Depriving Partnerships of Access to the Independent Office of Appeals: Old and New IRS Challenges to Conservation Easements

By Hale E. Sheppard*

Hale E. Sheppard examines various enforcement tools used by the IRS in the conservation easement context, which might negatively affect all taxpayers.

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I. Introduction

Congress has supported Code Sec. 170(h), which allows for conservation easement donations and related tax deductions, for decades. In upholding and expanding the benefits of this tax provision over time, Congress has been fully aware of the recurrent complaints by the U.S. Internal Revenue Service ("IRS") about perceived abuses, particularly in terms of valuation. Despite this repeated backing by Congress, the IRS insists on attacking certain partnerships that donate easements or real property to charitable organizations. Some of its methods are overt, others obscure, but all are subject to some degree of criticism and controversy.

This article analyzes various tactics that the IRS uses to challenge so-called syndicated conservation easement transactions ("SCETs") and substantially similar transactions ("SSTs"), focusing on the most recent, depriving partnerships of their general right to seek review by the Independent Office of Appeals before being forced into long, expensive, complicated tax litigation.

HALE E. SHEPPARD, Esq. (B.S., M.A., J.D., LL.M., LL.M.T.) is a Shareholder in the Tax Controversy Section and Chair of the International Tax Section of Chamberlain Hrdlicka.

II. 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

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appreciates sufficiently, (ii) determine how to maximize profitability from the property and do that, regardless of the negative effects on the local environment, community, or economy, or (iii) voluntarily restrict certain future uses of the property, 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.[1]

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.[2]

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.[3] These activities are called "reserved rights." The IRS openly recognizes, in its Conservation Easement Audit Techniques Guide ("ATG"), that reserved rights are ubiquitous.[4]

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."[5] 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.[6]

The value of the conservation easement is the fair market value ("FMV") of the property at the time of the donation.[7] 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.[8] 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.[9] 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.[10] The difference between the "before" value and "after" value, with certain other adjustments, produces the value of the easement donation.

A property's HBU is the most profitable use for which it is adaptable and needed in the reasonably near future.[11] The term HBU also means the use of property that is physically possible, legally permissible, financially feasible, and maximally productive.[12] Importantly, valuation in the easement context does not depend on whether the owner has actually put the property to its HBU in the past.[13] The HBU can be *any* realistic potential use of the property.[14] 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.[15]

III. Existing Government Enforcement Actions

Congress has endorsed conservation easements for many years. Indeed, a recent congressional report acknowledges that "the conservation-easement tax incentive under [Section 170(h)] has enjoyed broad bipartisan support."[16] Notwithstanding this widespread backing by the legislative branch, the IRS, along with the Department of Justice ("DOJ"), persist in attacking partnerships involved in what they consider SCETs or SSTs. The enforcement methods that the IRS and DOJ employ in this area far exceed those utilized in normal situations, yet most people are unaware of them or fail to appreciate their extent. Below is a partial list.

A. Labeling Donations "Listed Transactions"

The IRS issued Notice 2017-10, labeling SCETs and SSTs as "listed transactions."[17] This triggered the need for various parties to file Forms 8886 (*Reportable Transaction Disclosure Statement*) and Forms 8918 (*Material Advisor Disclosure Statement*), providing the IRS lots of details and threats that it could utilize in its enforcement activities.[18]

B. Implementation of Compliance Campaign

The IRS launched a "compliance campaign," devoting dozens of specialized Revenue Agents and other IRS personnel to the cause. The stated goal of the IRS is to audit *every* SCET and SST, presumably until its exhausts the funding and/or human resources, or Congress enacts some type of legislative "fix" based on the debated position that something is broken.[19]

C. Predetermined Conclusions During Audits

The IRS implemented a practice of issuing audit reports and notices of Final Partnership Administrative Adjustment ("FPAAs") claiming that *all* partnerships that engaged in an SCET or SST should get a charitable deduction of $0 and should be severely penalized, *regardless* of the amount of pre-donation due diligence performed by the partnerships, strength of the conservation values, existence of multiple independent appraisers, attainment of all necessary permits and authorizations for the potential land usage, *etc*.

Particularly galling to taxpayers is the fact that, in issuing the FPAAs triggering many years of litigation, the IRS refuses to specify the factual, legal, or procedural reasons for its attacks. Below is the language from an FPAA in a recent Tax Court case, which is representative of the stance that the IRS is taking in essentially all easement cases:

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

In addition to fully disallowing the easement-related deduction based on a combination of alleged technical and valuation issues, the IRS ordinarily proposes in the FPAA several alternative penalties, ranging in severity. These include negligence, substantial understatement of income tax, substantial valuation misstatement, gross valuation misstatement, or reportable transaction understatement penalty.[20] This is consistent with the ATG, which explains that an FPAA "will generally include a tiering of proposed penalties with multiple alternative positions."[21]

D. Attempts to Enjoin Activities

The DOJ filed a Complaint in District Court seeking a permanent injunction against alleged organizers and appraisers, along with disgorgement of the proceeds obtained from their dealings with SCETs or SSTs.[22]

E. Name Calling

The IRS featured SCETs and SSTs on its "dirty dozen" list for several years.[23] These transactions were absent from the list for 2020, though.[24]

F. Congressional Inquiry

The Senate Finance Committee conducted an inquiry and issued a report in August 2020, suggesting that the SCETS and SSTS that it reviewed constituted "abusive tax

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shelters," understood as such by both organizers and partners.[25] However, the report did not offer any specific recommendations about how to address perceived problems and it underscored that the Code Sec. 170(h) deduction should remain.[26] In this regard, the report explains that the Senate Finance Committee believes that Congress, the IRS, and Treasury Department "should take further action to preserve the integrity of the conservation-easement tax deduction."[27]

G. Warnings, Threats, and Rhetoric

The IRS has engaged in a media blitz, disseminating a significant amount of threats and warnings recently *via* new releases, tax conference presentations, and articles. The IRS emphasizes 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.[28]

H. Pursuing Supposed "Promoters"

The IRS appointed a new "Promoter Investigations Coordinator," who is in charge of coordinating with the Civil Division, Criminal Investigation Division, Chief Counsel, and OPR to develop and implement promoter enforcement, on both an individual and strategic level.[29]

The IRS can assert severe "promoter penalties" against people falling into various categories, namely, any person who (i) organizes, or assists in the organization of, a partnership or other entity, an investment plan or arrangement, or any other plan or arrangement,[30] (ii) participates directly or indirectly in the sale of ownership interests in any such entity, plan, or arrangement,[31] (iii) 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 a taxpayer, and actually knows, or has reason to know, that such statement is materially false or fraudulent,[32] and/or (iv) makes or furnishes, or causes another to make or furnish, a "gross valuation overstatement" as to any material matter.[33] The IRS, perhaps at the behest of the new Promoter Investigations Coordinator, has recently initiated various "promoter investigations" of alleged organizers of SCETs or SSTs.

I. Searching for Fraud

In 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 in the preceding paragraph.[34] No recent Tax Court decisions involving SCETs feature 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 Code Sec. 170(h), as enacted and expanded over the years by Congress, (iii) disclosed the donation to the IRS by filing Form 1065, Form 8283, Form 8886, Form 8918, and a qualified appraisal, (iv) maintained all relevant tax, financial, and legal records, and (v) fully cooperated with the IRS audit.[35]

While the IRS has not raised fraud in Tax Court battles, its counterpart, the DOJ, made numerous allegations of fraudulent activity in its Complaint seeking a permanent injunction of easement-related activities by certain individuals and entities.[36] For instance, the DOJ claimed, without yet providing any proof, that the defendants "knew or had reason to know that the statements they made or furnished (and the statements they caused others to make or furnish) regarding the allowance of the deductions from the conservation easement syndicates or the securing of other tax benefits by reason of purchasing interests in the conservation easement syndicates *were false or fraudulent as to a material matter*."[37]

J. Mandating More Disclosure

The IRS introduced a new Form 8886 in early 2020. It adds three new subparts to Line 7, all of which obligate a taxpayer to reveal yet more details about the tax benefits from participation in a reportable transaction, like an SCET or SST.[38] The new, expanded Form 8886, unnoticed by most taxpayers and their advisors, should trigger some degree of concern. According to a recent IRS update to Congress, nine percent of 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."[39] New Lines 7b, 7c, and 7d

on Form 8886 represent yet more chances for participants to get tripped up.

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 required data only in an attachment, miscalculating the basis, or erroneously misstating the manner in which property was obtained), alone, warrants a total disallowance of the tax deduction related to the conservation easement.[40] Given that the IRS has applied this line of argument to Forms 8283, it might do the same with Forms 8886.

K. Swifter Summonses

The IRS issued a legal memo in February 2020 containing important changes to the audit process involving "listed transactions," such as SCETs and SSTs.[41] The general Information Document Request ("IDR") enforcement process, with "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.[42] This multi-layer process "is mandatory and has no exceptions."[43]

The IRS is now streamlining matters in the context of SCETs and SSTs by eliminating the graduated three-step process. Thanks to the recent IRS legal memo, the previous "mandatory" process is no longer required; Revenue Agents in the Large Business & International Division will follow the normal, swifter Summons procedures followed by other IRS personnel going forward.[44]

L. Neglecting the Facts

The IRS has eradicated the acknowledgement-of-facts IDR process. Revenue Agents in the Large Business & International Division have traditionally issued taxpayers an acknowledgement-of-facts IDR at the end of the audit process. The purpose was to ensure that both the taxpayers and the IRS agreed on the key facts, such that the dispute, before the Appeals Office and/or Tax Court, could focus solely on legal/tax issues.[45] 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 Appeals Officers referring cases back to Revenue Agents for further development, and allows the IRS to prepare the most comprehensive audits reports and FPAAs possible.[46]

These positive attributes notwithstanding, the IRS changed its tune in February 2020, when it issued a legal memo dictating that Revenue Agents who audit "listed transactions," like SCETs and SSTs, are not required from this point forward to send taxpayers acknowledgement-of-facts IDRs.[47] One might interpret this as disinterest by the IRS in getting the facts straight before pushing cases toward litigation.

M. Revoking Procedural Protections for Appraisers

The IRS has revoked procedural protections for appraisers, including those involved with valuing SCETs and SSTs. The Internal Revenue Manual ("IRM") has historically contained a multi-level review process designed to ensure that an appraiser had engaged in a certain degree of wrongdoing before assessing penalties, making referrals to OPR, *etc.*[48] 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 Code Sec. 6695A penalties could be assessed.[49]

However, the IRS issued a memo in January 2020 called "Interim Guidance on IRC 6695A Penalty Case Reviews" ("Interim Guidance") whose purpose was remarkably clear: "Eliminating the multi-tiered review process for IRC 6695A appraiser penalty cases."[50] Under the Interim Guidance, if an Examining Appraiser determines a gross valuation misstatement while, say, auditing an SCET, he simply needs to obtain written approval from his immediate supervisor (with an email sufficing) and then notify the Revenue Agent that the Code Sec. 6695A penalty might apply.[51] Moreover, the Interim Guidance says that, while the decision to open a Code Sec. 6695A penalty case normally is based on the recommendation of an Examining Appraiser, Revenue Agents "should open" a case "whenever they [alone] determine penalty consideration is warranted."[52] Finally, the Interim Guidance states that Revenue Agents are solely responsible for assessing the Code Sec. 6695A penalty based on information obtained during the examination, preparing the related report, and closing the penalty case.[53]

In summary, the prior procedures required concurrence by at least five experienced IRS employees before seeking Code Sec. 6695A penalties, whereas the Interim Guidance contemplates that a Revenue Agent, who likely has no training or education whatsoever in the field of valuation, making this decision alone, or with input from just one Examining Appraiser.

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N. Polemical Settlement Initiative

Leveraging the momentum from its recent Tax Court victories based on inadvertent flaws in Deeds, Baseline Reports, Forms 8283, and/or appraisals, the issued a News Release in June 2020 describing a potential path to resolution ("Settlement Initiative").[54] It then started sending offer letters to eligible partnerships. Opinions vary on the Settlement Initiative, of course, with many interpreting it as a big stick, as opposed to an olive branch, from the IRS.[55]

Those characterizing the Settlement Initiative as just another IRS enforcement tactic point to several things, including the fact that participation does not serve to limit or prohibit the IRS from later asserting criminal penalties, promoter penalties, appraiser penalties, return preparer penalties, or any other sanction. This is noteworthy because, when taxpayers normally execute a Form 906 (*Closing Agreement*) with the IRS, all matters covered thereby are considered "final and conclusive," unless there is a subsequent showing of fraud, malfeasance, or material misrepresentation by the taxpayer.[56]

Skeptics also underscore the differential treatment contemplated by the Settlement Initiative. So-called "Category One Partners" did one or more of the following in connection with an SCET or SST: Organized, sold, or promoted it; Prepared an appraisal; Provided legal or tax advice; Supplied return preparation services; or Took actions making them "material advisors." They get hit with a charitable deduction of $0 and a 40 percent penalty, plus they must pay the entire amount right away. Thus, if Category One Partners participate in the Settlement Initiative, they are assuring themselves of the worst possible outcome, consistent with most FPAAs.

By contrast, "Category Two Partners" can claim an ordinary tax deduction equal to the out-of-pocket costs paid to participate in the SCET or SST, which includes cash and other property contributed in exchange for partnership interests. Moreover, their penalties are not 40 percent of the tax underpayment, but rather 10 percent to 20 percent, depending on their return-on-investment ratio.

This large disparity might put Category One Partners at odds with Category Two Partners, triggering anger, distrust, infighting, legal actions, *etc*. A cynic might speculate that this is exactly what the IRS intended, a classic divide-and-conquer strategy. This theory finds support in gratuitous, inflammatory statements by the IRS, like the following:

> Taxpayers should note that the U.S. Tax Court has held in the government's favor in several opinions and orders in syndicated conservation easement cases. The IRS realizes that some promoters may tell their clients that their transaction is "better" than or "different" from the transactions previously rejected by the Tax Court and that it may be better for the client to litigate than accept this resolution. When deciding whether to accept the offer, the IRS encourages taxpayers to consult with independent counsel, meaning a qualified advisor who was not involved in promoting the transaction or handpicked by a promoter to defend it.[57]

> The IRS is aware that some promoters of these abusive transactions have downplayed the significance of the string of recent court decisions holding in the government's favor, arguing that their cases are somehow different or that those decisions might be reversed on appeal. These promoters ignore common sense and argue that the real dispute is about value, neglecting to explain how the reporting of short-term appreciation, often exceeding many multiples of reality, could possibly survive judicial scrutiny.[58]

O. Efforts to Undermine Privilege

The IRS has become more aggressive in its efforts to gather all potentially relevant data (including pre-donation communications involving accountants, appraisers, experts, and others), despite the fact that some might be confidential. This scenario often arises when partnerships decline to provide copies of correspondence with advisors on grounds that they are protected by the federally authorized tax practitioner ("FATP") privilege established in Code Sec. 7525. This provision generally states that the protections that apply to communications between taxpayers and their attorneys extend to communications between taxpayers and FATPs.[59] However, Code Sec. 7525 clarifies that these expanded protections *only* apply to (i) "tax advice," not return-preparation and other services, (ii) provided by a person who qualifies as an FATP, such as a certified public accountant, enrolled agent, registered tax return preparer, and others, (iii) involving non-criminal matters, (iv) in connection with an administrative or judicial tax matter, where the IRS or DOJ is a party, and (v) not regarding "tax shelters."[60]

The IRS has started trying to overcome the FATP privilege in SCET and SST cases by arguing, among other things, that (i) the relevant advisors were not providing "tax advice" in the first place, (ii) even if they were offering "tax advice," the privilege was later waived when the relevant information was forwarded to third parties, (iii) SCETs and SSTs are "listed transactions" and thus "tax shelters"

pursuant to Notice 2017-10, (iv) "a significant purpose" of the SCETs and SSTs is federal income tax avoidance, and (v) the advisors were involved in the "promotion" of the SCETs and SSTs, as this term is broadly defined in applicable case law.[61]

IV. Newest Actions by the IRS

Understanding the IRS's newest actions in its quest to halt SCETs and SSTs requires some background knowledge. The following segment of this article explains, in abbreviated fashion, how we got to where we are today.

A. Evolution of Access to an Administrative Appeal

The IRS has declared that taxpayers have a "right" to seek review by the Appeals Office for many decades. Indeed, regulations issued more than five decades ago, in 1967, stated that when the IRS proposes tax adjustments, "the taxpayer has the right (and will be so advised by the district director) of administrative appeal to the Appeals organization."[62]

Later, in 1987, the IRS issued Rev. Proc. 87-24, which explains the following about universal review by the Appeals Office in situations involving cases docketed with the Tax Court:

> Except in unusual circumstances, a docketed case is referred by Counsel to Appeals to reach a settlement with the taxpayer.[63]
>
> Appeals has exclusive jurisdiction of a docketed case involving a deficiency of more than $10,000 per period (including taxes and penalties), as long as Appeals believes there is a reasonable likelihood of settlement, or until the case appears on a trial calendar.[64]
>
> Appeals will have sole settlement authority over docketed cases referred to Appeals pursuant to these procedures until the case is returned to Counsel.[65]

Rev. Proc. 87-24 contained an important caveat, though. It stated that certain high-ranking IRS attorneys could, after internal consultation, "determine that a case, or an issue or issues in a case, should *not* be considered by Appeals [and] in such a situation Appeals with forego settlement authority over such case or issues."[66]

In 1998, Congress passed the IRS Restructuring and Reform Act. That legislation required the IRS to "ensure an independent appeals function."[67]

A few years later, in 2004, the IRS issued a Chief Counsel Directive ("CCD"), which was later incorporated into the IRM.[68] It featured yet more ways for the IRS to deprive taxpayers of a chance to seek reconsideration by the Appeals Office. The CCD explained that certain cases involve recurring, important legal issues that affect large numbers of taxpayers. In such instances, when there is a "critical need for enforcement activity," the IRS can "designate for litigation" the relevant cases "in the interest of sound tax administration" and for purposes of establishing legal precedent, conserving resources, and reducing costs.[69] The CCD indicated that this maneuver might be appropriate, for example, with "tax shelters."[70] If taxpayers have an issue that the IRS designates for litigation, they will not get an Examination Report, will not get a chance to file a Protest Letter contesting the Examination Report, will not have a chance to present their side of the story to the Appeals Office before the IRS issues a Notice of Deficiency, and will not have their cases routed back to the Appeals Office after the IRS issues a Notice of Deficiency and they file a Petition with the Tax Court disputing it.[71]

In 2015, Congress enacted Code Sec. 7803(a), which mandates that the IRS Commissioner carry out his or her duties "in accord with taxpayer rights." Specifically, this provision explains that the IRS Commissioner must ensure that all IRS employees understand and act consistently with taxpayer rights granted throughout the Internal Revenue Code, including, but not limited to, "the right to appeal a decision of the [IRS] in an independent forum."[72]

The following year, 2016, the IRS issued Rev. Proc. 2016-22. It confirmed that the IRS attorneys generally will refer docketed cases to the Appeals Office for settlement consideration, and the Appeals Office has sole authority to resolve the cases until it returns them to the IRS attorneys to prepare for litigation.[73] However, Rev. Proc. 2016-22, like earlier administrative guidance, contained disclaimers allowing the IRS to circumvent the Appeals Office in certain scenarios. It stated the following in this regard:

> Counsel will *not* refer to Appeals any docketed case or issue that *has been designated for litigation* by Counsel.[74]
>
> In limited circumstances, a docketed case or issue that *has not been designated for litigation* will *not* be referred to Appeals if Division Counsel or a higher level Counsel official determines that *referral is not in the interest of sound tax administration*. For example, Counsel may decide not to refer a docketed case to Appeals in cases involving a significant issue common

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> to other cases in litigation for which it is important that the IRS maintain a consistent position.[75]
>
> If Counsel determines that a docketed case or issue will not be referred to Appeals, Counsel will notify the taxpayer that the case will not be referred to Appeals.[76]

Congress then enacted Code Sec. 7803(e) as part of the Taxpayer First Act of 2019 ("TFA").[77] This provision accomplished several things of note. First, it created the so-called "Independent Office of Appeals."[78] Second, it explained that the purpose of the Independent Office of Appeals is to resolve federal tax disputes, without litigation, on a basis that is fair and impartial to the IRS and taxpayers, promotes consistent application of federal tax laws, and increases public confidence in the integrity and efficiency of the IRS.[79] Third, it generally provided that the resolution process, described in the preceding sentence, should be "available to all taxpayers."[80] Finally, it created limits on the IRS in designating cases for litigation.[81] The provision states, in particular, that in situations where taxpayers receive a Notice of Deficiency, request that their cases be routed to the Independent Office of Appeals, and have their requests rejected, the IRS must supply the taxpayers with written notice of the IRS's basis for the rejection and the procedures for disputing such rejection.[82]

Most recently, the IRS issued in August 2020 a memorandum with guidance about designation of cases or issues for litigation, as required by the TFA.[83] The language of the memorandum is technical and dense, of course. The most important aspect for purposes of this article is the description of the circumstances in which the IRS believes it is appropriate to deprive taxpayers of their general right to seek review by the Independent Office of Appeals. The memorandum suggests that some tax issues are susceptible to recurring compliance challenges, IRS rulings or other administrative guidance do not effectively address such matters, and audit personnel may request designation "where sound tax administration is best served" by forcing the Tax Court (or another appropriate court) to act as the heavy.[84] Importantly, the memorandum goes on to provide various examples where "sound tax administration is best served by establishing judicial precedent," including situations where revoking access of taxpayers to the Independent Office of Appeals supposedly would (i) "stem the proliferation of abusive tax shelters or other significant non-compliance," (ii) reduce future compliance and dispute costs, for the IRS and other taxpayers, (iii) resolve issues where published IRS guidance, has not resulted in what the IRS considers compliance, and/or (iv) obtain clarity where "there is a wide divergence between the IRS and taxpayer viewpoints on the law."[85]

B. Recent Actions by the IRS

The National Taxpayer Advocate ("NTA") issued reports for several years, claiming that the IRS was abusing its power by depriving taxpayers of their right to seek reconsideration by the Appeals Office (now rebranded as the Independent Office of Appeals) based on questionable proclamations of "sound tax administration."[86] The NTA offered the following illustration of how things work:

> Taxpayer, a diversified business, enters into a transaction that the IRS believes to be suspiciously similar to a type of transaction that it has previously identified as a tax shelter. As a result, the IRS asserts large deficiencies and penalties against Taxpayer. Thereafter, Taxpayer files a [Protest Letter] with Appeals, arguing that the transaction in question is fundamentally different from the tax shelter transaction with which the IRS is attempting to equate it. Further, Taxpayer contends that, in addition to being distinguishable from a tax shelter, the transaction is question has a legitimate business purpose, and should not generate either tax deficiencies or penalties. The Office of Chief Counsel, however, unilaterally decides that Taxpayer should not have the opportunity to raise these arguments at Appeals. Instead, Counsel determines that the case should proceed directly to litigation on the basis of "sound tax administration." As a result, Taxpayer is unable to present its arguments to an independent third party within the IRS and is prevented from seeking the administrative case resolution it believes could be achieved. Instead, Taxpayer is forced to pursue its case in court, as a matter of public record, incurring substantial cost, delay, and ill-will for the IRS along the way.[87]

Most people do not realize it, but the IRS has already started taking similar actions in certain cases involving SCETs and SSTs. A common technique is for a Revenue Agent to summarily inform a partnership, at the end of a long audit in which the partnership fully cooperated, that the IRS will not issue a Summary Report, not hold a Closing Conference, not provide a Notice of Proposed Adjustments, and thus not allow the partnership to obtain review by the Independent Office of Appeals before initiating tax litigation. This occurs, even though the partnership has granted, or has offered to grant, a lengthy extension of the assessment-period by signing a Form 872-P (*Consent to Extend the Time to Assess Tax Attributable to Partnership*

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Items). The Revenue Agent invariably cites "sound tax administration" in taking these actions, without providing any details. In short, unbeknownst to most, the IRS has started depriving some partnerships of pre-litigation access to the Independent Office of Appeals, without formally designating SCETs and SSTs for litigation.[88]

A related question is whether the IRS will up the *ante* in the future, officially designating SCETs and SSTs for litigation. As explained above, the IRS issued a memorandum in August 2020 taking the position that "sound tax administration is best served" by designating cases where doing so would stop "abusive tax shelters" or other significant non-compliance, decrease enforcement costs, resolve issues where IRS guidance has not rendered the desired results, and provide clarity on highly disputed tax/legal matters.[89] The IRS has tried to demonize SCETs and SSTs as "abusive tax shelters," the IRS has allocated enormous resources to challenging these transactions, the issuance of Notice 2017-10 did not diminish participation, and partnerships and the IRS have vastly different views on what really matters, with the former focused on easement valuation, and the latter fixated on "technical" issues wholly unrelated to value. Fortunately, the IRS has not taken the drastic step of designating SCETs and SSTs for litigation. It recently submitted its first annual report to Congress, as required by the TFA, reporting that "no issues have been designated for litigation."[90]

V. Conclusion

The IRS is poised to continue challenging SCETs and SSTs, and it has demonstrated a willingness to implement additional, increasingly extreme, enforcement techniques as part of the process. As this article explains, the newest tactic is depriving (or threatening to deprive) partnerships of their general right, in existence for decades, to seek reconsideration by a neutral party, the Independent Office of Appeals, *before* engaging in long, expensive, complicated tax litigation. To maximize their chances of prevailing against the IRS, partnerships must remain hyperaware of the evolving enforcement tools. They need to retain tax professionals who are at the forefront, too.

ENDNOTES

* Hale defends businesses and individuals in tax audits, tax appeals, and tax litigation. You can reach Hale by email at *hale.sheppard@chamberlainlaw.com*.

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

2 Code Sec. 170(h)(4)(A); Reg. §1.170A-14(d)(1); S. Rept. 96–1007, at 10 (1980).

3 Reg. §1.170A-14(b)(2).

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

5 Reg. §1.170A-14(g)(5)(i).

6 Reg. §1.170A-14(g)(5)(i).

7 Code Sec. 170(a)(1); Reg. §1.170A-1(c)(1).

8 Reg. §1.170A-1(c)(2).

9 Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 11/4/2016), at 41.

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

11 *Olson*, SCt, 292 US 246, 255 (1934).

12 *Esgar Corp.*, CA-10, 2014-1 USTC ¶50,207, 744 F3d 648, 659 n.10.

13 *Esgar Corp.*, CA-10, 2014-1 USTC ¶50,207, 744 F3d 648, 657.

14 *Symington*, 87 TC 892, 896, Dec. 43,467 (1986).

15 *See* Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 11/4/2016), at 24–30; IRS Publication 1771, Charitable Contributions – Substantiation and Disclosure Requirements; IRS Publication 526, Charitable Contributions; Code Sec. 170(f)(8); Code Sec. 170(f)(11); Reg. §1.170A-13; Notice 2006-96; T.D. 9836.

16 U.S. Senate, Committee on Finance. Syndicated Conservation Easement Transactions, 116th Cong.; 2nd Session, Senate Report 116-44 (August 2020), at 1; *see also* Conservation Easement Incentive Act of 2015, Senate 330, 114th Cong. Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in 2015, JCS-1-16 (March 2016).

17 Notice 2017-10, 2017-4, IRB 544 (Dec. 23, 2016).

18 Notice 2017-10, 2017-4, IRB 544 (Dec. 23, 2016) (stating that the IRS might assert penalties under Code Sec. 6707A or extend the assessment-period under Code Sec. 6501(c)(10) for failures by "participants" to file proper Forms 8886, might assert penalties under Code Sec. 6707 for failure by "material advisors" to file proper Forms 8918, and might assert penalties under Code Sec. 6708 for failures by "material advisors" to meet their record-maintenance requirements).

19 HES—insert.

20 Code Sec. 6662; Code Sec. 6662A.

21 Internal Revenue Service. Conservation Easement Audit Techniques Guide (Rev. 11/4/2016), at 77.

22 *Nancy Zak, Claud Clark, EcoVest Capital Inc., Alan N. Solon, Robert M. McCullough, and Ralph R. Teal*, Case No. 1:18-cv-05774, DC ND GA, Compliant filed December 18, 2018, at 47.

23 *See, e.g.,* IR-2019-47, March 19, 2019.

24 IR-2020-160, July 16, 2020.

25 U.S. Senate, Committee on Finance. Syndicated Conservation Easement Transactions, 116th Cong., 2nd Session, Senate Report 116-44 (August 2020), at 105.

26 U.S. Senate, Committee on Finance. Syndicated Conservation Easement Transactions, 116th Cong., 2nd Session, Senate Report 116-44 (August 2020), at 4 and 105.

27 U.S. Senate, Committee on Finance. Syndicated Conservation Easement Transactions, 116th Cong., 2nd Session, Senate Report 116-44 (August 2020), at 4.

28 IR-2019-182, "IRS Increases Enforcement Action on Syndicated Conservation Easements," Nov. 12, 2019; IR-2019-213, "IRS Continues Enforcement Efforts in Conservation Easement Cases Following Latest Tax Court Decision," December 20, 2019; Nathan J. Richman, *Multiple Divisions Coming for Syndicated Conservation Easements*, 2019 TAX NOTES TODAY 220–223 (Nov. 13, 2019); William Hoffman, *Conservation Easement Crackdown a Portent, Rettig Says*, 2019 TAX NOTES TODAY 221–229 (Nov. 14, 2019); Kristen A. Parillo, *IRS Is Building Up Its Easement Toolbox*, 2019 TAX NOTES TODAY 222–226 (Nov. 15, 2019); Kristen A. Parillo, *IRS Looking for Promoter Links as Easement Crackdown Grows*, TAX NOTES TODAY, Doc. 2019-47134 (Dec. 13, 2019).

29 Kristen A. Parillo, *IRS Assigns Point Person on Promoter Investigations*, FEDERAL TAX NOTES TODAY Doc. 2020-6890 (Feb. 25, 2020).

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[30] Code Sec. 6700(a)(1).

[31] Code Sec. 6700(a)(1).

[32] Code Sec. 6700(a)(2)(A).

[33] Code Sec. 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* Code Sec. 6700(b)(1).

[34] IRS News Release, IR-2020-49, March 5, 2020.

[35] The Internal Revenue Manual provides shows the high standard that the IRS must 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." IRM 20.1.5.12.2 (Oct. 1, 2005). The courts consider a long list of factors in determining whether a taxpayer engaged in civil fraud. *See also J.E. Meier*, 91 TC 273, Dec. 44,995 (1988). *See also S.H. Toushin*, CA-7, 2000-2 USTC ¶50,646, 223 F3d 642; *R.W. Bradford*, CA-9, 86-2 USTC ¶9602, 796 F2d 303; *Hicks Co., Inc.*, 56 TC 982, Dec. 30,920 (1971).

[36] *Nancy Zak, Claud Clark, EcoVest Capital Inc., Alan N. Solon, Robert M. McCullough, and Ralph R. Teal*, Case No. 1:18-cv-05774, DC ND GA, Compliant filed December 18, 2018.

[37] *Nancy Zak, Claud Clark, EcoVest Capital Inc., Alan N. Solon, Robert M. McCullough, and Ralph R. Teal*, Case No. 1:18-cv-05774, DC ND GA, Compliant filed December 18, 2018 (emphasis added).

[38] Instructions for Form 8886 (*Reportable Transaction Disclosure Statement*) (Rev. Dec. 2019), at 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."

[39] *Land Trust Alliance Calls for Action on Conservation Easements*, 2020 TAX NOTES TODAY FEDERAL 38–39, Document 2020-7149 (Feb. 25, 2020) (*see* attached letter from IRS Commissioner Rettig to Senator Grassley, as Chairman of the Senate Finance Committee, dated Feb. 12, 2020); Kristen A. Parillo, *No Notable Decrease in Syndicated Easement Deals*," 2020 TAX NOTES TODAY FEDERAL 39–41, Document 2020-7321 (Feb. 27, 2020).

[40] *See, e.g., Belair Woods, LLC*, Dec. 61,275(M), TC Memo. 2018-159; *Cottonwood Place, LLC*, Tax Court Docket No. 14076-17, Order dated October 2, 2018; *Red Oak Estates, LLC*, Tax Court Docket No. 13659, Order dated October 2, 2018; *Evergreen Church Road, LLC*, Tax Court Docket No. 8493-17, Order dated June 5, 2019; *Dasher's Bay at Effingham, LLC*, Tax Court Docket No. 4078-18, Order dated December 10, 2019; *River's Edge Landing, LLC*, Tax Court Docket No. 1111-18, Order dated December 10, 2019; *Riverpointe at Ogeechee, LLC*, Tax Court Docket No. 4011-18, Order dated December 10, 2019; *Ogeechee River Preserve, LLC*, Tax Court Docket No. 2771-18, Order dated December 10, 2019; *Rock Creek Property Holdings, LLC*, Tax Court Docket No. 5599-17, Order dated February 10, 2020, fn. 2; *Oakhill Woods, LLC*, 119 TCM 1144, Dec. 61,629(M), TC Memo. 2020-24.

[41] Tax Notes Doc. 2020-7524 (Feb. 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.

[42] IRM 4.46.4.6.3 (Dec. 13, 2018) and IRM Exhibit 4.46.4-2.

[43] IRM Exhibit 4.46.4-2.

[44] Tax Notes Doc. 2020-7524 (Feb. 25, 2020), consisting of LB&I-04-0220-004.

[45] IRM 4.46.4.2 (Dec. 13, 2018) and IRM 4.46.4.10 (Dec. 13, 2018).

[46] IRM 4.46.4.10 (Dec. 13, 2018); IRS Publication 5125 (Large Business & International Examination Process) (Feb. 2016).

[47] Tax Notes Doc. 2020-7524 (Feb. 25, 2020), consisting of LB&I-04-0220-004.

[48] IRM 20.1.12.7 (Dec. 18, 2017).

[49] IRM 20.1.12.7.4 (Dec. 18, 2017).

[50] Tax Notes Doc. 2020-3440 (Jan. 22, 2020), consisting of LB&I-20-0120-001.

[51] Tax Notes Doc. 2020-3440 (Jan. 22, 2020), consisting of LB&I-20-0120-001.

[52] Tax Notes Doc. 2020-3440 (Jan. 22, 2020), consisting of LB&I-20-0120-001.

[53] Tax Notes Doc. 2020-3440 (Jan. 22, 2020), consisting of LB&I-20-0120-001.

[54] IRS Information Release 2020-130 (June 25, 2020).

[55] Kristen A. Parillo, *Partner Buy-in Rule Could Spoil Some IRS Easement Settlement*, Tax Analysts Doc. 2020-24312 (June 26, 2020); Kristen A. Parillo, *Criticism of Easement Settlement Deal Doesn't Worry IRS*, 2020 TAX NOTES TAX FEDERAL 135-4, Doc. 2020-26950 (July 15, 2020).

[56] Code Sec. 7121(b).

[57] IRS Information Release 2020-130 (June 25, 2020).

[58] IRS Information Release 2020-152 (July 13, 2020).

[59] Code Sec. 7525(a)(1).

[60] Code Secs. 7525(a)(1), 7525(a)(2), 7525(a)(3); Code Sec. 7525(b); 31 USC §330; and 31 CFR §10.3.

[61] *See, e.g., Microsoft Corporation et al.*, 125 AFTR 2d 2020-547 (DC WA 2020).

[62] Reg. §601.106(b); *see also* Reg. §601.103(c)(1).

[63] Rev. Proc. 87-24; Proposed Reg. §601.106(e)(3)(i)(A).

[64] Rev. Proc. 87-24; Proposed Reg. §601.106(e)(3)(i)(B)(1).

[65] Rev. Proc. 87-24, Section 2.04; *see also* Proposed Reg. §601.106(e)(3)(i)(C).

[66] Rev. Proc. 87-24, Section 2.08 (emphasis added).

[67] IRS Restructuring and Reform Act of 1998, P.L. 105-206, §1001(4).

[68] IRM 33.3.6 (Aug. 11, 2004).

[69] IRM 33.3.6 (Aug. 11, 2004).

[70] IRM 33.3.6 (Aug. 11, 2004).

[71] IRM 33.3.6 (Aug. 11, 2004). *See also* Marie Sapirie, *The Increase in Cases Designated for Litigation*, 150 TAX NOTES 1223 (Mar. 14, 2016) (indicating that the IRS had been designating a growing number of cases for litigation in the preceding years).

[72] Code Sec. 7803(a)(3)(D) and (E), as enacted by Protecting Americans from Tax Hikes Act of 2015, P.L. 11-4-113 (2015); *see also* Joint Committee on Taxation, *Technical Explanation of the Protecting Americans from Tax Hikes Act of 2015, House Amendment #2 to the Senate Amendment to H.R. 2029*, JCX-144-15 (Dec. 17, 2015).

[73] Rev. Proc. 2016-22, Section 3.01 and Section 3.05.

[74] Rev. Proc. 2016-22, Section 3.03 (emphasis added).

[75] Rev. Proc. 2016-22, Section 3.03 (emphasis added).

[76] Rev. Proc. 2016-22, Section 3.03.

[77] Taxpayer First Act of 2019, P.L. 116-25 (July 1, 2019), §1001; *see also* Joint Committee on Taxation, *Description of H.R. 1957, The Taxpayer First Act of 2019*, JCX-15-19 (Apr. 1, 2019).

[78] Code Sec. 7803(e)(1).

[79] Code Sec. 7803(e)(3) (emphasis added).

[80] Code Sec. 7803(e)(4).

[81] Code Sec. 7803(e)(5).

[82] Code Sec. 7803(e)(5)(A). Notably, this provision refers to a Notice of Deficiency but not an FPAA.

[83] IR-2020-188, August 24, 2020 (attaching a memorandum from the IRS Deputy Commissioner for Services and Enforcement, dated August 24, 2020, called "Interim Guidance on Designation of Cases for Litigation).

[84] IR-2020-188, August 24, 2020 (attaching a memorandum from the IRS Deputy Commissioner for Services and Enforcement, dated August 24, 2020, called "Interim Guidance on Designation of Cases for Litigation).

[85] IR-2020-188, August 24, 2020 (attaching a memorandum from the IRS Deputy Commissioner for Services and Enforcement, dated August 24, 2020, called "Interim Guidance on Designation of Cases for Litigation).

[86] Taxpayer Advocate Service, *2018 Annual Report to Congress*, Volume One, at 360; Taxpayer Advocate Service, *Fiscal Year 2019 Objectives Report to Congress*, Volume One, at 137.

[87] Taxpayer Advocate Service, *2018 Annual Report to Congress*, Volume One, at 360.

[88] *See, e.g., Hancock County Land Acquisitions, LLC*, Civil Action No. ___, U.S. District Court (ND GA), Complaint for Declarative, Injunctive, and Mandamus Relief, dated July 25, 2020.

[89] IR-2020-188, August 24, 2020 (attaching a memorandum from the IRS Deputy Commissioner for Services and Enforcement, dated August 24, 2020, called "Interim Guidance on Designation of Cases for Litigation).

[90] IR-2020-188, August 24, 2020.

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