THE IRS TAKES ANOTHER CRACK AT DEMONIZING CONSERVATION EASEMENTS

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This article discusses proposed regulations and new focus on land trusts.

Some might say that the Internal Revenue Service (IRS) has adopted a kill-them-all-and-let-God-sort-them-out approach when it comes to conservation easements. Indeed, during its longstanding quest to halt these transactions, the IRS has taken actions aimed at partnerships making the donations, direct and indirect partners, appraisers, accountants, sponsors, and others. Now, the IRS has turned its sights to an unexpected target, the land trusts that evaluate the attributes of a property, accept the easement, monitor adherence to the use restrictions, and generally protect the property forevermore. The notion of attacking land trusts is remarkable because the IRS has announced, from the outset, that it would exclude tax-exempt organizations from its compliance campaign. The IRS initially said it would not treat land trusts as participants in, parties to, or material advisors for easement transactions. The proposed regulations, issued by the IRS in December 2022 (Proposed Regulations) tell a different story, though.

This article explains the conservation easement donation process, evolution of the duty to file Form 8886 (Reportable Transaction Disclosure Statement), first attempt by the IRS to characterize certain easements as "listed transactions," recent Tax Court decision invalidating Notice 2017-10 because the IRS violated the Administrative Procedures Act (APA), and noteworthy aspects of the Proposed Regulations.

Overview of conservation easement donations

To grasp the main issues discussed in this article, readers need to understand the basics of conservation easement donations.

Taxpayers who own undeveloped real property have several choices. For instance, they might hold the property as an investment and then sell when it appreciates sufficiently. Another option is to determine how to maximize profitability from the property and do that right away, regardless of negative effects on the environment or local community. Another possibility is voluntarily restricting future uses of the property to benefit society as a whole. The last option, known as donating a conservation easement, might trigger tax deductions for donors.[1]

Any old property will not do. Taxpayers must demonstrate that the property placed under easement has at least one acceptable "conservation purpose."[2] Common purposes include preserving land

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for public recreation or education, safeguarding a relatively natural habitat for plants and animals, maintaining open space for scenic enjoyment by the public, and utilizing property pursuant to a government conservation policy.[3]

Taxpayers memorialize the donation by filing a Deed of Conservation Easement or similar document (Deed). In preparing the Deed, taxpayers often identify certain limited activities that can continue on the property after the donation, without prejudicing the conservation purposes.[4]

An appropriate party must receive the conservation easement in order to trigger the tax deduction. This means a government, private, or tax-exempt entity of a certain type, which is committed to protecting the conservation purposes, and which possesses sufficient resources to enforce the restrictions in the Deed (Qualified Organization).[5] A land trust often serves as the Qualified Organization, for logical reasons.

The IRS will not allow the tax deduction stemming from a conservation easement, unless the taxpayer obtains documentation establishing the condition and characteristics of the property (Baseline Report).[6] The land trust, given its expertise and policy of only accepting conservation-worthy projects, frequently prepares the Baseline Report.

Taxpayers pay the land trust for producing the Baseline Report, donate the conservation easement to the land trust, and then give the land trust cash (Stewardship Fee) so that it has sufficient resources to oversee and enforce the Deed. The land trust typically uses the Stewardship Fee to conduct annual inspections of the property, generate monitoring reports, initiate lawsuits to halt transgressions, and more.[7]

The value of the conservation easement is the fair market value (FMV) of the property at the time of the donation.[8] The term FMV ordinarily means the price on which a willing buyer and willing seller would agree, if neither party were obligated to participate in the transaction, and if both parties had reasonable knowledge of the relevant facts.[9] The best evidence of the FMV of an easement would be the sale price of other conserved properties that are comparable in size, location, etc. The IRS recognizes, though, that it is difficult, if not impossible, to find them.[10] Consequently, appraisers often must use the before-and-after method instead. This means that they must determine the highest and best use (HBU) of the property *and* the corresponding FMV twice. First, appraisers calculate the FMV as if the property had been put to its HBU, which generates the "before" value. Second, appraisers identify the FMV, taking into account the serious restrictions on the property imposed by the conservation easement, which creates the "after" value.[11] The difference between the "before" and "after" values of the property, with certain adjustments, produces the amount of the donation.

Claiming the tax deduction from an easement donation is surprisingly complicated. It involves a significant amount of actions and documents. Among other things, taxpayers must obtain an adequate appraisal, demonstrate that the land trust is a Qualified Organization, obtain a Baseline Report, complete Form 8283 (Noncash Charitable Contributions), file a timely tax return with all necessary enclosures and disclosures, and receive written acknowledgments of the donations from the land trust.[12]

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Brief history of disclosure requirements

The IRS has trouble auditing transactions and halting the ones it opposes when it cannot effectively identify them in the first place. The IRS, therefore, obligates taxpayers to report certain transactions on Form 8886. Read on to see how things got to this point.

Evolution of regulations. The IRS has published several versions of regulations over the years in connection with reportable transactions.[13] The first set, issued in March 2000, focused on disclo-

1 I.R.C. Section 170(f)(3)(B)(iii); Treas. Reg. 1.170A-7(a)(5); I.R.C. Section 170(h)(1); I.R.C. Section 170(h)(2); 1.170A–14(a);1.170A–14(b)(2).

2 I.R.C. Section 170(h)(4)(A); 170A–14(d)(1)S. Rept. 96–1007, at 10 (1980).

3 I.R.C. Section 170(h)(4)(A); 170A–14(d)(1).

4 Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 11/4/2016), pg. 23; see also Treas. Reg. 1.170A-14(b)(2); Treas. Reg. 1.170A-14(e)(2) and (3).

5 I.R.C. Section 170(h)(3); Treas. Reg. 1.170A-14(c)(1).

6 Treas. Reg. 1.170A-14(g)(5)(i).

7 Treas. Reg. 1.170A-14(c)(1); Treas. Reg. 1.170A-14(g)(5)(ii).

8 I.R.C. Section 170(a)(1); Treas. Reg. 1.170A-1(c)(1).

9 Treas. Reg. 1.170A-1(c)(2).

10 Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 1/24/2018), pg. 43.

11 Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 1/24/2018), pg. 43.

sure by *corporate* taxpayers.[14] At that time, the IRS was concerned about the proliferation of corporate tax shelters, and the regulations aimed to give the IRS early notification of large transactions that "may be indicative of such tax shelter activity."[15]

The IRS expanded 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 participated in reportable transactions.[16]

The IRS changed course in October 2002 when it discovered, unsurprisingly, that taxpayers were interpreting the characteristics of tax shelters in an "overly narrow manner," while simultaneously construing the exceptions to such characteristics in an "overly broad manner."[17] The IRS created rules that were more objective in an effort to remedy this.[18]

The IRS issued final regulations in March 2003.[19] They warned that the relevant years might be broader than taxpayers anticipated. Specifically, if a reportable transaction results in a loss that taxpayers *carry back* to a prior year, then they must enclose Forms 8886 with the application for tentative refund or amended tax return for the earlier year.[20] Conversely, if taxpayers participate in a reportable transaction in one year and *carry forward* a portion of the benefit, then they would be participating in the later years and would thus need to file Forms 8886.

Substantially similar transactions. The duty to file Forms 8886 applies not only to reportable transactions, but also to those that are "substantially similar." This term covers any transaction, which is expected to obtain the same or similar tax consequences as a reportable transaction, and which is either factually similar or based on a similar tax strategy.[21] The regulations underscore that taxpayers must broadly construe the concept of similarity in favor of making disclosures to the IRS.[22] They also state that a transaction may be substantially similar to a reportable transaction, even though it involves different entities and/or applies different tax provisions.[23]

The regulations contain several examples demonstrating just how liberally the IRS interprets the notion of substantially similar.[24] The IRS has also issued multiple Private Letter Rulings, Field Service Advisories, General Counsel Memos, and other guidance over time concluding that particular transactions are substantially similar to one reportable transaction or another.[25] The courts, likewise, have expansively interpreted the concept in upholding penalties related to unfiled Forms 8886.[26]

Recapping. In summary, the IRS has been using a big stick for more than two decades, obligating taxpayers who participate in reportable transactions (or substantially similar ones) to file Forms 8886.[27]

Certain easements become listed transactions

In December 2016, the IRS announced in Notice 2017-10 that it intended to challenge what is coined syndicated conservation easement transactions (SCETs) on grounds that they supposedly constituted "tax-avoidance transactions" that involve serious overvaluations.[28] The effect of Notice 2017-10 was that SCETs became "listed transactions," a subset of reportable transactions.[29]

The focus of the government's ire. Notice 2017-10 claimed that an SCET involves the following four steps:

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[12] See Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 1/24/2018), pgs. 24-31; IRS Publication 1771, Charitable Contributions – Substantiation and Disclosure Requirements; IRS Publication 526, Charitable Contributions; Section 170(f)(8); Section 170(f)(11); Treas. Reg. 1.170A-13; Notice 2006-96; TD 9836.

[13] See T.D. 8875 (March 2, 2000); T.D. 8876 (March 2, 2000); T.D. 8877 (March 2, 2000); T.D. 8896 (Aug. 16, 2000); T.D. 8961 (Aug. 7, 2001); T.D. 9000 (June 18, 2002); T.D. 9017 (Oct. 22, 2002); T.D. 9018 (Oct. 22, 2002); T.D. 9046 (March 4, 2003); T.D. 9108 (Dec. 30, 2003); T.D. 9350 (Aug. 3, 2007).

[14] T.D. 8877 (March 2, 2000); REG-103735-00.

[15] T.D. 8877 (March 2, 2000), Preamble.

[16] T.D. 9000 (June 18, 2002), Preamble; Temp. Reg. 1.6011-1T(a)(1).

[17] TD . 9017 (Oct. 22, 2002), Preamble.

[18] TD . 9017 (Oct. 22, 2002), Preamble.

[19] T.D. 9046 (March 4, 2003).

[20] Treas. Reg. 301.6707A-1(c)(1) and (c)(2), Example 3.

[21] Treas. Reg. 301.6011-4(c)(4).

[22] Treas. Reg. 301.6011-4(c)(4).

[23] Treas. Reg. 301.6011-4(c)(4).

[24] Treas. Reg. 301.6011-4(c)(4), Example s.

[25] See, e.g., Private Letter Ruling 201017076 (substantial similarity to Notice 95-34), Field Service Advice 200218014 (substantial similarity to Notice 2001-16), Chief Counsel Advice 200712044 (substantial similarity to Notice 2005-13), Chief Counsel Advice 200929005 (substantial similarity to Notice 2004-8).

[26] See, e.g., *Polowniak*, T.C. Memo 2016-31 (substantial similarity to Notice 2004-8), *Blak Investments et al.*, 133 T.C. 431 (2009) (substantial similarity to Notice 2000-44), *Our Country Home Enterprises, Inc.*, 145 T.C. 1 (2015) (substantial similarity to Notice 2007-83); *Turnham*, 123 AFTR 2d 2019-2042 (D.C. Alabama 2019) (substantial similarity to Notice 95-34), and *Interior Glass Systems, Inc.*, 123 AFTR 2d 2019-XXXX (9th Cir. 2019) (substantial similarity to Notice 2007-83).

[27] Treas. Reg. 1.6011-4(e)(1).

[28] Notice 2017-10, Preamble and Section 1.

> [Step 1] An investor receives promotional materials that offer prospective investors in a pass-through entity [such as a partnership] the possibility of a charitable contribution deduction that equals or exceeds an amount that is two and one-half times the amount of the investor's investment.
>
> [Step 2] The investor purchases an interest, directly or indirectly (through one or more tiers of pass-through entities), in the pass-through entity that holds the real property.
>
> [Step 3] The pass-through entity that holds the real property contributes a conservation easement encumbering the property to a tax-exempt entity and allocates, directly or through one or more tiers of pass-through entities, a charitable contribution deduction to the investor.
>
> [Step 4] Following that contribution, the investor reports on his or her federal income tax return a charitable contribution deduction with respect to the conservation easement.[30]

Effect on participants. Notice 2017-10 had various effects on those who participated in SCETs.

Scope of Participation. Notice 2017-10 indicated that "participants" included (i) the partnership that owned the property and donated the easement, (ii) the upper-tier partnership, if the transaction involved a multi-tier structure, with one partnership on top of another, (iii) the investors/partners who receive a Schedule K-1 (Partner's Share of Income, Deductions, Credits, etc.) from the partnership, and (iv) the catch-all, any other person whose tax return reflects tax consequences or a tax strategy described as an SCET.[31]

Exclusion from Participant Status. Importantly for purposes of this article, Notice 2017-10 explicitly stated that the Qualified Organization (*i.e.*, the land trust) that receives the conservation easement donation would *not* be treated as a "party" under Section 4965 and would *not* be a "participant" under Notice 2017-10.[32] This meant that the land trust would not be hit with excise taxes, Form 8886 filing obligations, or related penalties.

Form 8886 Filing Duties and Penalties. Participants in SCETs that occurred during or after 2010 generally had to file Forms 8886 with the IRS.[33] When it came to future transactions, participants needed to enclose Forms 8886 with their tax returns for every year of participation, as well as send copies for the first year to the Office of Tax Shelter Analysis.[34] Those objecting to SCET status, but fearing potential penalties, had the option to file "protective" Forms 8886 instead.[35]

Non-compliance by participants with Notice 2017-10 triggers at least three consequences.

Non-compliance by participants with Notice 2017-10 triggers at least three consequences. If participants fail to file timely, complete Forms 8886, then the IRS generally can assert a penalty equal to 75 percent of the tax savings resulting from their participation.[36] In the case of a listed transaction, like an SCET, the maximum penalty for individual taxpayers is $100,000, while the maximum for entities is $200,000.[37] Importantly, the IRS does *not* have authority to rescind or abate a penalty assessed against a listed transaction, and no "reasonable cause" exception exists.[38]

The IRS can penalize taxpayers in others ways, too. In particular, if a taxpayer participates in a reportable transaction, and the IRS later disallows the benefits claimed, then the IRS can impose a penalty under Section 6662A equal to 20 percent of the tax increase (Reportable Transaction Penalty).[39] The rate increases to 30 percent if the participant fails to file a Form 8886.[40]

In addition to financial penalties, if a participant does not enclose a Form 8886 with a tax return, then the assessment-period with respect to the tax return can remain open for a long time. Specifically, the assessment-period extends until one year after the participant eventually files Form 8886 or a material advisor remits the relevant records to the

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29 I.R.C. Section 6707A(c)(2); Treas. Reg. 1.6011-4(b)(2).
30 Notice 2017-10, Section 2.
31 Treas. Reg. 1.6011-4(e)(1).
32 Notice 2017-10, Section 3.
33 Notice 2017-10, Section 3; Treas. Reg. 1.6011-4(a); Treas. Reg. 1.6011-4(d).
34 Notice 2017-10, Section 33.
35 Treas. Reg. 1.6011-4(f)(2).
36 I.R.C. Section 6707A(a), (b); Treas. Reg. 301.6707A-1(a).
37 I.R.C. Section 6707A(b)(2); Treas. Reg. 301.6707A-1(a). The minimum penalty is $5,000 for individuals and $10,000 for entities. See I.R.C. Section 6707A(b)(3); Treas. Reg. 301.6707A-1(a).
38 I.R.C. Section 6707A(d)(1); *Barzillai*, 137 Fed Cl. 788, 121 AFTR 2d 2018-1582 (April 30, 2018); *Larson*, 888 F.3d 578, 121 AFTR 2d 2018-1598 (April 25, 2018).
39 I.R.C. Section 6662A(a).
40 I.R.C. Section 6662A(c).

IRS, whichever occurs earlier.[41] During the prolonged assessment-period, the IRS has authority to assess any taxes, penalties, or interest, whether or not directly related to the listed transaction.[42]

Effect on material advisors. The issuance of Notice 2017-10 had consequences for material advisors, too.

Key Definitions. The IRS, unsurprisingly, defines the term "material advisor" broadly. It generally means a person who provides material aid, assistance, or advice with respect to organizing, managing, promoting, selling, implementing, insuring, or carrying out any reportable transaction, and such person derives a certain amount of gross income for doing so.[43]

In this context, a person has material involvement if he (i) makes or provides a "tax statement," (ii) either directly to, or for the benefit of, certain taxpayers or other material advisors, (iii) before the first tax return reflecting the benefits of the reportable transaction has been filed with the IRS, and (iv) derives a certain amount of income for doing so.[44] A "tax statement" means *any* statement, oral or written, that relates to a tax aspect of a transaction that causes it to be a reportable transaction.[45]

Form 8918 Filing Duties and Penalties. Those persons categorized as material advisors normally must file Forms 8918 (Material Advisor Disclosure Statements) or at least "protective" ones to alert the IRS to their involvement.[46]

The IRS asserts penalties when violations occur, of course. In the case of a listed transaction, like an SCET, the penalty for an unfiled Form 8918 is $200,000 or 50 percent of the gross income that the material advisor obtained, which amount is larger.[47] The penalty increases where there is an intentional failure. In these situations, the penalty equals the greater of $200,000 or 75 percent of the gross income.[48] Once the IRS assesses a Form 8918 penalty for a listed transaction, it does not have the authority to rescind it.[49]

List-Maintenance Duties and Penalties. In addition to filing Forms 8918, material advisors must maintain for each reportable transaction a list of information about their clients, the transactions in which they participated, the amount invested by each client, the tax benefits derived, etc.[50] Material advisors must retain these lists for seven years and provide them to the IRS upon written request.[51] If any material advisor fails to supply the list within 20 days of a written request, then the IRS can assert a penalty of $10,000 per day.[52] The IRS will forego sanctions, though, if the material advisor has "reasonable cause" for any delays.[53]

Tax Court invalidates Notice 2017-10

All eyes have recently been on *Green Valley Investors*, a Tax Court case centered on four conservation easement donations generating about $90 million in tax deductions, because it addressed the critical issue of the validity or invalidity of Notice 2017-10.[54]

Background and court filings. The donations in this case occurred in 2014 and 2015, several years *before* the IRS issued Notice 2017-10 labeling SCETs "listed transactions." The IRS audited and, predictably, took the position that the partnerships were entitled to $0 in deductions because they supposedly failed to satisfy all technical requirements. The IRS also claimed that the partnerships deserved various sanctions. The partnerships disagreed with the IRS's stance and filed a Petition with the Tax Court.

The IRS then upped the ante, so to speak, by asserting in its Answer to the Petition that the partnerships should face the Reportable Transaction Penalty under Section 6662A because the tax understatements related to reportable transactions, *i.e.*, SCETs.

The parties eventually filed multiple Cross-Motions for Partial Summary Judgment on assorted issues, including whether the IRS could impose a Reportable Transaction Penalty in the first place.

Analysis of critical issue. The key issue in the case was whether the IRS violated the APA in issuing Notice 2017-10, such that it was invalid from the outset. The Tax Court's analysis filled nearly 40 pages; this article limits itself to the main points.

Summary of APA Rules and Exceptions. The Tax Court explained that the APA involves a three-step procedure, dictating that agencies, like the IRS, must (i) issue a general notice to the public about proposed rulemaking, (ii) allow interested persons to provide input, by submitting comments and/or participating in hearings, and (iii) feature in the final rule a "concise general statement" of its "basis and purpose." The Tax Court then acknowledged the existence of certain exceptions, including that the APA does not apply to "interpretive rules." Finally, the Tax Court recognized that Congress reserved the right to modify the APA requirements, but warned that a statute enacted after the APA cannot be interpreted as modifying or superseding the APA unless "it does so *expressly*."[55]

First Argument by the IRS. The IRS raised a couple of arguments, the first of which was that Notice 2017-10 supposedly constitutes an "interpretive rule," not a "legislative rule," such that it is not covered by the APA.

The Tax Court began by defining legislative rules as those that impose new rights or duties and change the legal status of parties. By contrast, interpretive rules simply inform the public of the interpretation by an agency, like the IRS, of a statute that it is in charge of administering. The Tax Court quickly determined that Notice 2017-10 is a legislative rule for two reasons. First, the Sixth Circuit Court of Appeals held just last year, in 2021, that a similar Notice issued by the IRS, labeling certain trust arrangements as listed transactions, was a legislative rule.[56]

Second, after citing the particular statutes in which Congress empowered the IRS to create rules about filing returns and identifying reportable transactions, the Tax Court offered the following broad conclusion:

> The act of identifying a transaction as a listed transaction by the IRS, by its very nature, is the creation of a substantive (*i.e.*, legislative) rule and not merely an interpretive rule. Identifying a transaction as a listed transaction does not merely provide the IRS's interpretation of the law or remind taxpayers of pre-existing duties. Rather, as we will detail below, identifying a transaction as a listed transaction imposes new duties in the form of reporting obligations and record-keeping requirements on both taxpayers and their advisors. Notice 2017-10 exposes these individuals to additional reporting obligations and penalties to which they would not otherwise be exposed but for the Notice. Creating new substantive duties and exposing taxpayers to penalties for noncompliance "are hallmarks of a legislative, not interpretive, rule."[57]

The Tax Court then devoted several pages to specifying the long list of filing and record-keeping duties that Notice 2017-10 imposed on both "participants" in, and "material advisors" to, SCETs. The Tax Court also highlighted the potential penalties for violations.[58] It then wrapped up its thoughts on the matter as follows:

> In sum, by its issuance, Notice 2017-10 creates new substantive reporting obligations for taxpayers and material advisors, including [the partnerships in *Green Valley Investors*], the violations of which prompts exposure to financial penalties and sanctions – the prototype of a legislative rule. We cannot see how Notice 2017-10 could be considered an interpretive rule; consequently, we find it to be a legislative rule.[59]

Because Notice 2017-10 is a legislative rule, with the force and effect of law, the Tax Court clarified that it was subject to the general three-step procedure created by the APA.[60]

Second Argument by the IRS. Down but not out completely, the IRS took another approach. It argued that *after* enacting the APA, Congress *later* *exempted* the IRS from complying with it when it passed Section 6707A, the provision allowing the IRS to penalize taxpayers for not filing Forms 8886.

Understanding the IRS's contention requires a step back.

Understanding the IRS's contention requires a step back. Section 6707A generally states that the IRS can penalize any person who fails to file Form 8886 to disclose a reportable transaction, as required and defined by Section 6011.[61] For its part, Section 6011 explains that all persons liable for any tax shall file a return or statement "according to the forms and regulations" issued by the IRS.[62] Finally, the regulations under Section 6011 require taxpayers who participated in a reportable transaction identified by the IRS "by notice, regulation, or other form of published guidance" to file Form 8886.[63]

The Tax Court added to that foundation. It first emphasized that the APA specifically states that a

[41] I.R.C. Section 6501(c)(10).
[42] Treas. Reg. 301.6501(c)-1(g)(7); see also Treas. Reg. 301.6501(c)-1(g)(8) (Example 14).
[43] Treas. Reg. 301.6111-3(b)(1).
[44] I.R.C. Section 6111(b)(1)(A); Treas. Reg. 301.6111-3(b)(2)(i).
[45] Treas. Reg. 301.6111-3(b)(2)(ii).
[46] I.R.C. Section 6111(a); Treas. Reg. 301.6111-3(a); Treas. Reg. 301.6111-3(d)(1); Treas. Reg. 301.6111-3(g).
[47] I.R.C. Section 6707(a), (b)(2); Treas. Reg. 301.6707-1(a)(1)(ii)(A).
[48] I.R.C. Section 6707(a), (b)(2); Treas. Reg. 301.6707-1(a)(1)(ii)(B).
[49] I.R.C. Section 6707(c); Treas. Reg. 301.6707-1(e)(1)(i).
[50] I.R.C. Section 6112; Treas. Reg. 301.6112-1.
[51] I.R.C. Section 6112(b)(1); Treas. Reg. 301.6112-1(b), (d), and (e).
[52] I.R.C. Section 6708(a)(1); Treas. Reg. 301.6708-1(a).
[53] I.R.C. Section 6708(a)(2); Treas. Reg. 301.6708-1(g), (h).
[54] *Green Valley Investors, LLC*, 159 T.C. No. 5 (2022).
[55] *Id.*, pgs. 7-8 (2022).
[56] *Id.*, pg. 9 (2022).
[57] *Id.*, pgs. 9-10 (2022) (internal citations omitted).
[58] *Id.*, pgs. 10-15 (2022).
[59] *Id.*, pg. 15 (2022).
[60] *Id.*, pg. 15 (2022).
[61] I.R.C. Section 6707A(a); I.R.C. Section 6707A(c)(2).
[62] I.R.C. Section 6011(a).
[63] Treas. Reg. 1.6011-4(a) and (b)(2).

subsequent statute cannot be interpreted to modify or supersede the APA "except to the extent that it does so *expressly*." The Tax Court also underscored that various Courts of Appeal have previously held that the express-statement mandate in the APA acts to prohibit later "amendment by implication."[64] It further observed that the Supreme Court has established a "powerful presumption against implied repeal" of existing laws, such as the APA.[65] Finally, the Tax Court referenced various cases for the proposition that "mere differences between a [later] statutory scheme and the APA are insufficient to establish Congress' intent to dispense with the standard APA procedures."[66]

The Tax Court then turned to the IRS's suggestion that Congress said it was free to ignore the APA when it comes to listed transactions. The Tax Court framed the issue in the following manner: "[T]he remaining question before us is whether Congress has established [post-APA] procedures so different from those required by the APA that it intended to displace the norm."[67]

The Tax Court parsed the two provisions cited by the IRS, Section 6011 and Section 6707A. The Tax Court observed that the former is "silent on any *express* congressional intent" and the latter "offers no *express* indication from Congress of exempting the IRS from the standard notice-and-comment rulemaking of the APA."[68] After analyzing some relevant cases, the Tax Court held that neither of the two tax provisions "says anything that would lead us to conclude that the IRS is exempt from the baseline procedures for rulemaking under the APA."[69]

The Tax Court went on to analyze, and reject, several more arguments raised by the IRS dealing with actions or inactions by Congress after the enactment of the APA decades ago.[70]

Tax Court rulings, narrow and broad. Based on the preceding analysis, the Tax Court declared itself "unconvinced that Congress *expressly* authorized the IRS to identify [an SCET] as a listed transaction without the APA's notice-and-comment procedures, as it did in Notice 2017-10."[71] Thus, when it comes to the taxpayers in *Green Valley Investors*, the result is that the IRS cannot assert the Reportable Transaction Penalty under Section 6662A.[72]

The Tax Court ruling will have much wider applicability, though. Tax procedure junkies will appreciate that the Tax Court issues three main types of decisions, namely, T.C. Opinions, T.C. Memorandum Opinions, and T.C. Summary Opinions. Only the first type, called a "published" opinion, generally constitutes binding precedent for Tax Court purposes.[73] The Tax Court ensured that *Green Valley Investors* would be authoritative for other taxpayers by issuing it as a T.C. Opinion. Lest anyone be confused about its importance and scope, the Tax Court expressly stated that it "intends to apply this decision setting aside Notice 2017-10 to the benefit of all similarly situated taxpayers who come before us."[74]

Other APA-based rulings

Green Valley Investors represents just the latest in a growing list of APA-related problems for the IRS. Here are some others.

- A District Court held that the IRS violated the APA when it issued Notice 2016-66 identifying certain micro-captive insurance arrangements as "transactions of interest."[75]
- Likewise, the Sixth Circuit Court of Appeals ruled in *Mann Construction* that the IRS improperly ignored the APA when it published Notice 2007-83 calling trusts using cash life insurance policies listed transactions.[76]
- Another District Court determined that the IRS failed to comply with the APA in issuing temporary regulations for the dividends-received-deduction under Section 245A.[77]
- The government filed an Answer in a pending District Court case admitting that Notice 2017-10 is a legislative rule, the IRS did not follow the notice-and-comment procedures of the APA, and the IRS was not exempt from such procedures; therefore, Notice 2017-10 is invalid.[78] The District Court later agreed, declaring Notice 2017-10 "unlawful" and setting it aside, but only with respect to the particular taxpayer in that case.[79]

[64] *Green Valley Investors, LLC v. Commissioner*, supra note 54, pg. 16 (2022).
[65] *Id.*, pg. 16 (2022).
[66] *Id.*, pg. 17 (2022).
[67] *Id.*, pg. 16 (2022).
[68] *Id.*, pg. 19 (2022) (emphasis added).
[69] *Id.*, pg. 19 (2022).
[70] For more details about this Tax Court case, see Sheppard, "The Accuser Becomes the Accused in the Conservation Easement Context: Courts Hold that the IRS Violated the law in *Green Valley Investors* and Elsewhere," 138 JTAX ___ (March 2023).
[71] *Green Valley Investors, LLC*, supra note 54, pg. 23(2022) (emphasis added).
[72] *Id.*, footnote 5 and 22 (2022).
[73] I.R.C. Section 6110(k)(3); I.R.C. Section 6110(b)(1)(A); I.R.C. Section 7463(b); *Nico*, 67 T.C. 647, 654 (1977) (stating that "we consider neither Revenue Rulings nor Memorandum Opinions of this Court to

- Finally, the IRS issued Chief Counsel Advisory 202244010, indicating that the IRS cannot argue that taxpayers must file both Forms 8275 (Disclosure Statement) and Forms 8886 to avoid the increased economic substance penalty for undisclosed transactions because the sole source of this double duty, Notice 2010-62, contravenes the APA and the IRS's own Policy Statement.[80]

Proposed regulations in 2022

In view of the APA-related snags described above, the IRS swiftly issued the Proposed Regulations in December 2022 as a step toward legally making SCETs listed transactions.[81] Much of the Proposed Regulations is analogous to that of the earlier Notice 2017-10. There is little value in rehashing the old; this article focuses on the new.

Down but not defeated. The IRS seems to be relying on the old belt-and-suspenders approach. It issued the Proposed Regulations to hedge against future losses in the Sixth Circuit Court of Appeals and Tax Court, but warned that it continues "to defend the validity of Notice 2017-10 and other Notices identifying transactions as listed transactions" elsewhere.[82] The IRS also admonished that, from its perspective, the duty to file Forms 8886 and Forms 8918, as well as to maintain certain records, remain in effect under Notice 2017-10 until the IRS can finalize the Proposed Regulations.[83] Indeed, the IRS underscored that the Proposed Regulations "do *not* revoke or modify Notice 2017-10."[84] On a broader note, the IRS, rebuffing recent court decisions, declared that it still adheres to its position that listed transactions, such as SCETs, "can be identified by Notice or other Subregulatory Guidance and that the APA's notice-and-comment procedure does not apply to such transactions."[85]

Fee simple donations. Notice 2017-10 broadly stated that it covered both SCETs and "substantially similar transactions," as defined in the relevant regulations. However, it was silent as to particular items that might fall into the latter category. The Proposed Regulations take a different approach, explaining that certain fee simple donations of real property are substantially similar to SCETs.[86]

Not just big transactions. According to the IRS, one of the hallmarks of SCETs is that the promotional materials offer potential partners the possibility of being allocated a tax deduction that is at least 2.5 times the amount of their capital contribution to the partnership (2.5 Times Rule).[87] However, the Proposed Regulations reserve the right of the IRS to dislike *any* conservation easement donation, regardless of its size. They state that "no inference should be drawn from Notice 2017-10 (or these regulations) regarding the appropriateness of *any* deduction in any specific case, including cases in which the deduction is *less than* two and one-half times the amount of an investor's investment."[88]

The IRS seems to be relying on the old belt-and-suspenders approach.

Focus on tax-exempt entities. Much of the Proposed Regulations is devoted to potential changes affecting tax-exempt entities, such as land trusts, in their role as Qualified Organizations receiving easements.

Excise Taxes and Disclosures. The Proposed Regulations explain that Section 4965 aims to deter

be controlling precedent"); *Huffman*, 126 TC 322, 350 (confirming that "memorandum opinions are not binding"); James S. Halpern, What Has the Tax Court Been Doing? An Update, Tax Notes 1277 (May 30, 2016) (explaining that the "official position of the Tax Court appears to be that, with respect to memorandum opinions, we are not bound by the doctrine of stare decisis").

[74] *Green Valley Investors, LLC*, supra note 54, footnote 22 (2022) (emphasis added).

[75] *CIC Services, LLC*, 129 AFTR 2d 2022-1119 (DC TN 2022).

[76] *Mann Construction, Inc.*, 27 F. 4th 1138 (6th Cir. 2022).

[77] *Liberty Global, Inc.*, 129 AFTR 2d 2022-1373 (DC CO 2022).

[78] "Government Concedes in Conservation Easement Reporting Notice Case," 2022 Tax Notes Today Federal 100-23 (May 20, 2022).

[79] *GBX Associates, LLC*, Case No. 1:22cv401, Memorandum Opinion & Order, District Court Ohio, Nov. 14, 2022.

[80] Chief Counsel Advisory 202244010 (Nov. 4, 2022); "Microcaptive Transactions Are Adequately Disclosed on Form 8886," 2022 Tax Notes Today Federal 214-21 (Oct. 3, 2022); Internal Revenue Service. Policy Statement on the Tax Regulatory Process. March 8, 2019.

[81] REG-106134-22, Syndicated Conservation Easement Transactions as Listed Transactions, Dec. 8, 2022; IRS Announcement 2022-28; DiSciullo, "Proposed Regs Require Reporting of Conservation Easement Deals," 177 Tax Notes Federal 1565 (Dec. 12, 2022).

[82] REG-106134-22, Dec. 8, 2022, pg. 14.

[83] REG-106134-22, Dec. 8, 2022, Background, Section VII (Purpose of Proposed Regulations), pg. 20.

[84] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section VIII (Effect on Other Documents), pg. 32 (emphasis added).

[85] IRS Announcement 2022-28.

[86] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section I (Definition of Syndicated Conservation Easement Transactions), pg. 21.

[87] REG-106134-22, Dec. 8, 2022; Prop. Treas. Reg. 1.6011-9(b)(1).

[88] REG-106134-22, Dec. 8, 2022, Background, Section VI (Syndicated Conservation Easement Transactions and Notice 2017-10), pg. 19.

tax-exempt entities from facilitating prohibited tax shelter transactions, which include listed transactions.[89] If a transaction is a tax-shelter transaction at the time the tax-exempt entity becomes a "party" to it, then the entity must pay certain excise taxes and comply with reporting obligations.[90] An entity is considered a "party" to a transaction if it facilitates such transaction by reason of its tax-exempt, tax-indifferent, or tax-favored status.[91]

An "entity manager" is also subject to excise taxes if such manager approves the entity as a party (or otherwise causes the entity to be a party) to a tax-shelter transaction and knows, or has reason to know, the status of the transaction.[92]

The amount of excise taxes depends on the circumstances. In situations where the tax-exempt entity "unknowingly" becomes a party to a tax shelter transaction, the tax generally is the greater of (i) the highest tax rate under Section 11 (which is currently 21 percent) multiplied by the "net income" of the tax-exempt entity that is attributable to the tax shelter transaction, or (ii) the highest tax rate multiplied by 75 percent of the "proceeds" received by the entity that are attributable to the transaction.[93] The excise taxes increase in cases were the tax-exempt entity "knew or had reason to know" that a particular transaction was a tax shelter. They reach 100 percent of the net income or 75 percent of the proceeds attributable to the tax shelter, whichever figure is larger.[94]

The Proposed Regulations also seek thoughts about the possibility of narrowing the current exception instead of discarding it altogether.

The excise taxes imposed against an entity manager are more straightforward. The IRS can collect $20,000 for each time the manager approves the entity or otherwise causes it to be a party to a tax shelter transaction and knew or should have known then that such transaction was off limits.[95]

When it comes to reporting, a tax-exempt entity subject to excise taxes must file Form 4720 (Return of Excise Taxes Under Chapters 41 and 42 of the Internal Revenue Code), an entity that is a party to a tax shelter transaction must file a Form 8886-T (Disclosure by Tax-Exempt Entity Regarding Prohibited Tax Shelter Transaction), and an entity that is party to a tax shelter and is required to file a Form 990 (Return of Organization Exempt from Income Tax) must disclose its role therein.[96]

Land Trusts as Parties and Participants. Consistent with Notice 2017-10 from six years ago, the Proposed Regulations state that a Qualified Organization to which an easement is donated, such as a land trust, will *not* be treated as a "party" to the SCET for excise tax purposes and will *not* be considered a "participant" for purposes of filing Forms 8886 and/or Forms 8918.[97] That might change, though.

The Proposed Regulations state that the IRS has received tens of thousands of Forms 8886 and Forms 8918 since it issued Notice 2017-10. The IRS claims that such disclosures show that "a small number of qualified organizations facilitate abusive [SCETs], sometimes for several hundreds of investors per year."[98] The IRS suggests that eliminating or limiting the exceptions for Qualified Organizations might deter them from further enabling SCETs.[99]

The Proposed Regulations acknowledge that good actors exist, referring to land trusts that take "affirmative steps" to avoid abuses, such as refusing to participate in a conservation easement transaction in which the appraisal shows a value exceeding the basis in the property by 2.5 times or more, the partnership donates the easement within 36 months of acquiring the property, and/or the value of the donation exceeds $1 million.[100] The Proposed Regulations solicit comments on specific ways that Qualified Organizations can conduct their due diligence to avoid involvement with SCETs.[101]

When it comes to exposure to excise taxes, the Proposed Regulations ask for public comments on potential elimination of the current rule that Qualified Organizations are not "parties" to SCETs. In particular, they seek input about situations in which an entity knows, or should have reason to know, that a particular donation is an SCET.[102] The Proposed Regulations also seek thoughts about the possibility of narrowing the current exception instead of discarding it altogether. In this regard, they explain that the IRS might not treat as "parties" those Qualified Organizations that complete "an adequate amount of due diligence before entering into a transaction."[103] Along with enlightening the IRS about what constitutes sufficient due diligence, the Proposed Regulations also ponder whether any surviving exception should be open only to Qualified Organizations that "have not been previously involved" with SCETs.[104]

Land Trusts as Material Advisors. The Proposed Regulations explain that promoters, appraisers, return preparers, and others who make any tax statement regarding an SCET are material advisors. This status triggers the duty to file Forms 8918 and maintain certain lists for IRS audits, as well as exposure to penalties for non-compliance.

Notice 2017-10 previously indicated that the IRS would *not* treat Qualified Organizations, like land trusts, as material advisors. The Proposed Regulations eliminate this exclusion.[105] They also seek comments on (i) whether land trusts and other Qualified Organizations are receiving fees in exchange for material aid, assistance, or advice with respect to SCETs, (ii) the nature of any services provided, and (iii) reasons why the IRS should or should not exempt Qualified Organizations from material advisor status.[106]

Calculating potential return on investment. The Proposed Regulations feature three new rules regarding how taxpayers determine their return-on-investment.

Cap on Valuation. The Proposed Regulations clarify the 2.5 Times Rule. In situations where the promotional materials suggest or imply *a range* of possible tax deductions, the highest amount in such range will determine whether the 2.5 Times Rule is triggered.[107] Moreover, where inconsistency exists, and one piece of promotional material indicates a higher return than another, the larger figure counts for purposes of the 2.5 Times Rule.[108]

Presumption of SCET Status. In situations where promotional materials are questionable, non-existent, or unavailable, the Proposed Regulations create a rebuttable presumption that the partnership violated the 2.5 Times Rule if the charitable donation occurred within three years after a partner made his capital contribution and the partner claims a tax deduction that is 2.5 times or more than his initial investment.[109] The IRS introduced the presumption "to address taxpayers and promoters who may not be forthcoming about the content or receipt of promotional materials."[110] The partnership can rebut the presumption by establishing, to the satisfaction of the IRS, that none of the promotional materials contained a suggestion or implication that partners might receive tax deductions of 2.5 times or greater.[111] Given the IRS's hostility towards SCETs, that seems like an uphill battle.

Anti-Stuffing Rule. For purposes of calculating the amount of a partner's capital contribution (*i.e.*, investment) in the context of the 2.5 Times Rule, the Proposed Regulations offer a mechanism to stop abuse (Anti-Stuffing Rule).[112] The partner's investment in the partnership is restricted to the amount attributable to the portion of the real property on which the partnership places a conservation easement. Stated another way, if a portion of a partner's investment is directed to something *other than* the real property on which the easement is donated (such as other real property, cash, cash equivalents, digital assets, securities, and other assets), then that portion is *not* counted in determining the applicability of the 2.5 Times Rule.[113] The Proposed Regulations offer an example of how the Anti-Stuffing Rule functions:

Facts. A, an individual, purchased an interest in a Partnership that owns both real property with a fair market value of $500,000 and marketable securities

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[89] I.R.C. Section 4965)(e)(1)(A); REG-106134-22, Dec. 8, 2022, pg. 12.
[90] I.R.C. Section 4965(a)(1); REG-106134-22, Dec. 8, 2022, pg. 12.
[91] Treas. Reg. 53.4965-4(a)(1); REG-106134-22, Dec. 8, 2022, pg. 13.
[92] I.R.C. Section 4965(a)(2); Treas. Reg. 53.4965-6; REG-106134-22, Dec. 8, 2022, pg. 12.
[93] I.R.C. Section 4965(b)(1)(A); REG-106134-22, Dec. 8, 2022, pg. 13. The terms "net income" and "proceeds" for these purpose are defined in Treas. Reg. 53.4965-8.
[94] I.R.C. Section 4965(b)(1)(B); REG-106134-22, Dec. 8, 2022, pg. 13.
[95] I.R.C. Section 4965(b)(2); REG-106134-22, Dec. 8, 2022, pg. 13.
[96] Treas. Reg. 53.6011-1, Treas. Reg. 1.6033-5, Treas. Reg. 1.6033-2, REG-106134-22, Dec. 8, 2022, pgs. 14-15.
[97] REG-106134-22, Dec. 8, 2022; Prop. Treas. Reg. 1.6011-9(e)(3) and (f).
[98] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section V (Party to a Prohibited Tax Shelter Transaction), pgs. 26-27.
[99] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section V (Party to a Prohibited Tax Shelter Transaction), pg. 27.
[100] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section V (Party to a Prohibited Tax Shelter Transaction), pg. 27.
[101] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section V (Party to a Prohibited Tax Shelter Transaction), pg. 27.
[102] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section V (Party to a Prohibited Tax Shelter Transaction), pg. 29.
[103] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section V (Party to a Prohibited Tax Shelter Transaction), pg. 29.
[104] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section V (Party to a Prohibited Tax Shelter Transaction), pg. 29.
[105] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section IV (Material Advisors), pgs. 25-26.
[106] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section IV (Material Advisors), pgs. 25-26.
[107] REG-106134-22, Dec. 8, 2022; Prop. Treas. Reg. 1.6011-9(d)(1).
[108] REG-106134-22, Dec. 8, 2022; Prop. Treas. Reg. 1.6011-9(d)(1).
[109] REG-106134-22, Dec. 8, 2022; Prop. Treas. Reg. 1.6011-9(b)(2).
[110] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section II (2.5 Times Rule), pgs. 23-24.
[111] REG-106134-22, Dec. 8, 2022, Explanation of Provisions, Section II (2.5 Times Rule), pg. 24.
[112] REG-106134-22, Dec. 8, 2022; Prop. Treas. Reg. 1.6011-9(b)(3).
[113] REG-106134-22, Dec. 8, 2022; Prop. Treas. Reg. 1.6011-9(d)(3).

with a fair market value of $500,000. A is one of four equal investors in Partnership, each of whom purchased his interest for $250,000. The promotional materials stated that the Partnership expected to allocate a charitable contribution deduction of $500,000 to each investor; that is, two times the amount invested. After all four investors purchased their interests, the Partnership donated a conservation easement to a qualified organization and reported a $2 million charitable contribution deduction on its Form 1065 based on an appraisal it obtained. The Schedule K-1 that the Partnership furnished to A indicated that that the Partnership allocated him a charitable contribution deduction of $500,000.

Analysis. Applying the Anti-Stuffing Rule, the amount of A's investment in the Partnership that is attributable to the real property on which a conservation easement was donated is $125,000 (i.e., 50 percent of his total investment of $250,000). A's investment for purposes of the 2.5 Times Rule was $125,000 and A's expected tax deduction according to the promotional materials was $500,000. Consequently, the expected return was four times A's investment, which exceeds the 2.5 Times Rule and makes the transaction an SCET.[114]

Expanded definition of promotional materials. As explained above, the definition of SCET contemplates, among other things, that the potential partner received "promotional materials" containing certain information. Notice 2017-10 simply cross-referenced existing regulations, which defined the term "promotional materials" as tax analyses, tax opinions, and other written items "that are material to an understanding of the purported tax treatment or tax structure of the transaction that have been shown or provided to any person who acquired or may acquire an interest in the transaction, or to their representatives, tax advisors, or agents, by the material advisor or any related party or agent of the material advisor."[115]

The Proposed Regulations expand on this notion. They indicate that "promotional materials" encompass everything in the prior definition, plus any other written or oral communication provided to potential investors, such as marketing materials, appraisals (preliminary, draft, or final), websites, deeds, private placement memoranda, operating agreements, subscription agreements, and statements about the anticipated value of the conservation easement or charitable deduction.[116]

Conclusion

Conservation easement battles continue, and the IRS's methods seem to get more drastic over time. After suffering multiple defeats based on violations of the APA, including the invalidation of Notice 2017-10, the IRS is now seeking redemption through the swift issuance of the Proposed Regulations. Taxpayers and their advisors will be watching the regulatory process closely, eager to gauge the effects on easement donations, fee simple gifts, land trusts, and more. ■

[114] REG-106134-22, Dec. 8, 2022; Prop. Treas. Reg. 1.6011-9(d)(4). The author modified the example to make it clearer to readers.

[115] Treas. Reg. 301.6112-1(b)(3)(iii)(B).

[116] REG-106134-22, Dec. 8, 2022; Prop. Treas. Reg. 1.6011-9(c)(4).