Critics Question Need for Proposed Syndicated Easement Regs

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Several stakeholders are urging the government to withdraw proposed regulations identifying syndicated easements as listed transactions, claiming they are unnecessary because of a new law limiting tax benefits from syndicated deals.

More than half of the 26 comment letters submitted to Treasury and the IRS asserted that the proposed regs (REG-106134-22) should be withdrawn and reproposed or abandoned altogether.

The proposed regs, issued in December 2022, convert Notice 2017-10, 2017-4 IRB 544, into a formal rule subject to Administrative Procedure Act rulemaking requirements. The notice designated some syndicated easement deals as listed transactions requiring disclosure by participants and material advisers.

The proposed regs came in response to a series of adverse court decisions holding that IRS notices identifying listed transactions are invalid because the agency issued them without using the notice and comment procedures required by the APA for legislative rules. Those decisions include *Mann Construction Inc. v. United States*, 27 F.4th 1138 (6th Cir. 2022), in which the Sixth Circuit invalidated a 2007 listing notice on cash value life insurance trusts (Notice 2007-83, 2007-45 IRB 960).

Citing the *Mann* opinion's reasoning, a majority of the Tax Court's judges concluded in a November 2022 reviewed opinion in *Green Valley Investors LLC v. Commissioner*, 159 T.C. No. 5, that Notice 2017-10 is invalid. The majority opinion included a footnote stating that the Tax Court "intends to apply this decision setting aside Notice 2017-10 to the benefit of all similarly situated taxpayers who come before us."

Treasury and the IRS said in Announcement 2022-28, 2022-52 IRB 659, released the same day as REG-106134-22, that while they disagree with the *Mann* and *Green Valley* decisions and will continue to defend the validity of Notice 2017-10 and other listing notices, they were issuing the proposed regs "to eliminate any confusion and to ensure that these decisions do not disrupt the IRS's ongoing efforts to combat abusive tax shelters throughout the nation."

Similar to Notice 2017-10, the proposed regs provide that transactions that are the same as or substantially similar to a syndicated conservation easement transaction are listed transactions for purposes of the disclosure and list maintenance requirements and related penalties.

The definition of syndicated conservation easement transactions uses the four-element test set out in Notice 2017-10: (i) the taxpayer receives promotional materials offering a charitable contribution deduction equal to or exceeding two and a half times the taxpayer's investment in a passthrough

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entity (called the "2.5 times rule"); (ii) the taxpayer invests directly or indirectly through a passthrough entity; (iii) the passthrough entity contributes the conservation easement to a qualified organization and allocates the charitable contribution deduction to its partners; and (iv) the taxpayer reports the charitable contribution deduction on their federal tax return.

The proposed regs differ from Notice 2017-10 by providing a broader definition of promotional materials and by creating a rebuttable presumption that the 2.5 times rule is met if the passthrough entity donates a conservation easement within three years after the taxpayer's investment in the passthrough entity. The government also added three provisions, including an "anti-stuffing" rule, to address potential avoidance of the 2.5 times rule.

While the proposed regs retain the rule in Notice 2017-10 that qualified donees are excluded from the definition of participants to the listed transaction, the regs no longer exclude them from the definition of material advisers. Treasury and the IRS asked for comments on whether they should also eliminate or restrict the carveout under Notice 2017-10, which excludes qualified donees from being subject to the section 4965 tax shelter excise tax.

Comments on the proposed regs were due February 6, and a public hearing is scheduled for March 1.

Superseded by Congress

A common theme among critics of the proposed regs is that they were preempted by Congress's adoption of a modified version of the Charitable Conservation Easement Program Integrity Act (H.R. 4164/S. 2256), a bill that a bipartisan group of lawmakers had sought to advance since 2017.

The easement legislation, included in the Consolidated Appropriations Act, 2023 (P.L. 117-328) enacted in late December 2022, provides that a conservation easement contribution by a partnership isn't deductible if the amount of the contribution exceeds two and a half times the sum of each partner's relevant basis in the partnership.

The disallowance provision doesn't apply if the contribution meets a three-year holding period test, substantially all the interests in the contributing partnership are held by members of a family, or the contribution is made to a certified historic structure (but only if new reporting requirements are met).

The Partnership for Conservation, a trade organization that has criticized the IRS's enforcement efforts against syndicated easement transactions, said in its February 2 comment letter that "as a practical matter, the vast bulk of the conservation easement donations that would be treated as listed under the proposed regulations would be totally non-deductible under the new statute."

According to the organization, the proposed regs are overbroad because they would pull in transactions that Congress excluded from the new deduction limit.

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"IRC section 170(h)(7) applies only where the deduction *exceeds* 2.5 times relevant basis, but the proposed listing would also apply where the deduction *equals* 2.5 times," the organization's letter says (emphasis in original). It added that the proposed regs don't include the new law's exceptions for contributions made after a three-year holding period, those made by family partnerships, or those made to certified historic structures.

Fox Rothschild LLP said in its February 6 letter that the new law "divorces the inquiry from the value of the donation and instead focuses on the limitation of the deduction for individual taxpayers." As a result, "all direct and indirect references to basis in the hands of the partnership should be completely removed from the Proposed Regulations," it said.

According to the National Taxpayers Union's February 6 letter, because many of the proposed regs' provisions conflict with the new law or have become moot, "this proposed rulemaking should be withdrawn, and a more surgical approach reissued in a manner in concord with the new statute."

Rubicon Capital asserted in its letter that because Congress has laid down the law on the treatment of syndicated easement transactions, "there should be a bright line of transactions which are meant to be included in the proposed regulations and such transactions which are not meant to be included and should not be listed transactions (i.e., private charitable land donations)."

The Heritage Preservation Trust's February 3 letter similarly said the new law addresses many of the IRS's concerns with syndicated easement transactions. "The Proposed Regulation does not address the most glaring issue in the IRC regarding conservation, which is valuation," the letter says, adding that the IRS should provide "meaningful guidance on appraisal methodology as the most pragmatic solution."

In its February 6 letter, Dentons Sirote asserted that because Congress has addressed through legislation the issues that the IRS was trying to address through enforcement, "there is no longer a need to require such reporting. To the extent final regulations are issued, the IRS should address whether and why such regulations are necessary in light of the new legislation."

Common Ground

One of the few supporters of the proposed regs was the Land Trust Alliance, which said in a February 5 letter that regulations are still needed despite the new law.

"In case promoters continue to create and market abusive syndicated conservation easement transactions, or challenge provisions of the Integrity Act, it is prudent for the IRS to codify in regulations the provisions of the Listing Notice," the alliance said. "This will allow the IRS to continue to readily discover whether abusive transactions continue and to identify the promoters, material advisors, investors and donee organizations that continue to be involved."

The alliance found some common ground with critics, with nearly every stakeholder urging Treasury and the IRS not to treat donee organizations as material advisers.

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"Donee organizations are mere recipients of a property interest under the Treas. Regs. and are not active transaction advisors," the alliance said. "Moreover, removal of the 'material advisor' carve-out would be a backdoor way of contradicting the longstanding, core principle of U.S. tax law that donee organizations are not responsible for the value of donated property. Including donee organizations in the definition of material advisor now also would create more confusion and increase the prospects of litigation, thus circumventing the purpose of the Proposed Regulations."

The alliance also agreed with critics that Treasury and the IRS should retain the section 4965 carveout.

"It bears emphasizing that the IRS states that the current disclosure regime — and the tens of thousands of listed transaction disclosures filed to date — have revealed that 'a small number of qualified organizations facilitate abusive syndicated conservation easement transactions,'" the alliance said. "The IRS is being notified of the transactions and all the entities involved, including the donee organizations. Therefore, the IRS has not established that it is necessary to eliminate the broad carve-out for donee organizations that currently exists under the Listing Notice."

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