

The Conservation Easement Controversy: IRS Attacks, Taxpayer Victories, and New Guidance



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INTRODUCTION

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- Misinformation, hyperbole, chest-thumping, other “noise”
- Purpose of this presentation

OVERVIEW OF CONSERVATION EASEMENT DONATIONS

OVERVIEW OF EASEMENT DONATION PROCESS

- What are common options for undeveloped land?
 - Hold for appreciation and later sale
 - Develop to maximize profitability at all costs
 - Conserve permanently

OVERVIEW OF EASEMENT DONATION PROCESS

- For what purposes can land be conserved?
 - Outdoor recreation by, or education of, public
 - A relatively natural habitat
 - Open space for scenic enjoyment by public + significant benefit
 - Open space pursuant to government policy + significant benefit
 - Historical land or structure

OVERVIEW OF EASEMENT DONATION PROCESS

- Can taxpayers reserve rights on conserved property?
 - Rights cannot unduly conflict with conservation purposes
 - Examples of reserved rights
 - Building structures
 - Residing
 - Operating golf course
 - Timbering
 - Farming
 - Hunting

OVERVIEW OF EASEMENT DONATION PROCESS

- How do taxpayers prove condition of property?
 - Baseline Report
 - Generally prepared by land trust
 - Contains maps, surveys, pictures, inventory, etc.

OVERVIEW OF EASEMENT DONATION PROCESS

- What is an easement donation worth?
 - Fair market value of the easement
 - Before-and-after method
 - Highest and best use = hypothetical

OVERVIEW OF EASEMENT DONATION PROCESS

- What is an easement donation worth? (cont.)
 - Highest and best use criteria
 - Physically possible
 - Legally permissible
 - Financially feasible
 - Maximally productive
 - Any realistic potential use, not current use

OVERVIEW OF EASEMENT DONATION PROCESS

- What is an easement donation worth? (cont.)
 - Highest and best use examples
 - Residential subdivision
 - Mixed-use development
 - Mineral mining
 - Solar energy
 - Active retirement community
 - Sports complex

OVERVIEW OF EASEMENT DONATION PROCESS

- How do taxpayers claim deductions?
 - Conduct extensive due diligence
 - Obtain tax, legal, and financial analyses
 - Research/get zoning, permitting, other approvals
 - Get Qualified Appraisal
 - From Qualified Appraiser
 - Donate to a Qualified Organization

OVERVIEW OF EASEMENT DONATION PROCESS

- How do taxpayers claim deductions? (cont.)
 - Get Baseline Report
 - Complete, execute, and attach Form 8283
 - Complete and file Forms 8886
 - Complete and file Form 8918

OVERVIEW OF EASEMENT DONATION PROCESS

- How do taxpayers claim deductions? (cont.)
 - Properly file Deed of Conservation Easement
 - Get contemporaneous written acknowledgments
 - Remove or subordinate all encumbrances
 - Issue Schedules K-1

LEGISLATIVE ACTIONS

LEGISLATIVE ACTIONS

- Congressional support for over 50 years
- Recurrent warnings by IRS
- Bipartisan support acknowledged

SPECIALIZED IRS ENFORCEMENT ACTIONS

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Introduction
 - Despite legislative actions, IRS attacks
 - Long list of enforcement techniques

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Labeling SCETs and SSTs “listed transactions”
 - Notice 2017-10 in December 2016
 - Effects
 - Participants file Forms 8886
 - Material advisors file Forms 8918
 - Material advisors keep records

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Implementing a “compliance campaign”
 - Designated IRS personnel
 - Audit all SCETs and SSTs

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Attacking “technical” flaws
 - Lack of charitable intent – quid pro quo
 - Conditional donation
 - No contemporaneous written acknowledgement
 - Qualified Appraisal not attached to Form 1065
 - Not a Qualified Appraisal
 - Not a Qualified Appraiser
 - Not a Qualified Organization

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Attacking “technical” flaws (cont.)
 - Qualified Appraisal out of time
 - Appraisal fee is percentage of deduction
 - Form 8283 missing, unexecuted, or incomplete
 - Inaccurate tax basis on Form 8283
 - Not all encumbrances subordinated
 - Deed not timely filed
 - Baseline Report is insufficient

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Attacking “technical” flaws (cont.)
 - Proceeds-upon-extinguishment clause
 - Merger clause
 - Amendment clause
 - Excessive reserved rights
 - Not accessible by public
 - Public benefit not “significant”
 - Insufficient protected specifics
 - Not linked to specific government policy

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Predetermined and vague conclusions
- Standard positions by IRS in litigation
 - \$0 deduction due to “technical” arguments
 - \$0 deduction due to conservation arguments
 - \$0 deduction to valuation arguments
 - Plus list of alternative penalties

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Attempts to enjoin activities
- Theories announced in injunction lawsuit
 - Lack of business purpose
 - Lack of true partnership
 - Lack of economic substance
 - Civil fraud
 - Sham transaction

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Name calling
 - “Dirty Dozen” list
 - Separate press releases

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Senate Finance Committee investigation
 - Report issued in August 2020 – predictable
 - No specific recommendations
 - Need to improve, not eliminate, Section 170(h)

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Warnings, threats, and rhetoric
- Avenues – press releases, conferences, quotes
- Expanded actions unveiled
 - Pursuing many parties
 - OPR referrals
 - Technical, procedural, judicial, etc. positions
 - All civil penalties
 - Simultaneous civil and criminal
 - Hiring outside appraisers

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Pursuing supposed “promoters”
 - New Promoter Investigations Coordinator
 - Starting several Section 6700 investigations

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Searching for fraud
 - New Fraud Enforcement Office
 - Two recent IRS memos about fraud

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Swifter summonses
 - Changes via IRS memo in February 2020
 - Eliminates three-step process
 - Urge use of all tools, including Summonses

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Neglecting the facts
 - Acknowledgment-of-facts IDRs
 - IRS underscores benefits before
 - New IRS memo in February 2020
 - No such IDRs for listed transactions

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Revoking protections for appraisers
 - Before - review by five IRS personnel
 - IRS memo in January 2020
 - Section 6695A penalties and OPR referral
 - Now - one Revenue Agent handles

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Polemical settlement initiative
 - Announced in June 2020
 - Does not conclude all matters
 - Differential treatment – category one and two
 - Divide and conquer strategy?

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Efforts to undermine privilege
 - IRS seeking all pre-donation communications
 - Section 7525 and FATP
 - Five limitations of FATP privilege
 - Privilege challenges by IRS

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Using same data in multiple contexts
 - Section 6103 protections
 - Covers returns and return information
 - Five exceptions
 - Three IRS Notices
 - Effects on SCETs and SSTs

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Disqualifying or punishing earlier advisors
 - Broad initial IDRs
 - Follow-up questions regarding professionals
 - Reasons for inquiries

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Challenging ability to make Qualified Offers
 - Option - Section 7430 and prevailing party
 - Option - Qualified Offer
 - Only two relevant cases; one precedential
 - Current stance by IRS despite precedent

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Attacking “substantially similar transactions”
 - Notice 2017-10
 - Applies to SCETs and SSTs
 - Effects
 - File Forms 8886 and Forms 8918
 - Potential penalties
 - List maintenance
 - Indefinite assessment-period

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Attacking “substantially similar transactions” (cont.)
- Attempts to differentiate from Notice 2017-10
 - Fee simple instead of easement
 - No promotional materials
 - Hold property more than one year
 - Benefit less than 2.5 times

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Attacking “substantially similar transactions” (cont.)
- Broad definition of SSTs
 - What do the regulations say?
 - What do the IRS examples say?
 - What do the IRS pronouncements say?
 - What do the courts say?

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Lack of sample Deed language
 - Various parties requested “model language”
 - Safe Harbor suggestion by the National Taxpayer Advocate
 - IRS response – “other workload priorities”

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Criminal penalties for ignoring Summonses
 - Several options available to the IRS
 - Section 7210 – criminal charge – one year and \$1,000
 - DOJ attorney says “underused” and “take it to heart”
 - Internal Revenue Manual – power tool but backfires

SPECIALIZED IRS ENFORCEMENT ACTIONS

- Making inappropriate third party contacts
 - IRS generally can make TPCs
 - Disagreement about proper starting point
 - Legislative history – ask the taxpayer first
 - Internal Revenue Manual – ask the taxpayer first
 - Court of Appeals – ask the taxpayer first

NEWEST ISSUES IN THE WORLD OF EASEMENTS

NEW EASEMENT ISSUES

- Reduced Deductions Based on Land Characterization
 - Overview
 - Tax deduction = FMV of donation
 - Reduced by non-long-term, non-capital gain property
 - Inventory character transfers with contribution
 - Called “inventory issue”

NEW EASEMENT ISSUES

- Reduced Deductions Based on Land Characterization (cont.)
 - First of many cases – Glade Creek
 - Three-round battle
 - Tax Court - \$0 and “substantial” penalty
 - Court of Appeals – invalid regulation
 - Tax Court – inventory, limited to basis

NEW EASEMENT ISSUES

- Proposed Regulations - Listed Transaction Status
 - Introduction
 - Courts held IRS violated APA with Notice 2017-10
 - IRS reaction – issued Proposed Regulations in Dec. 2022
 - Three weeks later, Congress issued Secure Act
 - Different purpose, timing, terms, etc. = confusion

NEW EASEMENT ISSUES

- Proposed Regulations - Listed Transaction Status (cont.)
 - Tax Court invalidates Notice 2017-10
 - Green Valley Investors in 2022
 - IRS imposed Reportable Transaction Penalty
 - TP disputes arguing not a reportable transaction
 - Tax Court rules IRS violated the APA
 - “Intends to apply to all similarly situated”

NEW EASEMENT ISSUES

- Proposed Regulations - Listed Transaction Status (cont.)
 - Lingering IRS defiance
 - Will respect only for Sixth Circuit cases
 - Filing duties remain until finalization date
 - APA does not apply, and Notices are okay

NEW EASEMENT ISSUES

- Proposed Regulations - Listed Transaction Status (cont.)
 - 2.5 Times Reporting Rule
 - Promotional materials offer 2.5 times or more ROI
 - IRS cannot dislike any transaction, even if below

NEW EASEMENT ISSUES

- Proposed Regulations - Listed Transaction Status (cont.)
 - Calculating 2.5 Times Reporting Rule – three items
 - Aiming high – range or inconsistency
 - Presumption of SCET status – no materials
 - Anti-Stuffing Rule
 - Only property money counted
 - IRS example

NEW EASEMENT ISSUES

- Proposed Regulations - Listed Transaction Status (cont.)
 - Definition of “promotional materials” expanded
 - What Notice 2017-10 said earlier
 - Expanded meaning in Proposed Regulations
 - Appraisals, Deeds, PPMs, subscriptions

NEW EASEMENT ISSUES

- Proposed Regulations - Listed Transaction Status (cont.)
 - Focus on tax-exempt entities
 - Overview
 - If TEO is a “party,” must pay excise taxes
 - Facilitates because of TEO status
 - Entity Manager also might get hit with excise taxes
 - Knows or should know

NEW EASEMENT ISSUES

- Proposed Regulations - Listed Transaction Status (cont.)
 - Land trusts as “parties” to listed transaction
 - Not a “party” for excise tax purposes
 - Not a “participant” for Form 8886 purposes
 - This might change – seeking comments
 - IRS says “good actors” exist

NEW EASEMENT ISSUES

- Proposed Regulations - Listed Transaction Status (cont.)
 - Land trusts as “Material Advisors” to listed transaction
 - Organizers, appraisers, accountants – yes
 - Triggers Form 8918 filing duty
 - Before – land trusts not Materials Advisors
 - Now – land trusts can be Materials Advisors

NEW EASEMENT ISSUES

- Congress Intervenes – Secure Act
 - General Disallowance Rule
 - New Section 170(h)
 - \$0 deduction if ROI exceeds 2.5 times “relevant basis”

NEW EASEMENT ISSUES

- Congress Intervenes – Secure Act
- General Disallowance Rule (cont.)
 - Three exceptions
 - Historic Preservation Exception
 - Family Limited Partnership Exception
 - Three-Year Hold Exception

NEW EASEMENT ISSUES

- Congress Intervenes – Secure Act
 - General Disallowance Rule (cont.)
 - Additional content
 - IRS shall issues more regulations
 - 40% penalty if 2.5 Times Disallowance Rule
 - No reasonable cause defense to penalty
 - Rejection of two arguments – “no inference”
 - ROI has no bearing on earlier donations
 - Later donations okay if less than 2.5 times

NEW EASEMENT ISSUES

- IRS Issues Safe Harbors
 - Background
 - Disallowances based on technical flaws
 - Flaws often in Deeds (or other documents)
 - IRS did not fix voluntarily
 - Congress mandated a fix in the Secure Act
 - Safe harbors had little effect/benefit

NEW EASEMENT ISSUES

- IRS Issues Safe Harbors
 - Safe harbors on the horizon
 - Only for extinguishment clauses and boundary line changes
 - Some donors could “correct” Deeds
 - Done within 90 days and effective to original filing

NEW EASEMENT ISSUES

- IRS Issues Safe Harbors
 - Safe harbors on the horizon (cont.)
 - Four restrictions by Congress
 - N/A to reportable transactions
 - N/A if violates 2.5 Times Disallowance Rule
 - N/A if already in litigation
 - N/A if Section 6662 or 6663 penalty determined

NEW EASEMENT ISSUES

- IRS Issues Safe Harbors
 - Background
 - Extinguishment clauses
 - Boundary line changes
 - Not a new idea – requests for model language
 - Deadline was July 24, 2023
 - IRS did minimum per Secure Act

CONCLUSION

Thank You

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