Analyzing Five Obscure IRS Actions in 2020 with Serious Implications for Conservation Easement Disputes

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This article provides an overview of the easement donation process, describes many of the well-known IRS enforcement techniques, and analyzes the significance of the more obscure steps, largely procedural in nature, taken by the IRS lately.

The IRS has been aggressively challenging partnerships that donate conservation easements for years, with widespread publicity being a hallmark of enforcement. As a result of this information campaign, supplemented by a steady flow of Tax Court decisions, most people have a decent understanding of the current state of affairs. The IRS has taken some critical steps in recent months, though, that have gone largely unnoticed. They consist of appointing a Promoter Investigations Coordinator, creating a new Fraud Enforcement Office, publishing an expanded Form 8886 (Reportable Transaction Disclosure Statement), eliminating certain procedural protections for taxpayers during easement audits, and scrapping a multi-level review process designed to avoid improper appraiser penalties. This article provides an overview of the easement donation process, describes many of the well-known IRS enforcement techniques, and analyzes the significance of the more obscure steps, largely procedural in nature, taken by the IRS lately.

Overview of Conservation Easement Donations and Deductions

Taxpayers who own undeveloped real property have several choices. For instance, they might (i) hold the property for investment purposes, selling it when it appreciates sufficiently, (ii) determine how to maximize profitability from the

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property and do that regardless of the negative effects on the local environment, community, economy, etc., or (iii) donate an easement on the property to a charitable organization, such that it is protected forever for the benefit of society.

The third option, known as donating a "conservation easement," not only achieves the goal of environmental protection, but also triggers another benefit, tax deductions for donors. Taxpayers generally must donate their entire legal interest in a particular piece of property, not just part of their interest, in order to qualify for a tax deduction.[1] This is a critical concept, as taxpayers who own all attributes of a piece of real property (i.e., they own it in "fee simple," in legal terms) do not donate the property outright to a charitable organization in the easement context. Instead, they retain ownership of the property, but give an easement on such property to an independent, non-profit organization with the ability, capacity, willingness, and resources to safeguard the property forever. This is usually a land trust. Provided that the easement, which is just a partial interest in property, constitutes a "qualified conservation contribution," taxpayers are entitled to the tax deduction.[2]

As one would expect, taxpayers cannot donate an easement on any old property and claim a tax deduction; they must demonstrate that the property was worth protecting. A donation has an acceptable "conservation purpose" if it meets at least one of the following requirements: (i) It preserves land for outdoor recreation by, or the education of, the general public; (ii) It preserves a relatively natural habitat of fish, wildlife, or plants, or a similar ecosystem; (iii) It preserves open space (including farmland and forest land) for the scenic enjoyment of the general public and will yield a significant public benefit; (iv) 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 (v) It preserves a historically important land area or a certified historic structure.[3]

Taxpayers memorialize the donation to charity by filing a public Deed of Conservation Easement ("Deed"). In preparing the Deed, taxpayers often coordinate with the land trust to identify certain limited activities that can continue on the property after the donation, without interfering with the Deed, without prejudicing the conservation purposes, and without jeopardizing the tax deduction.[4] These activities are called "reserved rights." The IRS openly recognizes, in its Conservation Easement Audit Techniques Guide ("ATG"), that reserved rights are ubiquitous in Deeds.[5]

The IRS will not allow the tax deduction stemming from a conservation easement unless the taxpayer provides the land trust, before making the donation, "documentation sufficient to establish the condition of the property at the time of the gift."[6] This is called the Baseline Report. It may feature several things, including, but not limited to, (i) the survey maps from the U.S. Geological Survey, showing the property line and other contiguous or nearby protected areas, (ii) a map of the area drawn to scale showing all existing man-made improvements or incursions, vegetation, flora and fauna (*e.g.*, locations of rare species, animal breeding and roosting areas, and migration routes), land use history, and distinct natural features, (iii) an aerial photograph of the property at an appropriate scale taken as close as possible to the date of the donation, and (iv) on-site photographs taken at various locations on the property.[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, with neither party being obligated to participate in the transaction, and with both parties having reasonable knowledge of the relevant facts.[9] The IRS explains in its ATG that the best evidence of the FMV of an easement would be the sale price of other easements that are comparable in size, location, usage, etc. The ATG recognizes, though, that it is difficult, if not impossible, to find comparable sales of properties encumbered by easements.[10] Consequently, appraisers often must use the before-and-after method instead. This means that an appraiser must determine the highest and best use ("HBU") of the property *and* the corresponding FMV 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.[11] The difference between the "before" value and "after" value, with certain other adjustments, produces the value of the easement donation.

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1 Section 170(a)(1); Reg. 1.170A-1(a); Section 170(f)(3)(A); Reg. 1.170A-7(a)(1).

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

3 Section 170(h)(4)(A); Reg. 170A-14(d)(1); S. Rept. 96–1007, at 10 (1980).

4 Reg. 1.170A-14(b)(2).

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

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

7 Reg. 1.170A-14(g)(5)(i).

8 Section 170(a)(1); Reg. 1.170A-1(c)(1).

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

10 Internal Revenue Service, Conservation Easement Audit Techniques Guide (rev. 11/4/2016), pg. 41.

11 *Id.*

12 Stanley Works & Subs., 87 TC 389, 400 (1986); Reg. 170A-14(h)(3)(i) and (ii).

13 Olson v. United States, 292 U.S. 246, 255 (1934).

14 Esgar Corp., 744 F.3d 648, 659 n.10 (CA-10, 2014).

15 *Id.* at 657.

16 Symington, 87 TC 892, 896 (1986).

17 *See* Internal Revenue Service, Conservation Easement Audit Techniques Guide (rev. 11/4/2016), 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.

18 IR-2019-182, 11/12/2019, "IRS Increases Enforcement Action on Syndicated Conservation Easements"; IR-2019-213, 12/20/2019, "IRS Continues Enforcement Efforts in Conservation Easement Cases Following Latest Tax Court Decision"; Nathan J. Richman, "Multiple Divisions Coming for Syndicated Conservation Easements," 2019 Tax Notes Today 220-3 (11/13/2019); William Hoffman, "Conservation Easement Crackdown a Portent, Rettig Says," 2019 Tax Notes Today 221-9 (11/14/2019); Kristen A. Parillo, "IRS Is Building Up Its Easement Toolbox," 2019 Tax Notes Today 222-6 (11/15/2019); Kristen A. Parillo, "IRS Looking for Promoter Links as Easement Crackdown Grows," Tax Notes Today, Doc. 2019-47134 (12/13/2019).

19 Section 6700(a)(1).

As indicated above, in calculating the FMV of property, appraisers and courts must take into account not only the current use of the property, but also its HBU.[12] A property's HBU is the most profitable use for which it is adaptable and needed in the reasonably near future.[13] The term HBU has also been defined as the use of property that is physically possible, legally permissible, financially feasible, and maximally productive.[14] Importantly, valuation in the easement context does not depend on whether the owner has actually put the property to its HBU in the past.[15] The HBU can be *any* realistic potential use of the property.[16] Common HBUs are construction of a residential community, creation of a mixed-use development, or mining.

Properly claiming the tax deduction stemming from an easement donation is surprisingly complicated. It involves a significant amount of actions and documents. The main ones are as follows: The taxpayer must (i) obtain a "qualified appraisal" from a "qualified appraiser," (ii) demonstrate that the land trust is a "qualified organization," (iii) obtain a Baseline Report adequately describing the condition of the property at the time of the donation and the reasons why it is worthy of protection, (iv) complete a Form 8283 (Noncash Charitable Contributions) and have it executed by all relevant parties, including the taxpayer, appraiser, and land trust, (v) assuming that the taxpayer is a partnership, file a timely Form 1065, enclosing Form 8283 and the qualified appraisal, (vi) receive from the land trust a "contemporaneous written acknowledgement," both for the easement itself and for any endowment/stewardship fee donated to finance perpetual protection of the property, and (vii) send all the partners their Schedules K-1 (Partner's Share of Income, Deductions, Credits, etc.) and a copy of Form 8283.[17]

Things People Know—A Potpourri of IRS Pressure

The U.S. government has been attacking partnerships that make easement donations in a variety of ways. For instance, it (i) identified them as "listed transactions" in Notice 2017-10, (ii) mandated the filing of Forms 8886 (Reportable Transaction Disclosure Statement) and Forms 8918 (Material Advisor Disclosure Statement) by various parties, (iii) launched a "compliance campaign" consisting of dozens of specialized Revenue Agents and other IRS personnel, (iv) filed a Complaint in District Court seeking a permanent injunction against certain organizers and appraisers, (v) featured easement transactions on the IRS's "dirty dozen" list, (vi) started an inquiry by the Senate Finance Committee on potential abuses, and (vii) initiated a widespread practice of issuing audit reports claiming that tax deductions should be $0 and imposing severe penalties, regardless of the amount of pre-donation due diligence conducted by taxpayers, the magnitude of the conservation values of the properties, the attainment of multiple independent appraisers, etc.

The IRS, through the Commissioner, Chief Counsel, and other high-ranking officials, began intensifying the rhetoric and warnings recently. This messaging has manifested itself in the form of IRS news releases, public statements at tax conferences, and articles. The IRS has emphasized that it is (i) pursuing promoters, appraisers, return preparers, material advisors, accommodating entities, charitable organizations, and others, (ii) making referrals to the Office of Professional Responsibility ("OPR"), (iii) raising a long list of technical, procedural, legal and tax arguments in disputes, while constantly trying to develop more, (iv) asserting all possible civil penalties, (v) conducting simultaneous civil examinations and criminal investigations, (vi) contracting with a significant number of appraisers from the private sector to handle the workload, and (vii) litigating a large number of cases in Tax Court.[18]

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Things People Might Not Know—Obscure Procedural Changes

Unless people have been living in isolation, deprived of outside communication, for years before the coronavirus appeared, they probably have some knowledge about the IRS actions described in the preceding segment of this article. However, many people, including lots of taxpayers and professionals involved in the conservation easement arena, might be unaware of several other recent actions by the IRS, as they were introduced with little fanfare. Below is a description of these actions.

Appointment of New Promoter Investigations Coordinator

Section 6700 is a provision whose title lacks no subtlety: "Promoting Abusive Tax Shelters, etc." It allows the IRS to assert "promoter penalties" against three main categories of people. First, the IRS can penalize any person who either personally organizes or assists in the organization of a partnership or other entity, an investment plan or arrangement, or any other plan or arrangement, or participates directly or indirectly in the sale of any ownership interest in any such entity, plan, or arrangement.[19] In essence, the IRS can castigate persons who organize or sell "tax shelters" to taxpayers.

Second, the IRS can pursue any person (i) who makes or furnishes, or causes another to make or furnish (in connection with the organization or sale of an entity, plan, or arrangement), a statement regarding the allowability of any deduction or credit, the excludability of any income, or the attainment of any other tax benefit by the taxpayer as a result of holding an ownership interest in the entity or participating in the plan or arrangement, and (ii) who actually knows, or has reason to know, that the statement is materially false or fraudu-

lent.[20] In short, the IRS is authorized to punish persons who intentionally make or cause others to make untrue or fraudulent statements to taxpayers regarding "tax shelters."

Finally, the IRS can sanction any person who personally makes or furnishes, or causes another to make or furnish, a "gross valuation overstatement" as to any material matter.[21]

The IRS indicated in late January 2020 that it intended to appoint one executive to be the "Promoter Investigations Coordinator" across the entire agency. Less than a month later, the IRS announced that it had put in place a "temporary" coordinator, who would be in charge of coordinating with the Civil Division, Criminal Investigation Division, Chief Counsel, and Office of Professional Responsibility to develop and implement promoter enforcement, on both an individual and strategic level.[22]

Creation of New Fraud Enforcement Office

The Internal Revenue Manual ("IRM") provides a clear description of the high standard that the IRS would be required to meet:

> Civil fraud penalties will be asserted when there is clear and convincing evidence to prove that some part of the underpayment of tax was due to civil fraud. Such evidence must show the taxpayer's intent to evade tax which the taxpayer believed to be owing. Intent is distinguished from inadvertence, reliance on incorrect technical advice, honest difference of opinion, negligence, or carelessness.[23]

Each allegation of fraud is decided on its own particular facts, and no single factor is decisive. Factors that courts have cited as indications of fraud include: (i) understatement of income, (ii) inadequate records, (iii) failure to file tax returns, (iv) implausible or inconsistent explanations of behavior, (v) fictitious transactions and entities, (vi) concealment of assets, (vii) failure to cooperate with tax authorities, (viii) engaging in illegal activities, (ix) attempting to conceal illegal activities, (x) dealing in cash, and (xi) failure to make estimated tax payments.[24]

The taxpayer's level of sophistication is another relevant factor in determining fraudulent intent, but the courts have not imposed fraud penalties on relatively sophisticated taxpayers who were uninformed about tax law. The case of *Graves* illustrates the concept.[25] In that case, a husband and wife were both college graduates. The husband was a stockbroker, while the wife worked as an assistant to a sales manager in a stock brokerage firm. Both were financially sophisticated individuals. They improperly deducted "contributions" to a "charitable foundation" they used to pay the private school tuition of their children, having failed to investigate the legality of the deductions. They did not conceal the nature of the contributions, either from their accountant or from the IRS during audit, nor did they display any other generally accepted badges of fraud. Under these circumstances, their financial sophistication, coupled with failure to investigate, did *not* indicate fraud.

No recent Tax Court decisions involving conservation easement donations contain claims by the IRS that the partnership committed fraud. This makes sense, because proving fraud would be difficult for the IRS to do, particularly when a partnership (i) engaged in considerable due diligence before making an easement donation, such as reliance on title reports, marketing studies, Baseline Reports, multiple valuations by independent appraisers, cost estimates, tax or legal opinions by attorneys, returns prepared by informed accountants, and more, (ii) claimed the easement deduction pursuant to Section 170(h), as enacted and expanded over the years by Congress, (iii) disclosed the donation to the IRS by enclosing with its timely Forms 1065 a Form 8283, qualified appraisal, and Form 8886, (iv) maintained all relevant tax, financial, and legal records, and (v) fully cooperated with the IRS audit.

The lack of civil fraud claims in the easement context is also logical because in order to be successful the IRS would have to establish, by clear and convincing evidence, that there is a tax underpayment, and such underpayment is attributable to fraud.[26] Fraudulent intent is determined at the time a taxpayer signs

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[20] Section 6700(a)(2)(A).

[21] Section 6700(a)(2)(B). For these purposes, the term "gross valuation overstatement" means any statement regarding the value of any property or service if such value exceeds 200 percent of the correct amount, and the value is directly related to the amount of any deduction or credit under Chapter 1 (normal taxes and surtaxes) of the Internal Revenue Code to any participant. *See* Section 6700(b)(1).

[22] Kristen A. Parillo. "IRS Assigns Point Person on Promoter Investigations," Federal Tax Notes Today Doc. 2020-6890 (02/25/2020).

[23] Internal Revenue Manual § 20.1.5.12.2 (10/01/2005).

[24] Meier, 91 TC 273 (1988). *See also* Toushin, 223 F.3d 642 (CA-7, 2000); Bradford, 796 F.2d 303 (CA-9, 1986); Hicks Co., 56 TC 982 (1971).

[25] Graves, TCM 1994-616; *See also* Gow, TCM 2000-93.

[26] Section 7454(a); Tax Court Rule 142(b); Section 6663.

[27] Merritt, 301 F.2d 484, 487 (CA-5, 1962); Wilson, 76 TC 623 (1981); Coleman, TCM 1988-538.

[28] Piekos, TCM 1982-602; Broadhead, TCM 1955-328.

[29] *See, e.g.,* Comparato, TCM 1993-52.

[30] IRS News Release IR-2020-49, 03/05/2020.

[31] Reg. 1.6011-4(e)(1).

[32] Notice 2017-10, section 3. In situations where a multi-tier partnership structure is used, all tiers are deemed to be "participants."

[33] Section 6707A(a), (b); Reg. 301.6707A-1(a).

[34] Section 6707A(b)(2); Reg. 301.6707A-1(a). The minimum penalty is $5,000 for individuals and $10,000 for entities. *See* Section 6707A(b)(3); Reg. 301.6707A-1(a).

[35] Section 6707A(d)(1).

[36] *See, e.g.*, Barzillai v. United States, 137 Fed. Cl. Ct. 788, 121 AFTR 2d 2018-1582 (2018); Larson v. United States, 888 F.3d 578, 121 AFTR 2d 2018-1598 (CA-2, 2018).

[37] Section 6662A(a); Section 6662A(c).

[38] Section 6501(c)(10); Reg. 301.6501(c)-1(g)(7); Reg. 301.6501(c)-1(g)(8) (ex. 14). The assessment-period remains open until one year after, the earlier of, when the participant eventually files Form 8886, or when the material advisor provides the IRS with the required list of data about the SCET in response to the written request from the IRS.

[39] Instructions for Form 8886 (Reportable Transaction Disclosure Statement) (rev. Aug. 2017), pg. 6.

[40] *Id.* at pp. 6-7.

[41] Instructions for Form 8886 (Reportable Transaction Disclosure Statement) (rev. Dec. 2019), p. 1. The "What's New" portion of the Instructions for Form 8886 state that "[n]ew Lines 7b, 7c and 7d request total dollar amounts of your tax benefit(s), number of years of anticipated benefit, and your total investment or basis in the reportable transaction."

[42] *Id.* at pg. 6 (emphasis added).

[43] *Id.*

a tax return with the intention of filing it, or when the return is actually filed.[27] Thus, the fraud penalty cannot be sustained if no fraudulent intent existed at these critical points, even if the taxpayer *later* acquires knowledge of an impropriety.[28] Courts have repeatedly refused to uphold civil fraud penalties where some post-filing events, such as contact by the IRS, triggered a taxpayer's awareness that a previous return was incorrect.[29]

The difficulties described above in assessing civil fraud penalties in the easement context have not deterred the IRS. Indeed, in early March 2020, the IRS announced that it had formed the new "Fraud Enforcement Office," whose leader will be working closely with the new "Promoter Investigations Coordinator," described above.[30]

Introduction of Expanded Form 8886

Notice 2017-10 identified syndicated conservation easement transactions ("SCETs") as "listed transactions." This characterization triggers several consequences, one of which is the need for participants to file Forms 8886.

A taxpayer has "participated" in an SCET if his/its tax return reflects the tax consequences or strategies described in Notice 2017-10. For instance, a partner who receives a Schedule K-1 from a partnership that has engaged in an SCET has "participated" in the transaction.[31] Notice 2017-10 indicates that "participants" in SCETs include investors/partners, the pass-through entity that actually engaged in the transaction, and any other person whose tax return reflects the tax consequences or strategies described as an SCET.[32]

Downsides of violating Form 8886 filing duties abound. First, if participants fail to file timely, complete Forms 8886, then the IRS can assert a penalty equal to 75 percent of the tax savings resulting from their participation.[33] 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.[34] Second, the IRS does *not* have authority to rescind or abate a penalty assessed against a listed transaction, and there is no "reasonable cause" exception.[35] Third, Form 8886 penalties are immediately "assessable." Thus, if the IRS imposes Form 8886 penalties, participants generally cannot fight them as they would other penalties, by filing a Protest Letter and addressing matters with the Appeals Office and/or by filing a Petition with the Tax Court. Rather, they must dispute the penalties through the collection process or by fully paying them, filing a Claim for Refund, and, if the IRS ignores or rejects the Claim for Refund, by lodging a refund suit in federal court.[36] Fourth, if a taxpayer participates in a reportable transaction and the IRS later disallows the benefits claimed, the IRS can assess a penalty equal to 20 percent of the tax increase, and the rate increases to 30 percent if the participant does not file Form 8886.[37] Finally, if a "participant" fails to enclose a Form 8886 with a tax return, then the assessment-period with respect to the entire tax return essentially remains open forever.[38]

Line 7 of the *former* Form 8886 had only two subparts. Line 7a instructed taxpayers to check boxes to identify all types of tax benefits that they would derive from participating in the reportable transaction, including deductions, capital losses, ordinary losses, exclusions from gross income, non-recognition of gain, adjustments to basis, lack of adjustments to basis, deferral, tax credits, or the catch-all, other.[39] For its part, Line 7b featured a broader, more intrusive tone, providing the following mandate:

> Further describe the amount and nature of the expected tax treatment and expected tax benefits generated by the transaction for all affected years. Include facts of each step of the transaction that related to the expected tax benefits, including the amount and nature of your investment. Include in your description your participation in the transaction and all related transactions, regardless of the year in which they were entered into. Also, include a description of any tax result protection with respect to the transaction.[40]

The IRS introduced the *new* Form 8886 in early 2020, without any drumroll. The only change is the addition of three new subparts to Line 7, all of which focus on the tax benefits received by the taxpayer thanks to his participation in a reportable transaction like an SCET.[41] Below is a one-by-one review of the updated IRS inquires.

- Line 7a remains the same.
- New Line 7b tells participants to enter the total dollar amount of tax benefits derived in the form of deductions, losses, exclusions, nonrecognition, basis adjustments, deferral, credits, etc. The Instructions to new Form 8886 clarify that the IRS is seeking here "the total anticipated dollar amount of *all items* checked in Line 7a, *over the entire anticipated life of the transaction*."[42] Anyone who handles tax work recognizes that, depending on the complexity of the transaction, types of benefits claimed, number of years over which the benefits will be used, varying tax rates, and more, completing Line 7b accurately would be difficult, if not impossible, for participants.
- New Line 7c requires participants to state the number of years during which they plan to derive benefits from the SCET. In other words, the IRS wants taxpayers to indicate, from the outset, just how many years they plan to "participate" in the SCET, which, coincidentally, would assist the IRS in identifying precisely which years to audit.[43]
- New Line 7d obligates participants to disclose their "total investment or basis" in the SCET. The Instructions to new Form 8886 expand on this obligation, explaining that the IRS wants "the total of the amounts [that participants] paid related to this transaction, which includes cash, fair market value of property

Properly claiming the tax deduction stemming from an easement donation is surprisingly complicated.

or services transferred or acquired, adjustments to basis, valuation of notes, obligations, shares, and other securities."[44]

- The previous Line 7b, unchanged in substance, has been renumbered as Line 7e.

The new, expanded Form 8886, unnoticed thus far by most taxpayers and their advisors, should trigger some degree of concern. The IRS continually penalizes participants who simply neglect to file Forms 8886, and it also sanctions participants who file timely, yet incomplete or inaccurate, Forms 8886. According to a recent IRS update to Congress, nine percent of the Forms 8886 for 2017 and three percent for 2018 were incomplete, and the IRS warned that "[f]urther analysis and/or examination is being performed to determine if penalties [for incompleteness or inaccuracy] are appropriate."[45] New Lines 7b, 7c, and 7d represent yet more chances for participants to get tripped up. It is not farfetched to think that the IRS would try to characterize a minor omission or mistake on new Form 8886 as a justification to impose huge penalties and keep the assessment-period open. Indeed, the IRS has frequently maintained, and the Tax Court has sometimes agreed, that relatively small problems with Form 8283 (such as omitting one piece of information, providing data only in an attachment, miscalculating the adjusted basis, or erroneously misstating the manner in which property was obtained), alone, warranted a total disallowance of the tax deduction related to the conservation easement donation.[46] Given that the IRS has applied this line of argument to Forms 8283, it might do the same with Forms 8886.

Elimination of Procedural Protections for Taxpayers

In late February 2020, the IRS discreetly introduced important changes to the audit process involving "listed transactions," including SCETs, and "transactions of interest." The IRS announced the modifications via a legal memo, which affects the Information Document Request ("IDR") enforcement process and the acknowledgement-of-facts IDR process currently used by the Large Business & International Division.[47]

The IDR enforcement process, which features "three graduated steps," can be summarized as follows. A Revenue Agent issues an IDR to the taxpayer under audit, and if the taxpayer does not adequately respond by the deadline, then the Revenue Agent has certain tools to "encourage" compliance. Specifically, Revenue Agents first issue a Delinquency Notice, followed by a Pre-Summons Letter, and, ultimately, a Summons.[48] This multi-layer process "is mandatory and has no exceptions."[49] While this process might render more data for the IRS in the long run, it can exhaust a significant portion of the limited audit period and administrative resources. This is a result of the time necessary for Revenue Agents to communicate with partially cooperative taxpayers, consider justifications for extensions and missing materials, prepare correspondence, seek approval from superiors, etc.[50] The IRS now seeks to streamline matters in the context of "listed transactions," such as SCETs, by eliminating the graduated three-step process before issuing Summonses to taxpayers. In other words, thanks to the recent IRS legal memo, the previously "mandatory" process is no longer required, much less obligatory. Revenue Agents in the Large Business & International Division must follow the normal, swifter Summons procedures followed by other IRS personnel going forward.[51]

The IRS has eradicated the acknowledgement-of-facts IDR process, too. Until recently, Revenue Agents in the Large Business & International Division generally were required to issue taxpayers an acknowledgement-of-facts IDR to ensure that the IRS had received, understood and considered all relevant facts before issuing a Notice of Proposed Adjustment ("NOPA"), thereby triggering the opportunity for taxpayers to file a Protest Letter and elevate the dispute to the Appeals Office.[52] As with the graduated three-step Summons process described above, the IRS indicated that sending a timely acknowledgement-of-facts IDR to taxpayers under audit was

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44 *Id.*

45 "Land Trust Alliance Calls for Action on Conservation Easements," 2020 Tax Notes Today Federal 38-9, Document 2020-7149 (02/25/2020) (see attached letter from IRS Commissioner Rettig to Senator Grassley, as Chairman of the Senate Finance Committee, dated 02/12/2020); Kristen A. Parillo. "No Notable Decrease in Syndicated Easement Deals," 2020 Tax Notes Today Federal 39-1, Document 2020-7321 (02/27/2020).

46 See, e.g. , Belair Woods, LLC, TCM 2018-159; Cottonwood Place, LLC, Tax Court Docket No. 14076-17, Order dated 10/02/2018; Red Oak Estates, LLC, Tax Court Docket No. 13659, Order dated 10/02/2018; Evergreen Church Road, LLC, Tax Court Docket No. 8493-17, Order dated 06/05/2019; Dasher's Bay at Effingham, LLC, Tax Court Docket No. 4078-18, Order dated 12/10/2019; River's Edge Landing, LLC, Tax Court Docket No. 1111-18, Order dated 12/10/2019; Riverpointe at Ogeechee, LLC, Tax Court Docket No. 4011-18, Order dated 12/10/2019; Ogeechee River Preserve, LLC, Tax Court Docket No. 2771-18, Order dated 12/10/2019; Rock Creek Property Holdings, LLC, Tax Court Docket No. 5599-17, Order dated 02/10/2020, fn. 2; Oakhill Woods, LLC, TCM 2020-24.

47 Tax Notes Doc. 2020-7524 (02/25/2020), consisting of LB&I-04-0220-004. This IRS guidance only applies to the Large Business & International Division, whose examination procedures differ from those used by the Small Business and Self-Employed Division.

48 IRM section 4.46.4.6.3 (12-13-2018) and IRM Exhibit 4.46.4-2.

49 IRM Exhibit 4.46.4-2.

50 *Id.*; IRS Publication 5125 (Large Business & International Examination Process) (2-2016).

51 Tax Notes Doc. 2020-7524 (02/25/2020), consisting of LB&I-04-0220-004.

52 IRM section 4.46.4.2 (12/13/2018) and IRM section 4.46.4.10 (12/13/2018).

53 IRM section 4.46.4.10 (12/13/2018).

54 *Id.*; IRS Publication 5125 (Large Business & International Examination Process) (2-2016).

55 Tax Notes Doc. 2020-7524 (02/25/2020), consisting of LB&I-04-0220-004.

56 Tax Notes Doc. 2020-3440 (01/22/2020), consisting of LB&I-20-0120-001.

57 *Id.* The Interim Guidance is directed to all employees in the Large Business & Internal Division and the Small Business/Self-Employed Division.

58 IRM section 20.1.12.7 (12/18/2017).

59 IRM section 20.1.12.7 (12/18/2017); IRM section 20.1.12.7.2 (12/18/2017).

60 IRM section 20.1.12.7 (12/18/2017); IRM section 20.1.12.7.2 (12/18/2017).

61 IRM section 20.1.12.7 (12/18/2017); IRM section 20.1.12.7.2 (12/18/2017).

62 IRM section 20.1.12.7.4 (12/18/2017).

63 *Id.*

64 *Id.*

65 *Id.*

66 Tax Notes Doc. 2020-3440 (01/22/2020), consisting of LB&I-20-0120-001.

67 *Id.*

68 *Id.*

not optional for Revenue Agents: "This process will be used by LB&I issue teams on all potentially unagreed issues, unless an exception is met."[53]

The IRS has underscored the benefits of the acknowledgement-of-facts IDR for years, suggesting that it facilitates resolution of issues during the audit phase, saves resources on both sides, avoids cases being returned to Revenue Agents for further development, and allows the IRS to prepare the most comprehensive NOPA possible, adequately analyzing all pertinent facts, documents, positions, and disagreements.[54] These positive attributes notwithstanding, the IRS changed its tune in February 2020, when it issued the legal memo dictating that Revenue Agents in the Large Business & International Division who audit "listed transactions," like SCETs, "will not be required" from this point forward to send taxpayers acknowledgement-of-facts IDRs.[55]

Elimination of Procedural Protections for Appraisers

Another important change occurred in late January 2020, and almost nobody took notice. This might have been the IRS's intent, when it released a memorandum called "Interim Guidance on IRC 6695A Penalty Case Reviews" ("Interim Guidance").[56] It seems to be just another tedious procedural modification at first glance, but the Interim Guidance deprives appraisers of crucial safeguards.[57] Because appraisals are pivotal in conservation easement cases, the Interim Guidance acquires major importance in this context.

Procedures before the Interim Guidance. The portion of the IRM called "Referrals and Penalty Case Review Procedures" has historically contained a multi-level review process designed to ensure that a particular degree of wrongdoing by the appraiser had occurred before assessing penalties, making referrals to OPR, etc.[58] The IRM featured the unique procedures and terminology described in the following paragraphs.

An Examining Appraiser (*i.e.*, an IRS Appraiser, Engineer, or Valuation Specialist) generally would recommend a Section 6695A penalty to the Revenue Agent, if the valuation reached the level of a gross valuation misstatement.[59] To support this recommendation, the Examining Appraiser prepared a memorandum, for internal use only, including an explanation as to why the appraiser was incorrect and why he knew or should have known better.[60] Next, a so-called Penalty Review Team would review the recommendation and opine *before* the IRS could assess a Section 6695A penalty. The Penalty Review Team was comprised of "experienced" IRS Appraisers and Valuation Specialists, along with one or more Review Managers.[61]

The process historically used by the Penalty Review Team was as follows. The Review Manager assigned the case to a Primary Review Appraiser, who studied the original appraisal, reviewed the memorandum prepared by the Examining Appraiser in support of a Section 6695A penalty, determined if the penalty case should proceed, and reported this decision to the Review Manager.[62]

If the Primary Review Appraiser recommended continuing the penalty case, then he assisted the Revenue Agent in preparing an IDR for the taxpayer's appraiser requesting his grounds for meeting the more-likely-than-not exception to penalties. Next, the Revenue Agent and Primary Review Appraiser met with the taxpayer's appraiser, in person or by phone, to allow him the chance to discuss his responses to the IDR. If the Primary Review Appraiser concluded the penalties were appropriate after the interview, he prepared a memorandum for the Revenue Agent explaining why the exception was inapplicable. The Primary Review Appraiser would then forward the entire case file to the Review Manager.[63]

Continuing the belt-and-multiple-suspenders approach, if the Primary Review Appraiser wanted to assess the Section 6695A penalty, the Revenue Manager assigned a Secondary Review Appraiser. His role consisted of reviewing the entire file, including the memorandum drafted by the Primary Review Appraiser, preparing his own written analysis and opinion about the applicability of the penalty, and returning the case file, as augmented, to the Review Manager.[64]

Finally (after obtaining and reviewing opinions about the Section 6695A penalty by the Revenue Agent, Examining Appraiser, Primary Review Appraiser, and Secondary Review Appraiser), the Review Manager prepared the "final concurrence" and forwarded the materials for inclusion in the appraiser's workfile.

The U.S. government has been attacking partnerships that make easement donations in a variety of ways.

Following the former process from start to finish, the IRS would not assess Section 6695A penalties against an appraiser until the matter had been considered by at least five separate, experienced IRS employees.[65]

Procedures after the Interim Guidance. The purpose of the Interim Guidance is evident: "[E]liminating the multi-tiered review process for IRC 6695A appraiser penalty cases and establishing a process for Examining Appraisers to notify the [Revenue Agent] of a potential IRC 6695A penalty case."[66]

Under the new Interim Guidance, if an Examining Appraiser determines a gross valuation misstatement while, say, auditing a conservation easement donation, he simply needs to get written approval from his immediate superviser (with an e-mail sufficing) and then notify the Revenue Agent that the Section 6695A penalty might apply.[67] Moreover, the Interim Guidance says that, while the decision to open a Section 6695A penalty case normally is based on the recommendation of an Examining Appraiser, Revenue Agents "should open" a penalty case "whenever they determine penalty consideration is warranted."[68] The Interim Guidance goes on to explain

that a Revenue Agent is only required to seek assistance, through the so-called Specialist Referral System, in situations where the Revenue Agent believes that he or she needs help from an Examining Appraiser.[69] Finally, the Interim Guidance expressly states that the Revenue Agent is solely responsible for assessing the Section 6695A penalty based on information obtained during the examination, preparing the related report, and closing the penalty case.[70]

Exploring impacts of the Interim Guidance. The prior procedures required analysis and agreement by at least five experienced IRS employees (*i.e.*, the Revenue Agent, Examining Appraiser, Primary Review Appraiser, Secondary Review Appraiser, and Review Manager) before Section 6695A penalties would be assessed. By comparison, the Interim Guidance contemplates the Revenue Agent, who likely has no training or education whatsoever in the field of valuation, making this decision alone, or at most with input from just one Examining Appraiser.

This expanded level of autonomy granted to Revenue Agents by the Interim Guidance becomes more disturbing after consulting related portions of the IRM. For instance, the IRM instructs Revenue Agents to assess Section 6695A penalties quickly, *before* conducting a detailed review, in situations where an appraiser refuses to voluntarily sign a Form 872-AP (Consent to Extend the Time on Assessment of IRC Section 6695A Penalty).[71] In this regard, the IRM states that the IRS ordinarily should not assess a Section 6695A penalty against an appraiser until the related audit of the taxpayer has been completed, but tells Revenue Agents to make a "protective assessment" if the assessment-period is within 180 days of expiring.[72]

The IRM also explains that "[i]f the claimed value of the property on the return or claim for refund, which is based on an appraisal, results in a . . . gross valuation misstatement, with respect to such property, the [Revenue Agent] should open an IRC 6695A penalty case."[73]

The IRM further instructs Revenue Agents to "exercise discretion" when referring an appraiser to OPR based on assessment of a Section 6695A penalty, but encourages referrals when there is a "pattern of conduct."[74] The IRM adds to this point, explaining that an OPR referral is "mandatory" when violations by an appraiser are "willful."[75]

The Treasury Department, through OPR, generally regulates the practice of taxpayer representatives before the IRS.[76] As part of this power, OPR may suspend, disbar, or censure any representative who is incompetent or disreputable, or who violates the pertinent regulations.[77] Moreover, when it comes to appraisers, OPR may provide that their appraisals shall have no probative effect in any administrative proceeding, and may also bar appraisers from presenting evidence or testimony in any such proceeding.[78] The ban applies, "regardless of whether the evidence or testimony would pertain to an appraisal made prior to or after the effective date of disqualification."[79]

Conclusion

Contrary to the cliché, what you do not know can hurt you, at least when it comes to defending partnerships that donate conservation easements. As this article demonstrates, the IRS has taken five crucial steps in early 2020, which could negatively affect taxpayers and others during the tax dispute process. It is vital that taxpayers and their advisors appreciate the significance of these recent actions.

NOTES

69 *Id.*
70 *Id.*
71 IRM section 20.1.12.3 (12/18/2017).
72 *Id.*
73 *Id.*
74 IRM section 20.1.12.7(1) (12/18/2017).
75 *Id.*
76 31 U.S.C. section 330(a)(1).
77 31 U.S.C. section 330(c).
78 31 U.S.C. section 330(d)
79 31 CFR section 10.50(b)(1).