easement donors reserve some rights to the property.* Depending on the nature and extent of these reserved rights, the claimed conservation purpose may be eroded or impaired to such a degree that the contribution may not be allowable. A determination of whether the reserved rights defeat the conservation purpose must be determined based on all the facts and circumstances.[11]

In an effort to cope with risks of claiming conservation easement donations, some partnerships obtain a financial product known by many names, among them tax gap insurance, tax result insurance, tax protection insurance, or tax indemnity insurance.

The regulations provide more specifics about reserved rights and uses that might be inconsistent with the conservation purpose of an easement.

> [A] deduction will not be allowed if the contribution would accomplish one of the enumerated conservation purposes but would permit destruction of other significant conservation interests … However, this requirement is not intended to prohibit uses of the property, such as selective timber harvesting or selective farming if, under the circumstances, those uses do not impair significant conservation interests … A use that is destructive of conservation interests will be permitted only if such use is necessary for the protection of the conservation interests that are the subject of the contribution … A donor may continue a pre-existing use of the property that does not conflict with the conservation purposes of the gift.[12]

How do taxpayers prove the condition of the property at donation time? In situations involving the donation of a QRPI where the donor reserves certain rights, the tax deduction will not be allowed unless the donor "makes available" to the easement-recipient, before the donation is made, "documentation sufficient to establish the condition of the property at the time of the gift."[13] This is generally called the Baseline Report.

The Baseline Report "may" (but not "must") include (1) the appropriate survey maps from the U.S. Geological Survey, showing the property line and other contiguous or nearby protected areas, (2) a map of the area drawn to scale showing all ex-

1 Section 170(a)(1); Reg. 1.170A-1(a).
2 Section 170(f)(3)(A); Reg. 1.170A-7(a)(1).
3 Section 170(f)(3)(B)(iii); Reg. 1.170A-7(a)(5).
4 Section 170(h)(1).
5 Section 170(h)(2); 1.170A; 1.170A.
6 treglink>.
7 1.170A; *Turner*, 126 TC 299, 311 (2006).
8 Section 170(h)(4)(A); 1.170A; S. Rept. 96–1007, at 10 (1980).
9 Section 170(h)(5)(A); Reg. 1.170A-14(e)(1).
10 Reg. 1.170A-14(b)(2).
11 IRS, Conservation Easement Audit Techniques Guide (Rev. 11/4/16), p. 23.
12 Reg. 1.170A-14(e)(2) and (3).
13 Reg. 1.170A-14(g)(5)(i).

isting man-made improvements or incursions (*e.g.*, roads, buildings, fences, or gravel pits), vegetation, and identification of flora and fauna (*e.g.*, locations of rare species, animal breeding and roosting areas, and migration routes), land use history, and distinct natural features, (3) an aerial photograph of the property at an appropriate scale taken as close as possible to the date of the donation, and (4) on-site photographs taken at appropriate locations on the property.[14] If the easement contains restrictions regarding a particular natural resource, such as water or air quality, the condition of the resource at or near the time of the donation must be established.[15]

The regulations provide special rules for calculating a deduction stemming from the donation of a conservation easement.

What is an easement worth? Generally, a deduction for a charitable donation is allowed in the year in which it occurs.[16] If the donation consists of something other than money, the amount normally is the fair market value ("FMV") of the property at the time the taxpayer makes the donation.[17] For these purposes, the term FMV ordinarily means the price on which a willing buyer and willing seller would agree, with neither party being obligated to participate in the transaction, and with both parties having reasonable knowledge of the relevant facts.[18]

The regulations provide special rules for calculating a deduction stemming from the donation of a conservation easement.[19] The IRS provides the following summary and hints about valuation to its personnel in the ATG. It explains that the best evidence of FMV of an easement is the sale price of easements comparable to the easement in question, but, "in most instances, there are no comparable easement sales."[20] Appraisers, therefore, often must use the before-and-after method. The ATG acknowledges that this effectively means that an appraiser must determine the highest and best use ("HBU"), *and* the corresponding FMV of the relevant property twice. First, the appraiser calculates the FMV if the property were put to its HBU, which generates the "before" value. Second, the appraiser identifies the FMV, taking into account the restrictions on the property imposed by the easement, which creates the "after" value.[21] The difference between the "before" and "after" value, with certain other adjustments, produces the value of the easement donation.

As indicated in the preceding paragraph, in deciding the FMV of property, appraisers and courts must take into account not only the current use of the property, but also its HBU.[22] A property's HBU is the highest and most profitable use for which it is adaptable and needed, or likely to be needed, in the reasonably near future.[23] The term HBU has also been defined as the reasonably probable use of vacant land or improved property that is physically possible, legally permissible, financially feasible, and maximally productive.[24] Importantly, valuation does not depend on whether the owner has actually put the property to its HBU.[25] The HBU can be *any* realistic potential use of the property.[26] Common HBUs are construction of a residential community, creation of a mixed-use development, and mining the property.

How do taxpayers claim an easement-related tax deduction? Properly claiming the tax deduction triggered by an easement donation is complicated. It involves a significant amount of actions and documents. The main ones are as follows: The taxpayer must (1) obtain a "qualified appraisal" from a "qualified appraiser," (2) demonstrate that the easement-recipient is a "qualified organization," (3) obtain a Baseline Report describing the condition of the property at the time of the donation and the reasons why it is worthy of protection, (4) complete a Form 8283 (Noncash Charitable Contributions) and have it executed by all relevant parties, including the taxpayer, appraiser, and easement-recipient, (5) assuming that the taxpayer is a partnership, file a timely Form 1065, enclosing the Form 8283 and qualified appraisal, (6) receive from the easement-recipient a proper "contem-

[14] Reg. 1.170A-14(g)(5)(i).
[15] Reg. 1.170A-14(g)(5)(i).
[16] Section 170(a)(1).
[17] Section 170(a)(1); Reg. 1.170A-1(c)(1).
[18] Reg. 1.170A-1(c)(2).
[19] Reg. 1.170A-14(h)(3)(i).
[20] IRS, Conservation Easement Audit Techniques Guide (Rev. 11/4/16), p. 41.
[21] Ibid.
[22] *Stanley Works & Subs.*, 87 TC 389, 400 (1986); 1.170A and (ii).
[23] *Olson*, 292 U.S. 246, 255 (1934).
[24] *Esgar Corp.*, 744 F.3d 648, 659 n.10 (CA-10, 2014).
[25] *Esgar Corp.*, 744 F.3d 648, 657 (CA-10, 2014).
[26] *Symington*, 87 TC 892, 896 (1986).
[27] *See* IRS, Conservation Easement Audit Techniques Guide (Rev. 11/4/16), pp. 24-30; IRS Publication 1771, Charitable Contributions—Substantiation and Disclosure Requirements; IRS Publication 526, Charitable Contributions; Section 170(f)(8); Section 170(f)(11); Reg. 1.170A-13; Notice 2006-96; TD 9836.
[28] IRS, Conservation Easement Audit Techniques Guide. (Rev. 11/4/16).

poraneous written acknowledgement," both for the easement itself and for any endowment/stewardship fee donated to finance the perpetual protection of the property, (7) ensure that all mortgages on the relevant property have been satisfied or subordinated to the easement, and (8) send all the partners their Schedule K-1 (Partner's Share of Income, Deductions, Credits, etc.) and a copy of the Form 8283.[27]

Evolution of attacks by IRS

The IRS has been advancing a series of arguments to challenge partnerships donating conservation easements, and the list continues to expand.

Common technical arguments raised by the IRS. The IRS has published an ATG concerning conservation easement donations, which Revenue Agents and other IRS personnel often follow when conducting examinations.[28] The ATG contains a "Conservation Easement Issue Identification Worksheet." It sets forth a large number of technical challenges (*i.e.*, those not related to the valuation of the conservation easement) that the IRS might raise, including the following reasons for completely disallowing an easement-related tax deduction. For purposes of clarity, below, easement donors are referred to as "Property-Holding-Partnerships" and easement recipients are called "Land Trusts."

- The donation of the easement lacked charitable intent, because there was some form of quid pro quo between the Property-Holding-Partnership and the Land Trust.
- The donation of the easement was conditional upon receipt by the Property-Holding-Partnership of the full tax deduction claimed on its Form 1065.
- The Land Trust failed to give a proper "contemporaneous written acknowledgement" letter.
- The appraisal was not attached to the Form 1065 filed by the Property-Holding-Partnership.
- The appraisal was not prepared in accordance with the Uniform Standards of Professional Appraisal Practice.
- The appraisal fee was based on a percentage of the easement value.
- The appraisal was not timely, in that it was not sufficiently proximate to the making of the donation or the filing of the Form 1065 by the Property-Holding-Partnership.
- The appraisal was not a "qualified appraisal."
- The appraiser was not a "qualified appraiser."
- The Form 8283 was missing, incomplete, or inaccurate.
- The Property-Holding-Partnership's cost or adjusted basis in the donated property, as listed on Form 8283, was improperly calculated.
- Not all appraisers who participated in the analysis signed Form 8283.
- The Baseline Report insufficiently described the condition of the property.
- The conservation easement was not protected in perpetuity.
- Any mortgages or other encumbrances on the property were not satisfied or subordinated to the easement before the donation.
- The Deed of Conservation Easement contains an improper clause regarding how the proceeds from sale of the property upon extinguishment of the easement would be allocated among the Property-Holding-Partnership and the Land Trust.
- The Deed of Conservation Easement contains an amendment clause, which, in theory, might allow the parties to modify the donation, after taking the tax deduction, in such a way to undermine the conservation purposes.
- The Deed of Conservation Easement contains a merger clause, as a result of which the fee simple title and the easement might end up in the hands of the same party, thereby undermining the ability to protect the property forever.
- The Deed of Conservation Easement was not timely filed with the proper court or other location.
- The Land Trust was not a "qualified organization."
- The Land Trust was not an "eligible donee."
- The property lacks acceptable "conservation purposes" for any number of reasons, including the habitat is not protected in a relatively natural state, there are insufficient threatened or endangered species on the property, the habitat or ecosystem to be protected is not "significant," the public lacks physical or visual access to the property, the property lacks historical significance, the conservation purposes do not comport with a clearly-delineated government policy, the easement allows uses that are inconsistent with the conservation purposes, the Property-Holding-Partnership has certain "reserved rights"

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that interfere with or destroy the conservation purposes, etc.[29]

As if this were not enough, the "Conservation Easement Issue Identification Worksheet" in the ATG expressly indicates that these are not all the possibilities. Indeed, it states that "[t]his worksheet is not an all-inclusive list of potential issues for donations of conservation easements [and] users should review IRC Section 170, DEFRA section 155, the corresponding Treasury Regulations, Notice 2006-96, and case law."

The IRS has been advancing a series of arguments to challenge partnerships donating conservation easements, and the list continues to expand.

Standard positions taken by IRS in litigation The standard approach by the IRS in recent easement cases is to fully disallow the easement-related deduction claimed by the Property-Holding-Partnership based on one or more of the "technical" arguments under Section 170 described above. In other words, the IRS initially claims that the Property-Holding-Partnership is entitled to a deduction of $0 because of supposed flaws in the hundreds, if not thousands, of pages that are prepared in connection with a conservation easement. Then, as a backup plan, the IRS fully disallows the deduction for supposed valuation problems. Below is the language from a notice of Final Partnership Administrative Adjustments ("FPAA") in a recent Tax Court case, which is representative of the stance that the IRS is taking in essentially all easement cases:

> It has not been established that all the requirements of I.R.C Section 170 have been satisfied for the non-cash charitable contribution of a qualified conservation contribution. Accordingly, the charitable contribution deduction is decreased by [the entire amount claimed by the partnership on its Form 1065].
>
> Alternatively, if it is determined that all the requirements of I.R.C Section 170 have been satisfied for all or any portion of the claimed non-cash charitable contribution, it has not been established that the value of the contributed property interest was greater than zero for the [relevant year]. Accordingly, the charitable contribution is decreased by [the entire amount claimed by the partnership on its Form 1065].

In addition to fully disallowing the easement-related deduction based on a combination of alleged technical and valuation issues, the IRS ordinarily proposes in the FPAA several alternative penalties against the Property-Holding-Partnership, ranging in severity. These include (1) negligence, (2) substantial understatement of income tax, (3) substantial valuation misstatement, (4) gross valuation misstatement, or (5) reportable transaction understatement penalty.[30] This is consistent with the ATG, which explains that an FPAA "will generally include a tiering of proposed penalties with multiple alternative positions."[31]

Theories announced in IRS Notices. The IRS has been threatening for years to raise various theories for attacking conservation easements. For example, the IRS announced in Notice 2017-10 that it intended to challenge certain easement transactions on grounds that they supposedly constitute "tax-avoidance transactions" and involve overvaluations.[32] The IRS further stated in Notice 2017-10 that it might also attack easements based on the partnership anti-abuse rules, the economic substance doctrine, and/or other unspecified rules and doctrines.[33]

Theories announced in injunction lawsuit. More recently, in the complaint filed by the Department of Justice (DOJ) in District Court in December 2018 seeking an injunction against various persons in the easement industry, the DOJ alleged that the Property-Holding-Partnerships are not true partnerships for federal tax purposes, they exist solely as a conduit to "sell" tax deductions, they are

[29] IRS, Conservation Easement Audit Techniques Guide (Rev. 11/4/16), pp. 78-81.

[30] Section 6662; Section 6662A.

[31] IRS, Conservation Easement Audit Techniques Guide (Rev. 11/4/16), p. 77.

[32] Notice 2017-10, Preamble and section 1.

[33] Notice 2017-10, section 1.

[34] *Zak, Clark, EcoVest Capital Inc., Solon, McCullough, and Teal*, Case No. 1:18-cv-05774, D.C. N.D. Ga, complaint filed 12/18/18, p. 47.

[35] Ibid, pp. 48-50.

[36] *Champions Retreat Golf Founders, LLC*, TCM 2018-146. With respect to the supposed "sale" of tax deductions, the DOJ urged the District Court to determine that the sale of federal tax deductions is prohibited, the defendants created a partnership structure in an attempt to avoid this prohibition, and the use of syndicated partnerships in the context of conservation easements equates to "a thinly veiled attempt to facilitate the sale of federal tax deductions by a person who cannot fully utilize them to people who can."

[37] *Champions Retreat Golf Founders, LLC*, TCM 2018-146, p. 21 and footnote 1.

[38] Section 6011(a); Reg. 301.6011-1

[39] *See* TD 8875 (3/2/00); TD 8876 (3/2/00); TD 8877 (3/2/00); TD 8896 (8/16/00); TD 8961 (8/7/01); TD 9000 (6/18/02); TD 9017 (10/22/02); TD 9018 (10/22/02); TD 9046 (3/4/03); TD 9108 (12/30/03); TD 9350 (8/3/07).

[40] TD 8877 (3/2/00); REG-103735-00.

"shams," and they "lack economic substance."[34] Specifically, the DOJ claimed that the defendants either knew, or should have known, that (1) the Property-Holding-Partnerships that they organized, promoted, sold, and/or opined on had no business purpose other than tax avoidance, (2) the partners did not join together for the purpose of carrying on a business and sharing in the profits or losses or both of that business, and (3) the partnerships lack economic substance and are shams.[35]

Theories announced in recent Tax Court case. The IRS also showed its willingness to raise novel positions in a recent case, *Champions Retreat Golf Founders, LLC.*[36] Despite the long list of initial challenges set forth in the FPAA issued in *Champion's Retreat*, the IRS eventually decided to drop many of them. Specifically, the IRS conceded the following arguments that it raised in the FPAA or elsewhere: (1) the easement donation was not a QRPI; (2) the land trust was not a "qualified organization;" (3) the partnership made a "disguised sale" of tax deductions; (4) the allocation of the easement-related deduction to the partners did not have substantial economic effect and thus should not be respected; (5) each partner's deduction should be limited to the amount of his capital contribution to the partnership; and (6) the allocations of ordinary business loss and interest income from the partnership were incorrect and inconsistent with the terms of the pertinent partnership agreements.[37]

Recent focus on tax result insurance

Given the IRS's uncompromising attacks on Property-Holding-Partnerships making conservation easement donations, the size of many easement-related deductions, and the large fees (*e.g.*, legal, accounting, expert, etc.) associated with defending a tax dispute against the IRS, many Property-Holding-Partnerships obtain some type of insurance. It falls into two broad categories. The first is tax audit or defense insurance ("Tax Defense Insurance"), which only covers certain fees and expenses linked to tax audits, administrative appeals with the IRS, and tax litigation. Tax Defense Insurance has no relationship to the tax liability of the Property-Holding-Partnership or its partners, and the IRS, appropriately, seems to have no serious gripes about it. The second type is Tax Result Insurance, which is a different story.

The IRS regularly inquires about Tax Result Insurance during audits nowadays. A typical Information Document Request ("IDR") includes the following mandate to Property-Holding-Partnerships:

> Describe all agreements, guarantees, representation or assurances relating to tax benefits anticipated from the easement donation, including agreements to reimburse or indemnify the partnership or its partners in the event that such tax benefits were not permitted by the [IRS].

The IRS thus appears poised to add Tax Result Insurance to the long list of items that it might challenge in future easement cases. As explained below, if the IRS proceeds down this path, it must be prepared to face several realities.

Reality #1—regulations show tax result insurance is not problematic

Any person liable for paying or collecting any tax generally must prepare and file a complete return, statement, form, list, etc. according to the regulations issued by the IRS.[38] In the case of "reportable transactions," like certain conservation easement donations made by Property-Holding-Partnerships, the relevant disclosure statement is Form 8886 (Reportable Transaction Disclosure Statement), which must be filed by those who "participate" in a transaction, and Form 8918 (Material Advisor Disclosure Statement), which pertains to "material advisors" to a transaction.

The IRS published several versions of proposed, temporary, and final regulations years ago in connection with reportable transactions.[39] As shown below, they indicate that the IRS has already analyzed the issue of Tax Result Insurance and concluded that its existence is *not* problematic.

Regulations in 2000. The first set of proposed and temporary regulations, published in March 2000, was focused on disclosure statements for corporate taxpayers.[40] The Preamble stated that the IRS was concerned about the proliferation of tax shelters, and the regulations were intended to give the IRS early notification of large corporate transactions that "may be indicative of such tax shelter activity."[41] The regulations identified two categories of reportable transactions. First, those that the IRS had specifically identified as tax-avoidance transactions. Second, those that warranted further scrutiny by the IRS because they possessed characteristics common in corporate tax shelters. Those in the second category consisted of (1) transactions entered into after 2/28/00, (2) that were expected to reduce a taxpayer's federal income tax liability by more than $5 million in any single year or by a total of more than $10 million for any combination of years, and

(3) that had at least two of five characteristics highlighted by the IRS. The characteristic relevant to this article focused on "contractual protection," as follows:

> The taxpayer has obtained or been provided with *contractual protection against the possibility that part or all of the intended tax benefits from the transaction will not be sustained*, including, but not limited to, rescission rights, the right to a full or partial refund of fees paid to any person, fees that are contingent on the taxpayer's realization of tax benefits from the transaction, *insurance protection with respect to the tax treatment of the transaction, or a tax indemnity or similar agreement (other than a customary indemnity provided by a principal to the transaction that did not participate in the promotion of the transaction to the taxpayer).*[42]

Regulations in June 2002. The IRS decided to expand the reach of the disclosure requirements in June 2002. From that point forward, they would apply not only to corporations, but also to individuals, trusts, partnerships, and S corporations that participate in reportable transactions.[43]

Regulations in October 2002. The IRS changed course in October 2002 because it discovered, unsurprisingly, that "taxpayers [were] interpreting the five characteristics in an overly narrow manner and are interpreting the exceptions in an overly broad manner."[44] To remedy this, the IRS created more objective rules, which featured six new categories of reportable transactions.[45] Among the categories was one that involved insuring tax results; it was called "Transactions with Contractual Protection." The new temporary regulations stated the following:

> *A transaction with contractual protection is a transaction for which the taxpayer has obtained or been provided with contractual protection against the possibility that part or all of the intended tax consequences from the transaction will not be sustained, including,* but not limited to, rescission rights, the right to a full or partial refund of fees paid to any persons, fees that are contingent on the taxpayer's realization of tax benefits from the transaction, *insurance protection with respect to the tax treatment of the transaction, or a tax indemnity or similar agreement (other than a customary indemnity provided by a principal to the transaction that did not participate in the promotion or offering of the transaction to the taxpayer).* Notwithstanding the foregoing, a transaction will not be considered to have contractual protection solely because the issuer of a debt instrument agrees to pay additional interest to compensate the holder of such debt for withholding tax imposed on interest paid on the debt instrument, or because the requirement to pay such additional interest entitles the issuer to redeem the debt instrument.[46]

Public comments to regulations. The IRS received significant public input to the proposed and temporary regulations, which came in the form of written comments.[47] A large percentage came from insurance companies and groups.[48] They, along with other interested parties, urged the IRS to remove or modify "contractual protection" as an indicia of tax shelter activity. Ideas by various commentators are described below.

The Association of Financial Guaranty Insurers focused its input on indemnity provisions in typical business transactions. It explained that tax indemnity provisions are often included in transactions to address unexpected and unknown tax risks, not to protect tax benefits customary to a tax shelter.[49] Such risks include property taxes, sales taxes, value-added taxes, withholding, etc. The Association of Financial Guaranty Insurers argued that the proposed exception to the "contractual protection" provision was too narrow because principals generally are involved to a degree in marketing transactions, by providing financials, engaging brokers, assisting with the preparation of term sheets, and more.[50]

The Association of Financial Guaranty Insurers suggested amending the proposed regulations to clarify that customary indemnities do not trigger a Form 8886 filing requirement, regardless of

[41] TD 8877 (3/2/00), Preamble.

[42] TD 8877 (3/2/00), Preamble; Temp. Reg. 1.6011-4T(b)(3)(B).

[43] TD 9000 (6/18/02), Preamble; Temp. Reg. 1.6011-1T(a)(1).

[44] TD 9017 (10/22/02), Preamble.

[45] Ibid.

[46] TD 9017 (10/22/02); Temp. Reg. 1.6011-4T(b)(4).

[47] Stratton, "Sole Witness Testifies before IRS on Tax Shelter Regs.," 2003 Tax Notes Today 5-3 (1/8/03) (summarizing the hearing and attaching the public comments).

[48] Ibid. Comments were submitted to the IRS by the American Council on Life Insurers, Association for Advanced Life Underwriting, National Association of Insurance and Financial Advisors, Association of Financial Guaranty Insurers, Financial Security Assurance, Security Financial Life Insurance Company, and The Hartford.

[49] Stratton, "Sole Witness Testifies before IRS on Tax Shelter Regs.," 2003 Tax Notes Today 5-3 (1/8/03).

[50] Ibid.

[51] Ibid.

[52] Ibid.

[53] Ibid.

[54] Ibid.

[55] Ibid.

[56] Ibid.

[57] Ibid.

[58] Ibid.

[59] Ibid.

[60] Ibid.

whether a principal participated in promoting the transactions, and that a customary indemnity includes coverage for taxes imposed because of (1) a change in law, (2) breach of a representation, warranty, or covenant, and (3) potential sales taxes, use taxes, property taxes, value-added taxes, withholding taxes, and other taxes imposed as a result of the transaction.[51]

Similarly, the New York State Bar Association had several recommendations related to the "contractual protection" language, one of which was to exclude from the Form 8886 filing duty customary tax representations, warranties, and indemnities provided by a principal to a transaction, or a shareholder of a principal, in connection with mergers, acquisitions, or spinoffs of entities engaged in an active trade or business.[52] The main reason for the recommendation was that such provisions are commonplace, most principals engage in at least some activities that might be considered "promoting" a transaction, and requiring taxpayers involved in legitimate transactions to file Forms 8886, and forcing the IRS to scrutinize them, would be burdensome and unproductive.[53]

Clark-Bardes Consulting, the Equipment Leasing Association, and Financial Security Assurance centered their comments on the potential application of the "contractual protection" language to leasing transactions. They explained that, in leasing transactions, lessees normally participate in the negotiation of documents, provide financial statements, and supply legal opinions about good corporate standing. Thus, they suggested that the IRS specify in the regulations that a lease with customary lessee indemnities should not trigger a Form 8886 duty.[54]

The International Swaps and Derivative Association indicated that traditional financial transactions, entered into in the ordinary course of business, for legitimate business and/or investment purposes, often employ tax indemnities to cope with unexpected tax consequences. It urged the IRS to narrow the definition of "contractual protection," such that it only applies to indemnities related to unintended federal tax consequences, not foreign or state taxes.[55]

McDermott Will & Emery wrote on behalf of a managing general agent ("MGA") for several insurance companies in the business of underwriting Tax Result Insurance. It explained that the MGA only gets involved if the taxpayer provides due diligence materials and makes a series of representations similar to those made to the IRS in seeking a private letter ruling ("PLR"), MGA conducts its own underwriting process, and the transaction justifies at least a "should" level tax opinion.[56] McDermott Will & Emery also explained that taxpayers often get Tax Result Insurance as a substitute for a PLR, in situations where the IRS refuses to issue one or the process will take too long.[57]

McDermott Will & Emery argued that forcing taxpayers that purchase policies from MGAs to file Forms 8886 is inappropriate for several reasons. First, the mere act of purchasing Tax Result Insurance does not reveal an improper tax motive, because taxpayers are simply seeking to identify and minimize tax risks that would otherwise detract from the viability of a proposed transaction, and the rationales for obtaining Tax Result Insurance are roughly equivalent to those for submitting a PLR request with the IRS.[58] Second, the insurance company is not related to, or affiliated with, any organizer or promoter of the transactions in question; the policies are often sourced by insurance brokers, after being bid by numerous competing underwriters.[59] Finally, MGAs usually price the Tax Result Insurance in the range of 5% to 15% of the dollar value of the tax exposure covered, and it would not be economically viable if the total payout on similar policies were to exceed the relatively low premium payments. Thus, MGAs avoid insuring transactions that have an unacceptably high risk of failure if challenged by the IRS.

Given the IRS's uncompromising attacks on partnerships making conservation easement donations, the size of many easement-related deductions, and the large fees (e.g., legal, accounting, expert, etc.) associated with defending a tax dispute against the IRS, many partnerships claiming such donations obtain some type of insurance.

The MGAs argue that "[t]his independent underwriting may serve as a check for taxpayers on the soundness of a proposed transaction and discourage entry into a transaction that is not suitable for insurance." Based on the preceding, MGAs, through McDermott Will & Emery, suggested that the IRS modify the proposed regulations to exclude transactions with "contractual protection" from the Form 8886 obligation, if Tax Result Insurance is provided by, funded by, or otherwise obtained directly or indirectly from a person that is engaged in the insurance business generally and that did not participate in the promotion or offer of the transaction to the taxpayer.[60]

Finally, The Hartford suggested that the IRS amend the proposed regulations to exclude from the concept of "contractual protection" several

items, including customary tax indemnity provisions and Tax Result Insurance. Grounds for this recommendation were as follows:

> Tax insurance provides a needed alternative to the expenses, limitations and uncertainties associated with [PLR] requests. Purchasers of tax insurance tend to be conservative, highly risk-averse taxpayers (or their lenders or investors) who choose to reduce or transfer even a modicum of tax risk identified in their transactions in order to increase certainty. Tax insurance was created due to a market need for a financial product to facilitate extraordinary transactions that may not otherwise close within the desired time frame because of the uncertainty with respect to a tax issue … .
>
> Tax insurance is underwritten by or with the support of tax attorneys who carefully review a transaction to "weed out" weak tax positions and insure strong tax positions. In stark contrast to certain tax practitioners (and promoters) who generate fees by creative applications of the Tax Code, tax insurance underwriters are "rewarded" for providing a conservative, prudent analysis of a proposed tax position.
>
> Thus, tax insurance fills the "gap" caused by the cost, limitations, uncertainties and delays associated with [PLRs] … Tax insurance allows customary commercial transactions (albeit complex transactions) to proceed timely and with certainty of the tax consequences. Most importantly, by refusing to insure tax shelters, abusive schemes and weakly supported tax positions, the tax insurance industry injects a distinctly conservative evaluation within the community of tax professionals and helps to cultivate a culture of compliance in which corporate tax shelters are less often created.

The IRS regularly inquires about tax result insurance during audits of conservation easement donations.

Regulations in March 2003. The IRS issued final regulations in March 2003.[61] The IRS indicated that, after considering the public input, it decided to narrow the list of reportable transactions.[62] Importantly, the IRS agreed to remove Tax Result Insurance from the concept of "contractual protection." The Preamble to the final regulations explained the change of heart by the IRS as follows:

> *Commentators indicated that it was inappropriate to require the reporting of a transaction for which the taxpayer obtains tax insurance. Other commentators suggested that the contractual protection factor would require the reporting of numerous non-abusive types of transactions, such as legitimate business transactions with tax indemnities or rights to terminate the transaction in the event of a change in tax law. In response to these comments, the IRS and Treasury Department changed the focus of the contractual protection factor to whether fees [instead of tax benefits] are refundable or contingent.* However, if it comes to the attention of the IRS and Treasury Department that other types of contractual protection, including tax insurance or tax indemnities, are being used to facilitate abusive transactions, changes to the regulations will be considered.[63]

The final regulations, effective as to all transactions entered into after 2/28/03, were devoid of talk about Tax Result Insurance and focused solely on contingent fees:

> *A transaction with contractual protection is a transaction for which the taxpayer or a related party … has the right to a full or partial refund of fees … if all or part of the intended tax consequences from the transaction are not sustained. A transaction with contractual protection also is a transaction for which fees … are contingent on the taxpayer's realization of tax benefits from the transaction.* All the facts and circumstances relating to the transaction will be considered when determining whether a fee is refundable or contingent, including the right to reimbursements of amounts that the parties to the transaction have not designated as fees or any agreement to provide services without reasonable compensation.[64]
>
> [The preceding paragraph] *only applies with respect to fees paid* by or on behalf of the taxpayer or a related party to any person who makes or provides a statement, oral or written, to the taxpayer or related party (or for whose benefit a statement is made or provided to the taxpayer or related party) as to the potential tax consequences that may result from the transaction … [65]

[61] T.D. 9046 (3/4/03).

[62] Ibid.

[63] Ibid., Preamble.

[64] TD 9046 (3/4/03); Reg. 1.6011-4(b)(4)(i).

[65] TD 9046 (3/4/03); Reg. 1.6011-4(b)(4)(ii).

[66] Section 6111(b)(1)(A); Reg. 301.6111-3(b)(1). The original bill introduced in the House of Representatives did not contain the word "insuring;" it was later added by the Senate amendment to the bill, without an explanation as to why. *See* House of Representatives, American Jobs Creation Act of 2004, 108th Congress, 2nd Session, Conference Report 108-755 (10/7/04), pp. 606-609.

[67] REG-103039-05 (11/2/06).

[68] REG-103039-05 (11/2/06).

[69] Form 8886 Item 7b; IRS Instructions to Form 8886, p. 5; Reg. 1.6011-4(d).

[70] Form 8918 Item 13; Instructions to Form 8918, pp. 4-5; Reg. 301.6111-3(d)(1).

[71] Rev. Proc. 2019-3, section 4.02(1). This is an issue on which the IRS "ordinarily will not rule."

[72] Rev. Proc. 2019-3, section 3.01(90).

[73] Rev. Proc. 2019-3, section 3.02(1).

[74] Rev. Proc. 2019-3, section 3.02(2).

[75] Rev. Proc. 2019-3, section 3.02(5).

Regulations in 2006. Section 6111 previously required certain "tax shelter organizers" to register transactions with the IRS. This changed in 2004 with the enactment of the American Jobs Creation Act. New Section 6111 mandated that "material advisors" disclose reportable transactions by filing Forms 8918. Important for purposes of this article, Congress decided to include among the material advisors parties involved in insuring a reportable transaction. The new law indicated that the term "material advisor" means "*any person who provides material aid, assistance, or advice with respect to* organizing, managing, promoting, selling, implementing, *insuring*, or carrying out an reportable transaction, and who directly or indirectly derives gross income in excess of the threshold amount … for such aid, assistance, or advice."[66]

The IRS issued proposed regulations to the new Section 6111 approximately two years later, in 2006.[67] The Preamble confirms that the existence of Tax Result Insurance does *not* create "reportable transaction" status for purposes of Form 8886, but it does trigger reporting for material advisors on Form 8918.

> *Previous comments to the regulations under § 1.6011-4 stated that it is inappropriate to require reporting of transactions under the contractual protection filter … for which the taxpayer obtains tax result protection (sometimes referred to as "tax result insurance") because numerous legitimate business transactions with tax indemnities would be subject to reporting. The IRS and Treasury Department removed tax result protection from that category of reportable transaction* but cautioned that if the IRS and Treasury Department became aware of abusive transactions utilizing tax result protection, the issue would be reconsidered.
>
> The IRS and Treasury Department have since become aware of taxpayers who have obtained tax result protection for the tax benefits of a listed transaction from a third party provider. In the AJCA, Congress expressed concern about tax result protection for reportable transactions and included insuring in the list of activities added to the statutory language under Section 6111. The IRS, Treasury Department, and Congress have an interest in learning more about the insuring of reportable transactions. *Accordingly, while a transaction will not be a reportable transaction simply because there is tax result protection for the transaction, tax result protection provided for a reportable transaction may subject a person to the material advisor disclosure rules under Section 6111 because a tax statement includes third party tax result protection that insures the tax benefits of a reportable transaction.*[68]

To quench its thirst for more information about Tax Result Insurance, the IRS now instructs participants in certain conservation easement transactions to "include a description of any tax result protection with respect to the transaction" on their Forms 8886.[69] The IRS makes the same demand in the context of Form 8918.[70] Notwithstanding this information-gathering exercise, which has endured for more than a decade, since 2006, the IRS has never indicated that the existence of Tax Result Insurance creates a reportable transaction.

Reality #2—IRS leaves taxpayers no choice

Those engaged in organizing Property-Holding-Partnerships that might make conservation easement donations generally would like to achieve tax certainty through manners other than purchasing Tax Result Insurance. The problem, explained below, is that the IRS has essentially made this impossible.

Taxpayers cannot get "insurance" from IRS. Many taxpayers, including those organizing Property-Holding-Partnerships, would like to obtain "insurance" directly from the IRS, in the form of a positive PLR. The rub is that the IRS outright refuses to grant PLRs on many issues fundamental to easements, thereby forcing taxpayers to turn elsewhere, such as to private companies offering Tax Result Insurance. Below is a list of the areas and items on which the IRS currently will *not* issue a PLR:

- "Any matter in which the determination requested is primarily one of fact, *e.g.*, market value of property …"[71]
- "Matters relating to the validity of a partnership or whether a person is a partner in a partnership."[72]
- "Whether the economic substance doctrine is relevant to any transaction or whether any transaction complies with the requirements of [Section] 7701(o)."[73]
- "The results of transactions that lack a bona fide business purpose or have as their principal purpose the reduction of federal taxes."[74]
- "Whether … reasonable cause, due diligence, good faith, clear and convincing evidence, or other similar terms that require a factual determination exist."[75]
- "Any matter dealing with the question of whether property is held primarily for sale to customers in the ordinary course of a trade or business."[76]
- "Questions that the [IRS] determines, in its discretion, should not be answered in the general interests of sound tax administration, including due to resource constraints."[77]

Taxpayers cannot get "insurance" from independent attorneys. Those involved in forming Property-Holding-Partnerships would also like to secure "insurance" from reputable tax attorneys, in the form of a tax opinion. The insurance-like role of tax attorneys has been described in the following manner:

> Transactional tax lawyers, by rendering tax opinions, provide an element of insurance to clients. This insurance is clearly incomplete, but by providing a tax opinion, a lawyer conditionally agrees to indemnify the client for part of the potential loss the client incurs if the favorable tax treatment described in the opinion is successfully challenged. Thus, tax lawyers serve, at least partly, as tax insurers.[78]

In light of the manner in which penalties stemming from easement donations function, the ability of independent tax attorneys to serve as pseudo-insurers has diminished, or in some instances, disappeared altogether.

As explained above, the IRS ordinarily asserts a long list of alternative penalties in conservation easement cases, including those for supposedly relying on a gross valuation misstatement. Some penalties can be avoided if the Property-Holding-Partnership can demonstrate that there was "reasonable cause" for the violation.[79] Others should disappear if the value was based on a qualified appraisal by a qualified appraiser, and the Property-Holding-Partnership made a good faith investigation of the value of the property.[80] Finally, under current law, certain penalties, like the one for making a gross valuation misstatement, cannot be overcome by evidence of "reasonable cause." It is mathematical in nature; that is, if the value of the easement-related deduction claimed by the Property-Holding-Partnership on its Form 1065 surpasses the value ultimately determined by the Tax Court by a certain percentage, the penalty applies, period.[81] The fact that the IRS tends to assert the gross valuation misstatement in every conservation easement case effectively means that Property-Holding-Partnerships cannot obtain penalty "insurance" from tax attorneys in the form of an opinion letter attesting to the suitability of a transaction or certain legal/tax aspects thereof.

The IRS outright refuses to grant private letter rulings on many issues fundamental to conservation easements, thereby forcing taxpayers to turn elsewhere, such as to private companies offering tax result insurance.

Reality #3—tax result insurance enjoys support from academics and experts

A significant number of scholarly and practitioner articles explain and underscore the legitimate function of Tax Result Insurance. Notable ones are summarized below.

One article describes the genesis of Tax Result Insurance as follows:

> Despite—or perhaps on account of—the incredibly complex nature of our tax laws, individuals and business organizations face uncertainty as to the tax results of many transactions. Congress and the [IRS], even if they so desired, could not set out rules in sufficient detail to provide certainty as to every possible transaction that may arise in the future. Unless alleviated, this uncertainty will cause some taxpayers to avoid engaging in transactions that would otherwise benefit society or the economy, resulting in a deadweight loss. Thus, it is desirable to derive ways to eliminate or mitigate this uncertainty in order to avoid deterring financially and socially beneficial transactions. Taxpayers frequently are faced with a choice of either abandoning a project or proceeding with it and accepting the question of the tax liability as one of the risks of the venture. Insurance companies have seen this circumstance as presenting an opportunity for them to enter the market and provide a useful service. To that end, some companies now provide insurance to protect a taxpayer against adverse tax consequences from a proposed transaction.[82]

[76] Rev. Proc. 2019-3, section 4.02(5). This is an issue on which the IRS "ordinarily will not rule."

[77] Rev. Proc. 2019-3, section 3.02(10).

[78] Field, "Tax Lawyers as Tax Insurance," 50 William & Mary Law Review 2111, 2114 (2019).

[79] Section 6664(c)(1); Section 6664(d)(1); Reg. 1.6664-4.

[80] Section 6664(c)(3); Reg. § 1.6664-4.

[81] Ibid.

[82] Kahn, "Hedging the IRS—A Policy Justification for Excluding Liability and Insurance Proceeds," 28 Yale Journal on Regulation 1 (2009).

[83] Ibid, pp. 4, 7, and 8.

[84] Ibid, pp. 4-5.

[85] Ibid, p. 7.

[86] Ibid, pp. 5-6. The author explains that the IRS has shown hostility towards tax advisor warranty arrangements and has indicated the need for oversight. Evidence includes the prohibition of certain "contingency fees" in Circular 230 and the need for participants in transactions with "contractual protection" to file Forms 8886.

[87] Ibid, p. 7.

[88] Ibid, p. 8.

[89] Logue, "Tax Law Uncertainty and the Role of Tax Insurance," 25 Virginia Tax Review 339 (2005).

[90] Ibid, p. 387.

[91] Ibid, p. 395.

[92] Ibid, p. 395.

[93] Ibid. p. 396.

After providing this overview of how Tax Result Insurance came to be, the article explains that "insurance" for tax issues has existed for a long time, in a variety of forms. First, the IRS historically issued PLRs, which is a type of protection or insurance against tax uncertainty, but it has become impossible or too time-consuming to obtain a PLR these days.[83] Second, tax return preparers have offered warranties for any mistakes they make, which shift the risk of taxes, penalties, interest charges, and defense costs from the taxpayer to the preparers.[84] Third, agreements effectuating the purchase and sale of businesses normally contain tax indemnity provisions.[85] Fourth, tax advisors, who structure a transaction and provide a legal/tax opinion regarding tax consequences, frequently give warranties to taxpayers that serve to refund fees paid if the IRS challenges and rejects the tax treatment.[86] The article concludes that Tax Result Insurance constitutes a "natural evolution" of the current types of insurance: "Instead of shifting liability risks between contracting parties, such as a buyer, seller, or broker, tax insurance shifts the tax uncertainty risk as to the consequences of a transaction to a neutral third party for a fee."[87]

The article goes on to explain that proponents of Tax Result Insurance argue that its existence does not cause aggressive transactions, to the contrary. The line of reasoning goes like this. A proposed transaction is presented to potential insurers, they refer it to a panel of tax and legal experts (both internal and external) who analyze it, and such experts are necessarily conservative when considering tax consequences because it is the assets of the insurers, not of the taxpayers, that will be at risk. In other words, in the open market, the financial interests of the independent insurance companies, which are driven by profit, are in conflict with those of the organizers of transactions, who aim to reduce tax liabilities at the lowest possible cost. Proponents of Tax Result Insurance explain that the willingness of an independent, profit-driven insurance company to offer a policy signals a legitimate tax position, reduces the IRS's auditing responsibilities, and effectively obligates the company to act "as a surrogate for the [IRS] in overseeing that the transaction is taxed properly."[88]

A second article makes similar observations and points.[89] In addition to confirming that various types of tax "insurance" have been used for many years, the second article emphasizes a key point, which is that Tax Result Insurance is legitimate insurance, offered by independent companies, which involves the shifting of risk, not the elimination of it. The second article states the following on this point:

> [T]ax insurance policies are not warranties. Neither are they merely contractual agreements that allocate risks between two parties who are contracting on other issues. Rather, tax indemnity polices are, as the name suggests, full-fledged insurance policies issued by real insurance companies that are regulated as such. Thus, when a tax insurance policy is purchased, certain tax risks are transferred to an insurance company, which then pools and distributes the risks across its other insureds and which sometimes reinsures some portion of those risks with other insurance companies.[90]

A significant number of scholarly and practitioner articles explain and underscore the legitimate function of tax result insurance.

The second article also discusses the case in support of, and against, Tax Result Insurance. Proponents explain that there is significant legal uncertainty in how the IRS and the courts will apply tax laws; this insecurity can inhibit welfare-enhancing, wealth-creating transactions that would benefit society; the IRS has a policy of not issuing many types of PLRs, which represent the traditional source of tax law risk "insurance;" private insurance companies fill the gap; such companies have more resources and more incentive than the IRS to hire talented tax professionals to review proposed transactions; and these private sector professionals do a better job than the IRS in screening against overly aggressive tax positions.[91] On the other hand, opponents of Tax Result Insurance primarily contend that this mechanism encourages or facilitates tax-avoidance transactions.[92]

The second article takes issue with the position of opponents for several reasons, including (1) Tax Result Insurance policies ordinarily contain clauses indicating that payouts will not occur if a transaction is deemed to involve criminal tax evasion, civil tax fraud, or any other type of wrongdoing, and (2) insurance companies would not sell policies without such clauses because they might get penalized for aiding and abetting improper behavior, and they would not risk the bad publicity associated with insuring abusive transactions.[93]

The second article recommends that, given the increasing complexity of tax laws, regulations, and related guidance, the IRS should raise penalties for participation in or non-reporting of certain aggressive transactions, increase the likelihood of de-

tection by the IRS, make available some form of Tax Result Insurance, and have the U.S. government consider ways of subsidizing it.[94] The second article also suggests the following:

> [G]iven the potential efficiency gains from the use of legitimate tax law uncertainty insurance, the government should consider ways of subsidizing it, at least in the short run. Privately provided tax risk insurance not only allows risk-averse taxpayers to shift this uncertainty from themselves to risk-neutral insurers, it creates an incentive for insurers—and their paid expert tax advisors—to serve as a sort of privatized [IRS]. By doing ex ante mini-audits in the form of tax risk underwriting, insurers can fill a void that the [IRS], through its [PLR] policies, is unwilling and probably unable to fill.[95]

A number of other articles discuss similar issues and reach similar conclusions about the reasons for, and benefits of, Tax Result Insurance.[96] Like the two articles explained at length above, one emphasizes how the existence of Tax Result Insurance and the related scrutiny by insurance companies help, not harm, the tax system:

> At bottom, the [tax insurance] underwriting process provides an informed assessment of complex tax risks by a sophisticated, neutral third party—a party with a strong economic incentive to confirm that the tax risk being insured conforms to the tax laws. This is good for our tax system.[97]

Consistent with the articles discussed above, a quick search of the Internet reveals that dozens of reputable, independent companies offer some variation of Tax Result Insurance.[98] It also confirms that there are numerous conferences devoted to this product.[99]

Reality #4—previous IRS guidance blesses insurance

In *Historic Boardwalk Hall, LLC*, the Third Circuit Court of Appeals held that an investor/member was not a bona fide partner for federal income tax purposes, and thus was not entitled to receive an allocation of historic rehabilitation credits from the partnership.[100] The primary reason for this decision was that the investor/member had the right to receive a guaranteed reimbursement of its investment if it did not receive the anticipated credits. This, concluded the Third Circuit Court of Appeals, meant that the investor/member did not incur any entrepreneurial risks and did not adequately par-

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ticipate in the financial upside or downside of the partnership's business, such that he was not a "partner." In the words of the Third Circuit Court of Appeals, "because [the investor/member] lacked a meaningful stake in either the success or failure of [the partnership], it was not a bona fide partner."[101]

In response to the decision in *Historic Boardwalk Hall,* the IRS issued Revenue Procedure 2014-12, which established a "safe harbor" for structuring historic rehabilitation credit transactions. Revenue Procedure 2014-12 describes certain "permissible guarantees" and "impermissible guarantees."[102] The latter included a restriction against any person involved in the transaction guaranteeing or otherwise insuring the ability of the partner to claim the historic tax credits, the cash equivalent of such credits, or the repayment of any portion of the partner's contribution to the partnership due to the inability to claim the credits, if the IRS were to challenge the transactional structure of the partnership.[103] It also stated that no person involved with the transaction could guarantee that the partner would receive distributions or consideration in exchange for its partnership interest, except for a sale at fair market value.[104] Importantly, Revenue Procedure 2014-12, referencing its description of "impermissible guarantees," expressly states that this "does *not* prohibit the [partner] from procuring insurance from persons not involved with the rehabilitation or the partnership."[105] In other words, the IRS concluded that obtaining Tax Result Insurance from an independent insurer is not problematic, at least in the historic rehabilitation tax credit context.[106]

Reality #5—indicia of true partners and partnership

The complaint filed by the DOJ in December 2018 seeking an injunction against various players in the real estate investment partnership industry provides some context to the type of situations that the IRS trying to halt. The complaint alleges that the Property-Holding-Partnerships and their organizers often possessed the following characteristics: (1) the organizers did not have any ongoing business ventures; (2) the investors did not anticipate receiving any distributions from the Property-Holding-Partnerships; (3) the only return to the investors derived from the easement-related tax deductions; (4) the Property-Holding-Partnerships were not funded (and had no financing plans or capability) for anything other than donating a conservation easement on real property; (5) the only asset held by the Property-Holding-Partnerships was the real property; (6) the manager of the Property-Holding-Partnerships had the ability to unilaterally sell the property or purchase the interests of the investors for a minimal amount after the expiration of the applicable assessment-period; (7) the investment risks identified by the organizers focused primarily on potential tax consequences triggered by an IRS challenge; and (8) the easement-related deductions were based on inflated appraisal values.[107]

If such allegations are true, which is far from certain at this point, the existence of Tax Result Insurance arguably might add to questions of potential impropriety. However, many Property-Holding-

[94] Ibid, p. 413.

[95] Ibid, p. 414.

[96] *See, e.g.*, Perrera, "Does the IRS's New Ruling Policy on Spin-Offs Enhance the Desirability of Tax Insurance?" 55 Tax Executive 362 (2003); Gray and Hadji, "Tax Insurance: Another Tool for Your Transaction Toolbox," 25 International Tax Review 37 (2014); Gary, "New Opportunity for Tax Lawyers: Insuring Tax Transactions," Tax Analysts Document No. 2004-11722 (7/7/04); Zelenak, "The Taxation of Tax Indemnity Payments: Recovery of Capital and the Contours of Gross Income," 46 Tax Law Review 381 (Spring 1991); Elliott, "Greater Reliance on Tax Liability Insurance Raises Questions," 149 Tax Notes 477 (10/26/15); Wolfe, "Tax Indemnity Insurance: A Valuable and Evolving Tool for Managing Tax Risks," 739 Practising Law Institute/Tax 371 (2006).

[97] Wolfe, "Tax Indemnity Insurance: A Valuable and Evolving Tool for Managing Tax Risks." 739 Practising Law Institute/Tax 371, 415-416 (2006).

[98] *See, e.g.,* websites for Aon, Chubb, Equity Risk Partners, QBE North America, Blue Chip Underwriting Services, Lloyd's of London, Hiscox, M&A Insurance Solutions, Great American Insurance Group, The Hartford, McGriff Seibels & Williams, Marsh & McLennan Companies, American Insurance Group, and Ambridge Partners.

[99] *See, e.g.*, the "Transaction Insurance Insights Conference" organized by Advisen, the "M&A, RIW and Transactional Risk Insurance Conference" organized by the American Conference Institute; the "Reps & Warranties and Transactional Liability Insurance Conference" organized by ExecuSummitt; and the "Insurance M&A Symposium" organized by S&P Global.

[100] *Historic Boardwalk Hall, LLC*, 694 F.3d 425 (CA-3, 2012), *rev'g* 136 TC 1 (2011).

[101] Ibid.

[102] Rev. Proc. 2014-12, 2014-3 IRB 415, section 4.05.

[103] Ibid, section 4.05(2)(a).

[104] Ibid, section 4.05(2)(a).

[105] Ibid, section 4.05(2)(a) (emphasis added).

[106] Rev. Proc. 2014-12. As one would expect, the IRS tries to narrow the applicability of its guidance, stating the following: "This revenue procedure applies only with respect to allocations of § 47 rehabilitation credits from qualified rehabilitation expenditures;" "This revenue procedure does not apply to federal credits other than the § 47 rehabilitation credit or to state credit transactions;" "It does not indicate the circumstances under which the [IRS] may challenge allocations of such other credits or the circumstances under which a transfer of state credits by a partnership may be treated as a disguised sale under § 707(a)(2)(B);" and "The Treasury Department and the [IRS] do not view the Safe Harbor as determinative of whether an Investor is a partner or acting in its capacity as a partner in an arrangement or transaction that is outside the scope of this revenue procedure."

[107] *Zak, Clark, EcoVest Capital Inc., Solon, McCullough, and Teal*, Case No. 1:18-cv-05774, D.C. N.D. Ga, complaint filed 12/18/18, pp. 49-60, allegations 136, 142 through 163.

Partnerships whose partners ultimately decided by majority vote to conserve land in perpetuity via an easement do *not* share any of the characteristics described in the complaint. Specifically, (1) the organizers often have many years of legitimate real estate and other business experience; (2) the Property-Holding-Partnerships have several assets, in addition to the conserved property, which generate material amounts of income or loss for the partners for many years after the easement donation; (3) no put, calls, options, or the like exist with respect to interests in the Property-Holding-Partnerships; (4) the Private Placement Memorandum or other materials provided to potential partners contain detailed information about all types of risks, with no particular emphasis on tax aspects; (5) the organizers, both personally and through the hiring of several experts in different fields, conduct extensive due diligence before determining the potential uses of the land held by the Property-Holding-Partnerships; (6) the organizers hire and rely on advice and services provided by independent tax and legal professionals; and (7) the amount of the easement-related deductions are determined by multiple, independent, informed, experienced individuals who meet the criteria to be "qualified appraisers."

Under these circumstances, the attainment of Tax Result Insurance from companies, which (1) are completely unrelated to the organizers, (2) conduct their own independent review and analysis, (3) assume (but not eliminate) certain tax risks, (4) often obligate the Property-Holding-Partnerships to retain a portion of the risk and pay hefty deductibles before making any claims, (5) are driven by profit, (6) are accountable to shareholders, and (7) have absolutely no incentive to offer policies covering conservation easement transactions that are likely to be disallowed by the IRS, should not be viewed as problematic.

Conclusion

IRS audits of Property-Holding-Partnerships making easement donations are gradually becoming more invasive, not less. Accordingly, one might expect the IRS to continue probing many issues, including the potential impact of Tax Result Insurance.

Perhaps, though, the IRS will reconsider this particular line of inquiry after dwelling on the realities examined in this article, including:

- The IRS determination more than 15 years ago that the existence of Tax Result Insurance does not trigger reportable transaction status for purposes of Form 8886.
- Property-Holding-Partnerships cannot obtain "insurance" from the IRS because it refuses to issue PLRs regarding issues essential to a conservation easement donation.
- Property-Holding-Partnerships are also unable to secure "insurance" from tax advisors because certain valuation-based penalties cannot be avoided even if reasonable cause/reliance exists.
- Tax Result Insurance enjoys considerable support in academic and practitioner articles.
- The IRS announced in Revenue Procedure 2014-12 that obtaining Tax Result Insurance from an independent company is not problematic in the context of certain tax credit partnerships.
- Many Property-Holding-Partnerships are radically different in many regards from those generalized by the IRS in Notice 2017-10 and by the DOJ in the injunction complaint that is discussed in this article. ■